

Issue 43 (06/2013)

INSIDER DEALING
"CAN I TRADE WITH THIS PIECE OF INFORMATION?"
證券內幕交易
「我可以利用這消息進行買賣嗎？」

"Case of a 7-year Imprisonment 七年重判案件①"

Information has always been a powerful asset. On many occasions, it matters not what you own but what you know.

As such, some people start to exploit and manipulate information in the securities market. The insiders control sensitive information in a particular transaction so that he may make use of such "news" to its monetary advantage.

However, when it comes to a point where fairness and level playing field are of the essence, like trading in the securities market, insider dealing is legally prohibited. It is unfair to allow a small circle of people to trade in a market with a unique edge against all the other members of the public by manipulating the secret information. Rules and regulations were developed to restrict insider dealing in the securities market.

In 2009, a major criminal prosecution in insider dealing (the "Case") took place in Hong Kong resulting in a 7-year imprisonment of the insider trader. The penalty was regarded as one of the most serious sanctions against insider trading in the world. The story denotes a typical insider dealing scenario where a managing director of ABC Investment Bank received material price sensitive information from his client, XYZ Corporation Limited, a listed company in Hong Kong. Lately, the case was appealed at the Court of Appeal level where the judges provided us with some profound insights clarifying some legal concepts in insider dealing which are sometimes misunderstood.

This article will also talk about the traps which innocent investors may fall into when they get hold of a piece of material price sensitive information.

"Is it inside information 是否内幕消息?"

Whether a piece of information is so material and price sensitive that it may amount to the degree of "inside information" as defined in s245 of the Securities and Futures Ordinance (the "SFO"), the Court suggests that:-

"So the issue was whether the information was relevant information; most particularly whether it was sufficiently advanced or precise to constitute "specific information" and, ... whether, if it was generally known to those accustomed likely or accustomed to deal in the security, it was "likely to materially affect the price of the listed security" and, if so, whether it was proved that the applicant knew it to be information with those characteristics." ②

In approaching this question, the Court stresses the importance of common sense:-

"There is much to commend the value of the common sense approach in this case because we feel bound to say that on its face the contents of P1 [Prosecution Evidence No.1, being an email sent to the managing director, a short time before he traded in the shares of the company] strike us as important information likely to be of interest to the ordinary reasonable investor." ②

If you receive a piece of information that you, being an ordinary reasonable investor, think is a piece of good news about a stock and no one knows about it, such information will legally be regarded as inside information.

"Can I trade upon receipt of inside information 收到内幕消息後，我還可以進行買賣嗎?"

The usual practice is to wait until the information has become "stale". By becoming stale, it means either the information has gone public (e.g. newspaper reports) or that the information can no longer affect the share price of the stock (e.g. a deal falls through). Appendix 10 Rule A.3 of the Listing Rules forbids the directors of a listed company from trading its stocks during the period of 60 days preceding the publication date of the annual results. Many financial institutions also device a clear set of rules to avoid their employees trading with inside information.

In the Case, the managing director in question did not trade the stocks when he was first involved in the deal and also became privy to the inside information. He started trading when much of the material price sensitive information has gone public but for one piece which was about the acquisition of an oilfield in China. The share price had risen significantly for over 6 months because of all the other news. He argued that the so-called information about the acquisition of an oilfield in China might only form a small part of the good news.

The Court states that:-

“What was at issue between [the prosecution and the defence], in essence, was whether the dramatic rise in price on 9 May 2007 was mostly attributable to news of the Tincy deal or was only partly attributable to that news. It seems to us to matter not which it was, for the question is the likelihood of a material effect on the price and there are passages in Mr. White’s [expert for the defence] testimony which in their effect constituted an acceptance that the information in P1 (i.e. Prosecution Witness 1) was relevant information.” ②

“What if I had made up my mind to trade before receiving the inside information 假若我在收到內幕消息之前已決定進行買賣?”

This is another key dispute in the Case and the Court states that:-

“All that the relevant provisions require is proof that the information in question was relevant, as defined; that the applicant possessed that information; that he knew it to be relevant information and that whilst possessed of that information, knowing it to be relevant information, he dealt in the listed security”. ②

The prosecution is not required to prove that the accused traded the stock under the mental state of being motivated of using material price sensitive information. What the prosecution needs to prove is merely that the accused traded the stock while he was in possession of the information and he knew that the information was material and price sensitive. The fact that the accused has already had the mind of trading in the stock in question before possessing the inside information will be a futile defence. The question is not “Can I trade **with** this piece of information?” but “Can I trade when **I am in possession of** this piece of information?”

To conclude, the above legal views of the Court may be technical and the applications of such views in real cases can be challenging. To play safe, always practically staying away from dealing with the stock about which you are in possession of any information that the others don’t know!

① “DCCC NO. 787 of 2008” The case was appealed by the Defendant and the sentence was reduced to 6 years by the Court of Appeal.

② “CACC 334/2009, Judgment handed down on 20 Sep 2012”

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(Website: www.wmleehk.com)

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