

THE SECURITIES
LITIGATION
REVIEW

FOURTH EDITION

Editor
William Savitt

THE LAWREVIEWS

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LITIGATION
REVIEW

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PREFACE

This fourth edition of *The Securities Litigation Review* is a guided introduction to the international varieties of enforcing rights related to the issuance and exchange of publicly traded securities.

Unlike most of its sister international surveys, this review focuses on litigation – how rights are created and vindicated against the backdrop of courtroom proceedings. Accordingly, this volume amounts to a cross-cultural review of the disputing process. While the subject matter is limited to securities litigation, which may well be the world’s most economically significant form of litigation, any survey of litigation is in great part a survey of procedure as much as substance.

As the chapters that follow make clear, there is great international variety in private litigation procedure as a tool for securities enforcement. At one extreme is the United States, with its broad access to courts, relatively permissive pleading requirements, expansive pretrial discovery rules, readily available class-action principles and generous fee incentives for plaintiffs’ lawyers. At the other extreme lie jurisdictions like China, where private securities litigation is complex, expensive, seldom remunerative and accordingly quite rare. As the survey reveals, there are many intermediate points in this continuum, as each jurisdiction has evolved a private enforcement regime reflecting its underlying civil litigation system, as well as the imperatives of its securities markets.

This review reveals an equally broad variety of public enforcement regimes. Canada’s highly decentralised system of provincial regulation contrasts with Brazil’s Securities Commission, a powerful centralised regulator that is primarily responsible for creating and enforcing Brazil’s securities rules. Every country has its own idiosyncratic mixture of securities lawmaking institutions; each provides a role for self-regulating bodies and stock exchanges but no two systems are alike. And while the European regulatory schemes have worked to harmonise national rules with Europe-wide directives – an effort now challenged by the imminent departure of the United Kingdom from the European Union – few countries outside Europe have significant institutionalised cross-border enforcement mechanisms, public or private.

We should not, however, let the more obvious dissimilarities of the world’s securities disputing systems obscure the very significant convergence in the objectives and design of international securities litigation. Nearly every jurisdiction in our survey features a national securities regulatory commission, empowered both to make rules and to enforce them. Nearly every jurisdiction focuses securities regulation on the proper disclosure of investment-related information to allow investors to make informed choices, rather than prescribing investment rules. Nearly every jurisdiction provides both civil penalties that allow wronged investors

to recover their losses and criminal penalties designed to punish wrongdoers in the more extreme cases.

Equally notable is the fragmented character of securities regulation in nearly every important jurisdiction. Alongside the powerful national regulators are subsidiary bodies – stock exchanges, quasi-governmental organisations, trade and professional associations – with special authority to issue rules governing the fair trade of securities and to enforce those rules in court or through regulatory proceedings. Just as the world is a patchwork of securities regulators, so too is virtually each individual jurisdiction.

The ambition of this volume is to provide readers with a point of entry to these wide varieties of regulations, regulatory authorities and enforcement mechanisms. The country-by-country treatments that follow are selective rather than comprehensive, designed to facilitate a sophisticated first look at securities regulation in comparative international perspectives, and to provide a high-level road map for lawyers and their clients confronted with a need to prosecute or defend securities litigation in a jurisdiction far from home.

A further ambition of this review is to observe and report important regulatory and litigation trends, both within and among countries. This perspective reveals several significant patterns that cut across jurisdictions. In the years since the financial crisis of 2008, nearly every jurisdiction has reported an across-the-board uptick in securities litigation activity. Many of the countries featured in this volume have seen increased public enforcement, notably including more frequent criminal prosecutions for alleged market manipulation and insider trading, often featuring prosecutors seeking heavy fines and even long prison terms.

Civil securities litigation has continued to be a growth industry as the 2008 crisis has given rise to a new normal in the private enforcement of securities laws. While class actions are a predominant feature of US securities litigation, there are signs that aggregated damages claims are making significant inroads elsewhere. Class claims are now well established as part of the regulatory landscape in Australia and Canada, and there appears to be accelerating interest around the world in securities class actions and other forms of economically significant private securities litigation. Whether and where this trend takes hold will be one of the important securities law developments to watch in coming years.

This suggests the final ambition for *The Securities Litigation Review*: to annually reflect where this important area of law has been, and where it is headed. Each chapter contains both a section summarising the year in review – a look back at important recent developments – and an outlook section, looking towards the year ahead. The narrative here, as with the book as a whole, is of both divergence and convergence and divergence, continuity and change – with divergence and change particularly predominant in recent years, following political upheaval in the United States and Britain that could herald a sharp break from international cooperation and forceful government regulation in the global finance capitals of New York and London.

An important example is the matter of cross-border securities litigation, treated by each of our contributors. As economies and commerce in shares become more global, every jurisdiction is confronted with the need to consider cross-border securities litigation. The chapters of this volume show jurisdictions grappling with the problem of adapting national litigation systems to a problem of increasingly international dimensions. How the competing demands of multiple jurisdictions will be satisfied, and how jurisdictions will learn to work with one another in the field of securities regulation will be a story to watch over the coming years. We look forward to documenting this development and other emerging trends in securities litigation around the world in subsequent editions.

Many thanks to all the superb lawyers who contributed to this fourth edition, which covers more countries than ever before. For the editor, reviewing these chapters has been a fascinating tour of the securities litigation world, and we hope it will prove to be the same for our readers. Contact information for our contributors is included in Appendix 2. We welcome comments, suggestions and questions, both to create a community of interested practitioners and to ensure that each edition improves on the last.

William Savitt

Wachtell, Lipton, Rosen & Katz

New York

June 2018

HONG KONG

Thomas So, Alan Linning and Wilson Fung¹

I OVERVIEW

i Sources of law

Ordinances

- a* Securities and Futures Ordinance (Cap. 571) (SFO);
- b* Companies (Winding Up and Miscellaneous Provisions) Ordinance (Cap. 32) (CWUMPO);
- c* Companies Ordinance (Cap. 622) (CO); and
- d* Financial Institutions (Resolution) Ordinance (Cap. 628) (FIRO).

Regulations

Subsidiary legislation under the SFO, in particular:

- a* Securities and Futures (Stock Market Listing) Rules (Cap. 571V);
- b* Securities and Futures (Disclosure of Interest – Securities Borrowing and Lending) Rules (Cap. 571X);
- c* Securities and Futures (Short Position Reporting) Rules (Cap. 571AJ); and
- d* Securities and Futures (OTC Derivative Transactions – Reporting and Record Keeping Obligations) Rules (Cap. 571AL).

Codes and guidelines

- a* The Rules Governing the Listing of Securities on the Stock Exchange of Hong Kong Limited (the Listing Rules).
- b* Codes and guidelines issued by the Securities and Futures Commission, in particular:
 - Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission;
 - Code on Real Estate Investment Trusts;
 - Codes on Takeovers and Mergers and Share Buy-backs;
 - Code on Unit Trusts and Mutual Funds;
 - Fund Manager Code of Conduct;
 - The Guidance Note on Short Selling Reporting and Stock Lending Record Keeping Requirements; and
 - Guidelines on Disclosure of Inside Information.

¹ Thomas So and Alan Linning are partners and Wilson Fung is a counsel at Mayer Brown JSM.

ii Regulatory authorities

- a* The Securities and Futures Commission (SFC): regulates and supervises Hong Kong's securities and futures markets (including the Hong Kong Exchanges and Clearing Limited).
- b* The Hong Kong Monetary Authority (HKMA): regulates and supervises banking business and the business of taking deposits in Hong Kong.
- c* Hong Kong Exchanges and Clearing Limited: regulates and supervises listed issuers and administers listing, trading and clearing rules; provides service, primarily at the wholesale level, to participants and users of its exchanges and clearing houses.

iii Common securities claims

Common market misconduct claims include:

- a* insider dealing;
- b* false trading;
- c* price rigging;
- d* disclosure of information about prohibited transactions;
- e* disclosure of false or misleading information inducing transactions;
- f* stock market manipulation; and
- g* offences involving fraudulent or deceptive devices in transactions in securities, futures contracts or leveraged foreign exchange trading.

Sponsors are licensed by the SFC and therefore are subject to the provisions of the SFO and the various rules, codes and guidelines issued by the SFC, including the Code of Conduct for Persons Licensed by or Registered with the Securities and Futures Commission, the Additional Fit and Proper Guidelines for Corporations and Authorised Financial Institutions applying or continuing to act as Sponsors and Compliance Advisers, the Corporate Finance Adviser Code of Conduct, the Management, Supervision and Internal Control Guidelines for Persons Licensed by or Registered with the Securities and Futures Commission, as well as the Listing Rules.

While the codes and guidelines issued by the SFC do not have the force of law and any breach will not render a sponsor liable to any judicial or other proceedings, the SFC may take disciplinary actions against the sponsor and may impose appropriate sanctions (e.g., revocation of the sponsor's licence).

Further, under Sections 40 and 40A of the CWUMPO, any person who authorises the issue of a prospectus that includes untrue statements shall be liable to pay compensation to the victims, imprisonment and a fine, unless he or she proves either that the statement was not material or that he or she had reasonable grounds to believe and did up to the time of the issue of the prospectus believe that the statement was true.

Insofar as offences of market misconduct are concerned, the general legal principles applicable to accessory liability also apply.

For both disciplinary action and civil proceedings, the parties will need to prove their case on the balance of probabilities. For criminal prosecutions, the prosecution will need to prove beyond reasonable doubt the elements of the relevant offence. Therefore, it is in general more likely that a person may be disciplined or ordered by the court to make compensation in civil proceedings.

II PRIVATE ENFORCEMENT

i Forms of action

Class actions are not available in Hong Kong. However, under Part 14 Division 4 of the CO, a shareholder may, with the leave of the court, bring a derivative action in the name of the company in respect of the misconduct committed against the company, or intervene in the proceedings before the court for the purpose of continuing, discontinuing or defending those proceedings on behalf of the company.

For the purpose of seeking the court's leave to bring a derivative action in the name of the company or intervene in proceedings, under Section 733 of the CO, a member needs to show that:

- a* it appears to be in the company's interests that leave be granted to the member;
- b* in the case of an application for leave to bring proceedings, there is a serious question to be tried and the company has not itself brought the proceedings; and
- c* in the case of an application for leave to intervene in proceedings, the company has not diligently continued, discontinued or defended the proceedings.

Under Section 108 of the SFO, if a person makes any fraudulent, reckless or negligent misrepresentation that induces another person to enter into or offer to enter into an agreement to acquire, dispose of, subscribe for or underwrite securities, the person who makes the misrepresentation shall be liable to pay compensation to the person who suffers pecuniary loss as a result of the misrepresentation.

Further, under Sections 281 and 305 of the SFO, if a person has engaged in or committed market misconduct, he or she shall be liable to pay compensation by way of damages to any other person for any pecuniary loss sustained by the other person as a result of the market misconduct.

ii Procedure

The right to bring statutory derivative actions applies to both companies incorporated in Hong Kong and companies incorporated outside Hong Kong that have established a place of business in Hong Kong. Before a statutory derivative action can be brought, a member needs to first make an application to the court by issuing an originating summons to obtain leave. Once the court grants leave, the proceedings may be brought or continued in a manner similar to other civil proceedings.

To commence a civil action (including actions based on Sections 108, 281 and 305 of the SFO), the plaintiff needs to file with the court a writ of summons (if there are disputes as to facts) or an originating summons (if the facts are not in dispute).

For actions commenced by writs of summons, the parties will file pleadings in which the parties will need to state all the relevant facts and give necessary particulars.

After pleadings are closed, the parties will need to make discovery of relevant documents and prepare witness statements and expert reports (if necessary) before proceeding to trial.

For proceedings commenced by originating summons, the parties will adduce evidence by affidavits and the court will determine the matter based on that evidence. There is no automatic discovery in proceedings commenced by originating summons.

In an action before the court (whether commenced by writ of summons or originating summons), the parties may seek discovery of specific documents. A party who seeks specific discovery needs to show the existence of the document; that the party from whom discovery

is sought has in his or her possession, custody or power the relevant document; that the document relates to one or more of the matters in question in the action; and that discovery of the document is necessary.

iii Settlements

Derivative actions may only be discontinued or settled with the leave of the court.²

Other proceedings, such as proceedings based on contract or tort, can be settled by the parties' agreement and the agreement is not subject to review or approval by third parties. The parties are free to agree on how matters related to the action are to be disposed of, including the costs of the action.

iv Damages and remedies

In general, damages are assessed to compensate the plaintiff in the action. For an action based on breach of contract, damages are payable to the plaintiff to place the plaintiff in the position as if the contract had been properly performed. For an action based on tort, damages are payable to the plaintiff to place the plaintiff in the position that the plaintiff would have been in had the tort not occurred.

In addition to payment of damages, the court may also grant other equitable reliefs, which include:

- a* specific performance – an order requiring the defendant to fulfil his or her contractual obligation;
- b* injunction – an order prohibiting the defendant from doing a certain act or requiring him or her to perform a certain act that he or she has failed to do; and
- c* declaration – the court declaring certain rights and obligations of the parties; for example, that the defendant has contravened a certain provision of the SFO.

III PUBLIC ENFORCEMENT

i Forms of action

- a* Market Misconduct Tribunal (MMT) proceedings;
- b* criminal prosecutions;
- c* SFC disciplinary proceedings; and
- d* High Court proceedings (which are remedial in nature; for example, winding up, injunction and disqualification).³

Under Sections 252, 283 and 307 of the SFO, MMT proceedings, which deal with market misconduct and are civil in nature, and criminal prosecution for market misconduct are mutually exclusive. In appropriate cases, the SFC would apply to the Court for an injunction to freeze the assets of a person who contravenes the provisions of the SFO before the MMT proceedings or criminal prosecution. This is to ensure that the relevant parties can be compensated in future.

2 CO Section 735.

3 SFO Sections 212 to 214.

ii Procedure

Before enforcement action is taken, the SFC (and the HKMA – if the party being investigated is a bank) will first conduct an investigation into the matter. This involves obtaining relevant records and interviewing witnesses. If the investigation shows that there has been a contravention of the relevant legislation or any code published by the SFC, further action may be taken.

MMT proceedings

The SFC may institute proceedings in the MMT concerning market misconduct by giving a written notice containing a statement.⁴ However, the consent of the Secretary of Justice must be obtained before the institution of the MMT proceedings.⁵

The MMT will determine whether any market misconduct has taken place, the identity of any person who has engaged in the market misconduct and the amount of any profit gained or loss avoided as a result of the market misconduct.⁶ The MMT may determine whether a person has engaged in market misconduct even if that person is not within the jurisdiction.⁷

*Criminal proceedings*⁸

Criminal prosecutions for contravention of the provisions under the SFO are similar to prosecutions of other criminal offences. The defendant will first be asked to tell the court whether he or she pleads guilty or not. If he or she pleads guilty, the court will usually pass sentence on the same day. If the defendant pleads not guilty, the matter has to proceed to trial.

The prosecution has the duty to provide all used and unused materials to the defendant, and a person can only be prosecuted if he or she is within the jurisdiction or is extradited from other jurisdictions.

If the defendant is not satisfied with the decision of the court, he or she may apply to review or appeal against the decision, as the case may be.

*SFC disciplinary proceedings*⁹

After the SFC has completed its investigation against a person licensed with the SFC, it will decide whether to initiate disciplinary proceeding.

If the SFC decides to bring disciplinary proceedings against a licensed person, it will issue a notice of proposed disciplinary action, which states its preliminary views on the misconduct, sanctions that the SFC is going to impose and a list of supporting documents. The regulated person will also be invited to make an explanation.¹⁰

The licensed person will then have 30 days from the date of the receipt of the notice to make written representation.

4 SFO Section 252.

5 SFO Section 252A.

6 SFO Section 252(3).

7 *Securities and Futures Commission v. C, D, E and F* (HCMP 727/2008).

8 www.judiciary.gov.hk/en/crt_services/pphlt/html/mag.htm#2.

9 SFC, 'Disciplinary Proceedings at a Glance' (September 2011) (www.sfc.hk/web/EN/files/ENF/PDF/Disciplinary%20Proceedings%20at%20a%20Glance_Sept.2011.pdf).

10 SFO Section 198(1).

Afterwards, the SFC will make its decision, which will be set out in its decision notice. The decision notice will also set out the reasoning of the decision, the effective date, the duration and the terms of any revocation, suspension or prohibition to be imposed, the terms of any reprimand under the decision and the amount of any fine that may be imposed, as well as the date by which it must be paid.¹¹

The licensed person may appeal against the SFC's decision to the Securities and Futures Appeals Tribunal within 21 days after a decision notice is served or given, otherwise the decision becomes effective after the expiry date.¹²

For disciplinary proceedings, the licensed person who is proposed to be disciplined does not have the right to seek discovery from the SFC of documents other than those referred to in the notice of proposed disciplinary action.¹³

In December 2017, the SFC published an update to its Guidance Note on Cooperation with the SFC.¹⁴ In the Guidance Note, the SFC explained its approach to cooperation in disciplinary, civil court and MMT proceedings. Forms of cooperation with the SFC include providing information regarding breaches, acceptance of liability and taking rectification measures. Insofar as disciplinary proceedings are concerned, cooperation with the SFC may result in reduction of sanction up to 30 per cent.

High Court proceedings

Although MMT proceedings and criminal proceedings are mutually exclusive, the SFC may commence proceedings for winding up, injunction and disqualification under Sections 212, 213 and 214 of the SFO in addition to such proceedings. Proceedings under Sections 212, 213 and 214 are free-standing and not contingent or conditional on there being other substantive proceedings in parallel, including proceedings in the MMT or criminal proceedings before the court.¹⁵

iii Settlements

MMT proceedings

A person who is subject to MMT proceedings may approach the SFC to seek the SFC's agreement on the facts related to the enquiry by the MMT. If both sides can reach an agreement, a statement of agreed and admitted facts will be signed, which will be provided to the MMT and the MMT will make findings based on that statement.¹⁶

11 SFO Section 198(3).

12 SFO Section 217(3).

13 *X v. Securities and Futures Commission* [2012] 4 HKLRD 296.

14 SFC, 'Guidance Note on Cooperation with the SFC' (December 2017) (<http://www.sfc.hk/web/EN/assets/components/codes/files-current/web/guidelines/guidance-note-on-cooperation-with-the-sfc/guidance-note-on-cooperation-with-the-sfc.pdf>).

15 *Securities and Futures Commission v. C and Others* [2009] 4 HKLRD 315; www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=09PR74.

16 For example, see 'The Report of the Market Misconduct Tribunal into dealings in the shares of Bank of China Limited and China Construction Bank Corporation on and between 19 December 2008 to 13 January 2009', dated 7 October 2014.

Criminal proceedings

The defendant may contact the SFC (or the Department of Justice, in cases where the prosecution is conducted by the Department of Justice in the District Court or the High Court) to make a plea bargain. For example, the defendant may offer to plead guilty to particular charges in exchange for the prosecution offering no evidence in relation to other charges.

Disciplinary proceedings

The regulated person may make a resolution proposal to the SFC and the latter has power to determine whether to accept the proposal after considering the interest of the investing public or the public interest.¹⁷

High Court proceedings

As in other civil proceedings, the defendant may contact the SFC to discuss whether the matter can be settled. For proceedings to disqualify a director, the defendant may seek to agree with the SFC on the relevant facts. If an agreement can be reached, a statement of agreed facts will be submitted to the court for the court to decide on the length of disqualification.

iv Sentencing and liability

MMT proceedings¹⁸

The MMT may order the wrongdoer to pay to the government of the Hong Kong Special Administrative Region an amount not exceeding the amount of any profit gained or loss avoided by the person as a result of the market misconduct in question.

The MMT may also order that the person shall not, without leave of the Court of First Instance, be a director, liquidator, or receiver or manager of a corporation or acquire, dispose of or deal in any securities, etc.

Cease-and-desist and ‘cold shoulder’ orders can also be issued as civil sanctions by the MMT.

Criminal proceedings

If a defendant is guilty of an offence relating to dealing in securities and future contracts under Part XIV of the SFO, he or she shall be liable:

- a* on conviction on indictment to a fine of HK\$10 million and to imprisonment for 10 years; or
- b* on summary conviction to a fine of HK\$1 million and to imprisonment for three years.

In addition, the court may also order:

- a* the defendant shall not, without leave of the court, be a director, liquidator, or receiver or manager of the property or business, of a listed corporation or any other specified corporation, or acquire, dispose of or deal in any securities;
- b* any body that may take disciplinary action against the defendant as one of its members be recommended to take disciplinary action against the defendant; and

¹⁷ SFO Section 201(3).

¹⁸ SFO Section 257.

- c* the defendant pays the government an amount not exceeding the amount of any profit gained or loss avoided by the defendant as a result of the commission of the offence in question.

Disciplinary proceedings¹⁹

The SFC is empowered to impose one or more of the following sanctions:

- a* revocation or partial revocation of licence or registration;
- b* suspension or partial suspension of licence or registration;
- c* revocation of approval to be a responsible officer;
- d* suspension of approval to be a responsible officer;
- e* prohibition of application for licence or registration;
- f* prohibition of application to become a responsible officer, executive officer or relevant individual;
- g* fine (up to the maximum of HK\$10 million or three times the profit gained or loss avoided, whichever is higher); and
- h* reprimand (private or public).²⁰

High Court proceedings

Under Section 212 of the SFO, the SFC may present a petition for winding-up orders and bankruptcy orders if it appears to the SFC that it is in the public interest to do so.

Under Section 213 of the SFO, the SFC may apply to the Court of First Instance for injunctions and orders requiring the person to take such steps as the Court directs to restore the parties to any transaction to the position in which they were before the transaction was entered into.

Under Section 214 of the SFO, the SFC may apply to the Court of First Instance for an order against a person who is wholly or partly responsible for the business or affairs of a listed corporation to be disqualified and not to take part in the management of the corporation or any other corporation for a period not exceeding 15 years. The period of disqualification depends on the seriousness of the misconduct.

IV CROSS-BORDER ISSUES

A number of companies listed in Hong Kong have businesses based in the People's Republic of China (PRC) or have their directors located in the PRC, or both.

Further, under the cross-border investment channels that are known as the 'Shanghai-Hong Kong Stock Connect' and the 'Shenzhen-Hong Kong Stock Connect', investors in the PRC and Hong Kong may trade shares listed on the other market.

The above can present difficulties to the SFC when conducting investigations against directors and other persons who may have committed wrongdoings.

In this connection, the SFC and the China Securities Regulatory Commission (CSRC) have signed memoranda of understanding to assist each other with their investigations,²¹ as

19 SFC, 'Disciplinary Proceedings at a Glance' (September 2011), 'Disciplinary measures available to the SFC', p. 3.

20 SFO, Section 194(1) and (2).

21 See www.sfc.hk/web/EN/about-the-sfc/collaboration/mainland/investigatory-assistance-and-exchange-of-information.html.

well as a memorandum of understanding on the regulatory and enforcement cooperation under the stock connects.²² In December 2017, the Court of First Instance refused a judicial review application instituted by Mr Tang Hanbo against the SFC²³ in which Mr Tang sought to quash a search warrant obtained by the SFC from a magistrate and the SFC's decision to transmit materials seized during its search to the CSRC. This decision confirms that the SFC may pass on what it has gathered in its investigations to the CSRC, even if the information was collected by the SFC for its own investigations in the first place.

In addition, as mentioned above, there are difficulties in prosecuting a person who is not within the jurisdiction of Hong Kong. In such a case, the SFC may consider instituting MMT proceedings if appropriate.

V YEAR IN REVIEW

i Regulatory development

The FIRO came into effect on 7 July 2017. It establishes a regime in Hong Kong for the orderly resolution of financial institutions with a view to avoiding or mitigating the risks otherwise posed by their non-viability to the stability and effective working of the financial system of Hong Kong.²⁴ Under the FIRO, the HKMA, the Insurance Authority and the SFC are designated as resolution authorities. They are vested with a range of necessary powers to effect orderly resolution of a failed systemically important financial institution, which means maintaining continuity of access to the essential financial services it provides by imposing losses on creditors, while minimising the risks posed to public funds.²⁵

The CO was amended by the Companies (Amendment) Ordinance 2018. After the amendment, certain companies incorporated in Hong Kong are required to obtain and maintain up-to-date beneficial ownership information by way of keeping a significant controls register, which should be open for inspection by law enforcement officers (which includes officers of the SFC and the HKMA) upon demand.²⁶

ii SFC enforcement actions

According to the latest quarterly report published by the SFC,²⁷ the Enforcement Division of the SFC has undertaken the following activities for the period from April to December 2017:

Enforcement activities

Item	Number
Production of records and documents inquiries commenced under Section 179 of the SFO	20
Trading inquiries commenced under Section 181 of the SFO	199

22 See www.sfc.hk/web/EN/files/ER/MOU/ENF_MOU_Eng_2016.pdf.

23 *Tang Hanbo v. The Securities and Futures Commission and Another* [2018] 1 HKLRD 272.

24 Financial Institutions (Resolution) Ordinance Section 4(1).

25 www.info.gov.hk/gia/general/201606/30/P201606300349.htm.

26 Long title of Companies (Amendment) Ordinance 2018; CO Part 12, Division 2A, Subdivisions 2, 4 and 5.

27 SFC, 'SFC Quarterly Report October–December 2016' (http://www.sfc.hk/web/EN/files/ER/Reports/QR/201710-12/Eng/00_full.pdf), p. 12.

Item	Number
SFO offences and other misconduct investigation directions issued under Section 182 of the SFO	203
Investigations started	215
Investigations completed	174
Individuals or corporations charged in criminal proceedings	11
Criminal charges laid	44
Notices of proposed disciplinary action issued*	22
Notices of decision issued**	19
Individuals or corporations subject to ongoing civil proceedings	110
Compliance advice letters issued	215
Cases with search warrants executed	19
<p>* A notice issued by the SFC, to regulated persons, that it proposes to exercise its disciplinary powers on grounds that they appear to be guilty of misconduct or not fit and proper.</p> <p>** A decision notice sets out the SFC's decision and its reasons for taking disciplinary action against regulated persons.</p>	

iii Significant decisions

Mayer Holdings Limited

On 5 April 2017, the MMT fined Mayer Holdings Limited (Mayer) and nine of its former directors and senior executives a total of HK\$10.2 million as a result of their failure to disclose inside information as soon as reasonably practicable as required under the SFO, and imposed disqualification orders against the senior executives of Mayer.²⁸

The SFC alleged that, between April and August 2012, Mayer's auditors had repeated communications with the company's management regarding issues identified in the course of auditing Mayer's financial statements for the year ending 31 December 2011.²⁹ However, Mayer failed to give satisfactory answers to the auditor's inquiries, and in August 2012 the auditors indicated to Mayer that they would qualify their audit opinion for the financial statements if the outstanding audit issues were not resolved.³⁰ Mayer later received a resignation letter from the auditors on 27 December 2012.

The SFC alleged that Mayer did not adequately disclose three categories of 'inside information' within the meaning of Section 307A of the SFO, namely the auditors' resignation, the outstanding audit issues together with the potential qualified audit report and the US\$10 million prepayment to a supplier.³¹ Such information was specific information

28 <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=17PR44>; paragraph 181 of the MMT report dated 5 April 2017 (http://www.mmt.gov.hk/eng/reports/Mayer_Holdings_Limited_PartII_Report_e.pdf).

29 Paragraph 8 of the Statement of Institution of Proceedings, which is referred to in paragraph 1 of the MMT report dated 7 February 2017 (http://www.mmt.gov.hk/eng/rulings/Mayer.Holdings.Ltd.04032016_e.pdf).

30 Paragraph 10 of the Statement of Institution of Proceedings, which is referred to in paragraph 1 of the MMT report dated 7 February 2017 (http://www.mmt.gov.hk/eng/rulings/Mayer.Holdings.Ltd.04032016_e.pdf).

31 Paragraph 16 of the Statement of Institution of Proceedings, which is referred to in paragraph 1 of the MMT report dated 7 February 2017 (http://www.mmt.gov.hk/eng/rulings/Mayer.Holdings.Ltd.04032016_e.pdf).

relating to Mayer, and was not generally known to the persons who were accustomed to or would be likely to deal in the listed securities of Mayer but would if generally known to them have been likely to materially affect the price of those securities.³²

Mayer and eight of the senior executives have filed appeals against the MMT's decision and orders.³³

CITIC Limited

On 10 April 2017, MMT handed down its decision in the proceedings against CITIC Limited (CITIC) and five of its former executive directors. The MMT decided that CITIC and the directors had not disclosed false or misleading information that was likely to maintain, increase, reduce or stabilise the price of CITIC shares and thus had not engaged in market misconduct pursuant to Section 277 of the SFO.³⁴ The MMT proceedings related to the publication of a circular by CITIC on 12 September 2008, in which CITIC disclosed that 'the Directors are not aware of any adverse material change in the financial or trading position of the Group since 31 December 2007'. In a subsequent announcement, CITIC disclosed that it suffered a massive mark-to-market loss up to that date arising from a number of leveraged foreign exchange contracts. This profit warning also revealed that CITIC had become aware of the exposure arising from those contracts on 7 September 2008. The SFC, therefore, claimed that the circular contained a false or misleading statement about CITIC's financial position and that CITIC and the directors engaged in market misconduct under Section 277 of the SFO.³⁵

The MMT found there was no evidence as to any actual influence occasioned by the publication of the 'no material adverse change' statement on the market at or about the time of the statement's publication, and concluded that it had not been demonstrated that the 'no material adverse change' statement had any influence on the market, that is, on the actions of ordinary reasonable investors so as to maintain (or stabilise) the price of CITIC securities.³⁶

In addition, in relation to the issue of whether the information contained in the 'no material adverse change' statement was false or misleading, the MMT considered that for a material adverse change to a company's financial position to be demonstrated, the change must be one of deep significance to that company's existing financial position and one that also undermined its financial integrity. Further, it must be demonstrated to be a change that is not merely temporary but is one that will endure over a matter of months or longer.³⁷ Applying this test, the MMT considered, bearing in mind that all losses were prospective by the time of the circular and the very real strength of CITIC to meet any cash flow stress,

32 Paragraph 17 of the Statement of Institution of Proceedings, which is referred to in paragraph 1 of the MMT report dated 7 February 2017 (http://www.mmt.gov.hk/eng/rulings/Mayer.Holdings.Ltd.04032016_e.pdf).

33 SFC's Quarterly Report April–June 2017 (http://www.sfc.hk/web/EN/files/ER/Reports/QR/201704-06/Eng/00_full.pdf), page 11.

34 Paragraphs 377–378 of the MMT report dated 7 April 2017 (http://www.mmt.gov.hk/eng/reports/Report_of_CITIC_e.pdf); <https://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=17PR45>.

35 <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=14PR108>.

36 Paragraphs 240 and 244 of the MMT report dated 7 April 2017 (http://www.mmt.gov.hk/eng/reports/Report_of_CITIC_e.pdf).

37 Paragraph 279 of the MMT report dated 7 April 2017 (http://www.mmt.gov.hk/eng/reports/Report_of_CITIC_e.pdf).

there was insufficient objective evidence of an actual material adverse change in CITIC's financial position,³⁸ and even if a material adverse change had occurred, it was one that would endure.³⁹

Lee Kwok Wa⁴⁰

On 9 November 2017, the Court of Appeal upheld the decision of the Court of First Instance (CFI) that held that two solicitors and two sisters of one of the solicitors committed insider dealing in the shares of a Hong Kong-listed company and engaged in fraud or deception in transactions involving the shares of a Taiwan-listed company and made restoration orders. In relation to the transaction involving the shares of the Taiwan-listed company, the Court of Appeal held that the preponderance of the activities under the scheme or the course of dealings took place in Hong Kong and, therefore, the Courts in Hong Kong have jurisdiction to hear the case. In addition, the Court of Appeal held that for the purpose of Section 300 of the SFO (which covers offences involving fraudulent or deceptive devices, etc., in transactions in securities, futures contracts or leveraged foreign exchange trading), it is open for liability to be established based on fraud or deception practised upon a person other than the counterparty directly engaged in the transaction.

On 6 March 2018, the Court of Appeal granted leave for the defendants to appeal to the Court of Final Appeal in relation to the interpretation of Section 300 of the SFO.⁴¹

SFC v. Qunxing Paper Holdings Company Limited and Others

On 7 February 2018, the CFI, pursuant to Section 213 of the SFO, granted orders sought by SFC in its proceedings against Qunxing Paper Holdings Company Limited (Qunxing), its former chairman and vice chairman, as well as its subsidiary, to compensate investors who subscribed for Qunxing shares in its initial public offering (IPO) or purchased them in the secondary market between 2007 and 2011.⁴²

The CFI found that Qunxing had disclosed false or misleading information in its IPO prospectus in 2007 as well as its results announcements for the financial years ending from 31 December 2007 to 31 December 2011 by overstating its turnover and understating its bank borrowings.⁴³

38 Paragraph 335 of the MMT report dated 7 April 2017 (http://www.mmt.gov.hk/eng/reports/Report_of_CITIC_e.pdf).

39 Paragraph 345 of the MMT report dated 7 April 2017 (http://www.mmt.gov.hk/eng/reports/Report_of_CITIC_e.pdf).

40 *The Securities And Futures Commission v. Young Bik Fung and Others*, CACV 33/2016, Judgment dated 9 November 2017.

41 *The Securities And Futures Commission v. Young Bik Fung and Others*, CACV 33/2106, Judgement dated 6 March 2018, [2018] HKCA 108.

42 <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR10>.

43 *Securities and Futures Commission v. Qunxing Paper Holdings Co Ltd* [2018] HKCFI 271, paragraphs 34–37.

VI OUTLOOK AND CONCLUSIONS

i Regulatory proposals

On 19 January 2018, the SFC published a public consultation paper on proposed amendments to the Codes on Takeovers and Mergers and Share Buy-backs (the Codes).⁴⁴

Under the proposal, investor protection would be enhanced by increasing the voting approval threshold for whitewash waivers to 75 per cent of independent shareholders, and empowering the Takeovers Panel to require compensation to be paid to shareholders who have suffered as a result of a breach of the Codes.⁴⁵

The deadline for responses is 19 April 2018.

ii Conclusion

The Hong Kong's securities litigation scene had another eventful year in 2017, with important MMT rulings in *Mayer* and *CITIC Limited* as well as Court decisions in *Lee Kwok Wa* and *Qunxing*. In the latest *Enforcement Reporter* issued by the SFC in February 2018,⁴⁶ the SFC stated that in 2018, it will adopt a 'real-time' regulatory approach with front-loading regulation through earlier, more targeted intervention. The SFC also stated that in 2018, 'corporate fraud remains our top enforcement priority and we will continue to target groups which collude to defraud investors'. Its enforcement priorities in 2018 are:

- a* corporate fraud: monitoring companies issuing false or misleading financial statements; IPO fraud and sponsor failures; and failures to manage conflicts of interest by senior management of listed companies;
- b* insider dealing and market manipulation: targeting more sophisticated market misconduct perpetuated by syndicates;
- c* intermediary misconduct: dealing with breaches by the same firm or by multiple firms within one corporate group together to strengthen deterrence;
- d* sponsor misconduct: reminding sponsors to uphold the highest standards and carry out proper due diligence; and
- e* money laundering: in 2017, the SFC strengthened actions against firms with internal control failures related to know-your-client or anti-money laundering requirements.

In view of the SFC's enforcement priorities referred to above, we expect to see more criminal prosecutions and MMT proceedings concerning market misconduct disciplinary proceedings against SFC licensees and court proceedings similar to the *Qunxing* case (referred to above).

44 <http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/doc?refNo=18CP1>.

45 <http://www.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=18PR5>.

46 SFC, *Enforcement Reporter* (February 2018) (http://www.sfc.hk/web/EN/files/ER/Reports/Enforcement%20Reporter/Enforcement%20Reporter_Feb2018.pdf).

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Alan is listed as a leading litigation and dispute resolution and financial services regulatory lawyer by *Chambers Global*, *Chambers Asia Pacific*, *The Legal 500 Asia Pacific* and *IFLR1000*. He is praised by clients for his 'deep knowledge and strong background' (*Chambers Asia Pacific* 2017) of the financial services regulatory practice and 'technical skills and client care' (*Chambers Global* 2016). He is also recognised as 'a key name for contentious regulatory matters, and is noted for his "consistently clear guidance and understanding of commercial concerns"' (*The Legal 500 Asia Pacific* 2015). He has 'excellent subject matter expertise' (*Chambers Asia Pacific* 2015) and 'knows enough about the SFC to give excellent counsel and solve problems' (*Chambers Asia Pacific* 2015).

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