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Court of Appeal confirms that trading while possessing price sensitive information not an offence if motivated by other reasons

In *Securities and Futures Commission v Yiu Hoi Ying Charles and Wong Nan Marian (CACV154/2016)* (the "**CA Decision**"), the Court of Appeal ("**CA**") recently upheld that dealing in securities while withholding or not disclosing price sensitive information ("**PSI**") does not constitute insider dealing provided that the dealing was not in any part caused by the PSI.

The Securities and Futures Commission ("**SFC**") commenced proceedings against various senior officers of Asia Telemedia Limited ("**ATML**") at the Market Misconduct Tribunal ("**MMT**") for alleged insider dealing. The MMT held that the trades were not caused by the PSI and upheld the statutory defence in section 271(3) of the Securities and Futures Ordinance ("**SFO**").[1]

The SFC appealed to the CA on the ground, amongst others, that the MMT had erred in applying the defence in section 271(3). The SFC's main argument was that the withholding and non-disclosure of the PSI constituted a "use" of the PSI and the statutory defence did not apply. The CA rejected such argument and rejected the subsequent application for leave to appeal to the Court of Final Appeal. This affirmed the decision of the MMT and clarified the scope of the defence in section 271(3) of the SFO.

Our alert discusses the implications of the CA Decision and suggests some practical action points for listed companies and their directors.

What it means for you

1. Handling PSI and disclosure obligation

Listed companies are obliged to disclose PSI to the public as soon as reasonably practicable after the information has come to their knowledge. Trading in listed securities while possessing PSI may constitute an offence. Section 271(3) provides a statutory defence if that person who traded while possessing PSI proves that the purpose of the trade was not or did not include obtaining a profit or avoiding a loss by using the relevant information. However, the application of this statutory defence is fact-sensitive and limited in scope.

2. Financial standing of business

The SFC Guidelines on Disclosure of Inside Information provides a non-exhaustive list of circumstances where disclosure of PSI is required. These include changes in financial condition, eg cashflow crisis and filing of winding up petitions. In this case, the relevant PSI included a series of statutory demands received over several years. Although ATML appeared to be managing the statutory demands and there was no risk of the company being wound up, the MMT held that the information constituted PSI because the

[1] Please also see our article discussing the MMT's decision dated 26 November 2015 in the Spring 2016 issue of Momentum, magazine of The Chamber of Hong Kong Listed Companies.

people accustomed to or those who would deal in ATML's shares would likely regard the information as price sensitive.

The MMT's decision mentioned that one of the questions to be considered is whether any demand received constitutes a real threat to the existence or continuance of the business. For example, the receipt of demand letters, including statutory demands, in modern day business can be commonplace. Creditors will often use statutory demands to put pressure on a debtor company in addition to this step being a precursor for winding up a debtor.

3. Purpose of the trade

Directors of listed companies need to remain vigilant when possessing PSI as the scope of the statutory defence remains limited in practice. Although the officers successfully proved that they did not use the PSI to make a profit or avoid a loss, this can often be difficult to prove. The MMT found that the officers conducted the trades due to a speculative rise in the share price of "small cap" stocks and considered that their sole motivation was to "*seize a sudden and unexpected speculative surge in the price of [ATML] shares*." The CA commented that this case involved "*very peculiar facts*".

On a final note, the SFC sought to advance a new argument in the appeal, that withholding or non-disclosure constituted a "use" of the PSI for the purpose of dealing. Although this was rejected by the Court, it shows that there will be close scrutiny on whether there is "use" of the PSI. The SFC will look at the purpose or motives for withholding the PSI and the consequences. Given that most business objectives are to make a profit or avoid a loss, directors should be extremely cautious when withholding PSI whilst trading as there is a fine line distinguishing between how PSI is used and its purpose.

Actions to take

We recommend that listed companies and their directors review their internal control procedures in respect of the handling of PSI including the following:

- Directors should be familiar with the relevant SFC Guidelines, be aware of what constitutes PSI and seek legal advice if in doubt.
- Upon receipt of a statutory or other demands or a threat for legal proceedings, the board must take the situation seriously and seek legal advice in relation to any disclosure obligations.
- All officers possessing PSI must refrain from dealing in the relevant securities in order to avoid the offence of insider dealing.
- Listed companies should review their internal control procedures to ensure compliance with their disclosure obligations in respect of PSI.
- Listed companies should review their internal flow of information and limit access to potential PSI including adopting a proper system of recordkeeping to retain all communication records which could be important evidence in any legal or regulatory proceedings.
- Legal advice should be sought whenever there is any intention to invoke the statutory defence under section 271(3) of the SFO.

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