REPORT OF THE INSIDER DEALING TRIBUNAL OF HONG KONG

on whether insider dealing took place
in relation to the listed securities of

CHEVALIER (OA) INTERNATIONAL LIMITED

between

April 26th and July 5th 1993 (inclusive)

and on other related questions

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CHAPTER 1

INTRODUCTION

The Insider Dealing Tribunal has heard evidence on 21 days and submissions from counsel for 3 days pursuant to a request from the Financial Secretary under s. 16 of the Securities (Insider Dealing) Ordinance CAP. 395 to inquire into and determine whether there has been insider dealing in relation to Chevalier (OA) International Limited (hereafter referred to as "COAL") arising out of dealings in the listed securities of that company by Mr. CHOW Yei-ching (hereafter referred to as "Mr. Y.C. Chow") between April 26th 1993 and July 5th 1993 (inclusive).

In this introductory chapter we will set out the essential non-contentious background information, identify the witnesses who have given evidence before us and highlight the main issues we have endeavoured to resolve.

1. Background: (as at the material time in 1993)

Mr. Y.C. Chow is and always has been the Chairman of the Chevalier Group of Companies. Within the group there were three listed companies. The holding company is Chevalier International Holdings Limited ("CIHL"). In 1988 COAL was set up and separately listed. Its main business has been in office equipment (computers, fax machines etc.) and more recently, telecommunications. In 1991 Chevalier Development International Limited ("CDIL") was spun off as a separate property orientated company. Within the group there are a further 108 subsidiary companies based both in Hong Kong and abroad. The overall group structure is therefore complex. All but one or two of the subsidiary companies have played no part in this inquiry. The complexity of the company structure has therefore been of no significance. The three listed companies have all been described as "third liners" on the Hong Kong Stock Exchange ("SEHK").

On April 26th 1993, 632,001,000 shares had been issued in

COAL. Mr. Y.C. Chow owned 339,952,000 of them i.e. 53.79%. Between April 26th and July 5th 1993 Mr. Y.C. Chow sold 28,180,000 (or 4.5%) of his share holding. In fact these sales were by a firm called Capital Growth Limited which was the trustee of Mr. Y.C. Chow's family trust known as the Grace Hsin Ya Jen Trust. This family trust set up a company called Oklahoma Investments Limited in whose name the shares were registered. Again this is a somewhat complicated, albeit not unusual, arrangement. Once more the complexity does not concern the Tribunal because it is accepted by all parties that the sales of the 28,180,000 COAL shares between the relevant dates were, for the purposes of the Securities (Insider Dealing) Ordinance ("CAP. 395") Mr. Y.C. Chow's sales. However, whether the sales resulted from Mr. Y.C. Chow "counselling or procuring" the sales on the one hand, or actually "dealing" himself, has been a matter for legal argument. We have also heard legal argument on the question of exactly when the dealing or counselling took place. These issues are dealt with in Chapter 5.

From the date of its incorporation in 1988 until the financial year 1992/3, COAL had always made a profit. However the size of its profits got smaller each year. In 1989 the profit was $45.9 million, in 1990 $21.5 million, in 1991 $5 million and in 1992 $4.5 million. In 1992 the company embarked on a new project which involved very heavy capital expenditure. The new project was the so-called second generation cordless telephone known as "CT2". It was a joint venture with an Australian company called "Telstra".

On January 13th 1993 COAL announced its half yearly figures i.e. for the period April 1st 1992 to September 30th 1992. In that period a loss of $16.878 million was recorded. In the interim report, under the heading "Business Review and Prospects" the company made the following announcement:-

> "During the period under review, the overall business of the Group continued to grow. As the CT2 (second generation cordless telephone system) network under the brand name of "Telepoint" was launched in April 1992 and is still in the investment stage, the profits generated from other major lines of business cannot offset the losses incurred from CT2

business.

In order to promote the direct sale business and to provide efficient services to our paging and "Telepoint" clients, the number of Chevalier Shops has increased to 21 during the period. Although the Shops cannot contribute profits to the Group within a short period, they are playing an important role in the business development of the Group.

As the potential of China market is very high, the Group is establishing a sales network in the major cities in China. It is anticipated that it would bring profits to the Group after 1994. The other overseas businesses were improving during the period.

Since competition is keen in the market and our new lines of business are still in investment stage, the Directors expect that losses will be incurred this year but they believe that better performance will be achieved next year."

Following the interim announcement the COAL share price fell slightly from marginally above 40 cents to 38 cents.

The company's final figures for the financial year 1992/3 were announced on August 12th 1993. The loss for the year was $84.51 million. The figures were published the next day. The immediate effect on the share price was a slight fall from about 40 cents before the announcement to 38 cents afterwards. In the next 2 weeks however there was a further steady decline down to 31 cents.

In between the two announcements of the interim and final results the share price performed significantly better on a number of occasions. On a few occasions in May it reached 50 cents or just over. In early June it again hit 50 cents, then, at the end of June there was a remarkable upward surge when the price was trading over 60 cents (with a high of 67 cents) for a two day period. The turnover on these days was enormous when compared with the previous trading pattern.

The period in which Mr. Y.C. Chow made his sales of 28 million COAL share (i.e. April 26th to July 5th) falls between the two announcements and, generally speaking, were at the times when the shares price was at its highest (Annexure F).

The evidence is that as early as March 1993 Mr. Y.C. Chow had instructed his brokers to sell COAL shares if and when they reached 50 cents. The brokers were carrying out these instructions when the trading was done.

The evidence further reveals that the reason Mr. Y.C. Chow disposed of 28 million COAL shares was to raise funds from the Trust in order to exercise certain warrants in CIHL which were also held by the Trust. The keys dates are these:-

December 31st 1993 - the date by which the CIHL warrants (for which approximately $19 million was required) had to be taken up.

September 22nd 1993 - the date by which the CIHL warrants had to be taken up in order to benefit from the value of the dividend [which in effect made each warrant about 7 cents (about 10%) cheaper].

August 13th 1993 - the date of COAL's announcements of its final figures

July 13th 1993 - Mr. Y.C. Chow's deadline for selling COAL shares so as not to breach the SEHK rule preventing Directors from dealing in their company's shares one month ahead of the annual financial statement.

It is Mr. Y.C. Chow's case that he made a decision before Easter 1993 to exercise the warrants prior to the September 22nd deadline so as to get the benefit of the dividend. He also decided to raise the money

by selling COAL shares before July 13th if they reached 50 cents per share, which they did. These sales produced approximately $14 million of the $19 million he needed.

He denies the allegation that he dealt at a time that he was in possession of relevant information about COAL which he knew was relevant information or that he counselled or procured other persons to so deal on his behalf. Such sales if proved, would be contrary to s. 9(1)(a) of CAP 395.

2. The Witnesses

During the 21 days of evidence we heard 13 witnesses. We here refer to each of them briefly together with a very brief outline of their evidence.

A. Directors of COAL who gave evidence were:-

(i) Mr. FUNG Pak-kwan: Mr. Fung's evidence is recorded at pages 56-202 of the transcript. He was at the material time, the Deputy Managing Director and is now the Managing Director of COAL. The routine day to day management of COAL was his responsibility. He has been employed by the Chevalier Group since 1974 and is also a director of CDIL and CIHL.

His evidence was that his business expertise was in areas of office equipment (office computers etc.) and telecommunications (pagers, mobile phones etc.) i.e. COAL's business. In this field his expertise and experience was much greater than Mr. Y.C. Chow. Mr. Y.C. Chow's field was that of lift and escalator engineering i.e. the original business of Chevalier.

Mr. Fung gave detailed evidence about COAL's performance over the relevant period. He was closely examined about the preparation of and distribution of the company's monthly management accounts and the impact on the company's finances by the CT2 project. [The joint venture company was called

Chevalier (Telepoint) Limited.] His opinion and comment was invited on the numerous press articles and company statements which were in the public domain so as to assist the Tribunal in its task of gauging what Mr. Y.C. Chow knew on the one hand and what the ordinary investor would have or could have known or found out on the other hand.

(ii) Mr. Norman Kan Ka-hon: Mr. Kan's evidence is at pages 436-548 of the transcript. He is a Director of COAL and the holding company, CIHL. He is also the Company Secretary of both companies. He is not a Director of the property arm of the group CDIL. The issues he dealt with in his evidence were similar to those Mr. Fung was asked about. His knowledge about the company accounts was more detailed because Mr. Ronald Ho, the Group's Financial Controller, reported to him. He was examined in detail about COAL's prospects for the second half of the 1992/3 fiscal year based firstly on the internal management accounts and secondly on the information which was presented to the public either by newspaper articles or by the company's interim results (published on January 13th 1993) and the company's written responses to SEHK inquiries about rumours and sudden share price movements. In particular he was questioned about the effect, if any, on the COAL share price by the "Shougang rumour". This will be referred to on a number of occasions in this report. In late April 1993 preliminary talks were held between CIHL and a Chinese company called Shougang. Ultimately nothing came of the talks and on May 5th CIHL and CDIL made official statements on the matter to the SEHK. Whether this rumour caused or contributed to the sudden rise in COAL to over 50 cents a share in mid-May and the dramatic rise to over 60 cents in late June has been the subject of much comment and debate by both witnesses and counsel.

Mr. Kan was also asked about the company's accounting policy, method and procedure.

(iii) Mr. Ronald HO Chung-leung: Pages 551-639 of the transcript contain Mr. Ho's evidence. Mr. Ho is the Chevalier Group Financial Controller. He is a qualified accountant. He reports to Mr. Norman Kan. Mr. Kan reports to the Board of Directors. Mr. Ho was the witness who was directly responsible for the preparation of the monthly accounts. He was also responsible for circulating them to the Directors, including Mr. Y.C. Chow. His evidence was confined to the preparation of these reports and the preparation and publication of COAL's interim and final results for 1992/3. He explained the different items in the accounts which accounted for the final loss of approximately $84 million being so much worse than the interim loss of approximately $17 million. Much of the inquiry was focused on the extent to which it was predictable that the year end figures would exceed a figure of double the interim figure, say $34 million and by how much. Firstly the extent to which it was predictable to the management and secondly the extent to which it was predictable to the investing public.

(iv) Mr. KUOK Hoi-sang: At the very end of the inquiry (transcript pages 1330-1340) Mr. Kuok was called as a witness for Mr. Y.C. Chow. He gave very brief evidence about Mr. Y.C. Chow's style of doing business and his relationship with his fellow directors.

(v) Mr. CHOW Yei-ching: Apart from Mr. Kuok, Mr. Y.C. Chow was the final witness to give evidence to the Tribunal. Naturally, the thrust of his evidence was to deal specifically with the primary issues which we list at the conclusion of this chapter.

B. The Auditors: Two witnesses from Chevalier's auditors, Messrs. Kwan, Wong, Tan & Fong were called to give evidence.

(i) Mr. Lawrence Leung: (transcript pages 219-269) is a qualified accountant and a partner of the firm. The Tribunal made an extensive investigation into the company's audit. In addition to the accounting procedures we also closely examined the

channels of communication between the audit team on the one hand and staff and management of COAL on the other. Most of the "audit" evidence was concerned with those audit adjustments which were not accounted for in the interim financial announcement (in January) but were included in the year end figures. In order of size these adjustments were for stock write-offs, deferred charges and bad debts. Of the final figure of $84 million loss about $30 million is accounted for by these adjustments. The calculation of the adjustments was not finalized until shortly before the final announcement (August 13th 1993). On any view this was well after the last day on which Mr. Y.C. Chow sold COAL shares (July 5th). Consequently our inquiry has concentrated on the extent to which the final loss was predictable net of the adjustments. In a nutshell:- knowing that the interim loss was $17 million, was a final loss of about $55 million information which Mr. Y.C. Chow had at the material time and was the investing public able to foresee such a loss?

(ii) Ms Ida LAM Wai-ming: (transcript pages 373-433) Ms Ida Lam was the Audit Manager in Messrs. Kwan, Wong, Tan & Fong. She was in charge of the audit. Mr. Lawrence Leung was her boss. Within COAL she dealt with Mr. Ronald Ho. She never spoke to Mr. Y.C. Chow about audit matters. Most of her evidence was concerned with the calculation of the adjustments and when the calculations were made and agreed. She started work on the audit in May 1993. Most of the field work was done in June and July. Her evidence was that her firm had not anticipated the increase in the final adjustments whilst the audit was being carried out. The largest item - over $21 million - for stock provision was not agreed until early August 1993. Our terms of reference require us to investigate disposals of COAL shares between April 26th and July 5th 1993.

C. Disposal of COAL shares: The next group of witnesses, of whom there were 3, are concerned with the reasons for and method of the actual selling off of 28 million COAL shares between the relevant

dates.

(i) Peter NG Hon-ying: (pages 643-689 in the transcript) Mr. Ng is a solicitor and a partner in the firm of Ng and Fong. In 1988 Mr. Ng was approached by Mr. Y.C. Chow to be a trustee of the Grace Hsin Ya Jen Trust. The name of the Trust is Mr. Y.C. Chow's sister. It was described as a family trust, the beneficiaries being various relatives of Mr. Y.C. Chow. Mr. Ng did not become a trustee in his personal capacity but, instead, used a company called Capital Growth Limited to act as the trustee. The Trust's only property was shares and warrants in all three companies of the Chevalier Group.

It was an agreed fact that the Trust held a substantial number of warrants in CIHL. As already mentioned those warrants had to be exercised by December 31st 1993 at the latest or by September 22nd 1993 to get the benefit of the dividend. Mr. Ng informed the Tribunal that the decision to sell COAL shares in order to raise funds to exercise the warrants was made as a result of a discussion between himself and Mr. Y.C. Chow before Easter 1993. He said the decision to sell COAL shares rather than CIHL or CDIL shares to raise the cash was based on two things. Firstly, it would be illogical to sell CIHL shares in order to buy CIHL warrants and secondly CDIL shares should not be sold because it was a relatively new company and it might give a bad signal to the market if the Chairman was seen to be disposing of a large number of shares.

Mr. Ng played no part in the decision to set 50 cents as the price at which they should be sold nor was he involved in the actual transactions between April 26th and July 5th.

(ii) Mr. CHOW Chien-hua: Mr. C.H. Chow's evidence is recorded at pages 270-321 of the transcript. He described himself as a friend of Mr. Y.C. Chow's. He was one of two people who transacted the disposal of shares on Mr. Y.C. Chow's behalf. His method of disposing of the shares was out of the ordinary.

His evidence was that Mr. Y.C. Chow was not aware of his chosen method. Briefly it was as follows:- Mr. C.H. Chow is not a stock broker. For these transactions he used two brokerages, North Sea Securities and Tung Tai Securities.

Normally he traded shares in his own name but for these transactions he traded them in the names of three of his relatives who were residents of Macau, Mr. Tai, Mr. Chao and Ms Chao. His explanation for this was that he wished to avoid any risk of being liable to U.S.A. tax. When Mr. C.H. Chow received the proceeds of sale in the form of a cheque in the account holder's name he would make out a cheque in favour of Mr. Y.C. Chow and credit his account accordingly.

Mr. C.H. Chow said he was unaware of any reasons for the movement in the COAL share price. He simply carried out his instructions. As a rule he did not contact Mr. Y.C. Chow directly about the continuing disposals but dealt with one of his staff, a Mr. Yu. It was a matter of some regret to the Tribunal that Mr. Yu had left Hong Kong. His whereabouts were unknown but believed to be somewhere in the U.S.A. The SFC attempted but failed to locate him. His absence left an important gap in the chain of evidence.

Mr. C.H. Chow said that his method of selling the COAL shares was not intended to conceal the fact that Mr. Y.C. Chow was selling his COAL shares. Whether that was the intention or not it nonetheless clearly had that effect.

(iii) Mr. David TUNG Wai: (Mr. Tung's evidence is at pages 321-372) Mr. Tung is a stock broker and has been a friend of Mr. Y.C. Chow's for over 30 years. He and his brother ran two firms called Chung Lee & Co. and Chung Hsin & Co.

Of the 28 million COAL shares sold between April 26th & July 5th, 19.4 million were sold through Mr. Tung's firm. The shares he sold were all registered in the name of Oklahoma

Investments Limited. This account had been set up at the request of Mr. Y.C. Chow in or about March 1993.

As with Mr. C.H. Chow, Mr. Tung's instructions were to sell if the price hit 50 cents. Most of his sales were at the end of June when the price suddenly went up. He said he had failed to sell earlier, in May, when the price reached 50 cents because he had not noticed that they were above 50 cents.

He also dealt with Mr. Yu at Chevalier. The proceeds of sale in the form of a cheque made out to the company were sent to Mr. Yu.

Mr. Tung made no transactions in the name of Oklahoma after July 2nd 1993.

D. The expert witnesses: In this inquiry the expert evidence has been of particular significance. The evidence of two experts, Mr. Toby Heale (called by counsel to the Inquiry) and Mr. Richard Witts (called on behalf of Mr. Y.C. Chow) together with the SFC's Director of Enforcement, Mr. Alex Pang spanned 7 days in court and 515 pages of the transcript (pages 697-1211). On crucial issues the two experts did not agree. However both Mr. Heale and Mr. Witts were witnesses with considerable expertise in their field. They were most impressive witnesses who gave the Tribunal considerable assistance. Their lack of agreement merely demonstrates the difficulty of some of the issues before us. Chapter 4 of this report is devoted solely to the expert evidence.

(i) Mr. Thomas Edward Fairfax Heale: In the 1960's Mr. Heale was a partner of the London firm of Francis & Praed. In the 1970's he joined a leading firm of stock brokers and became their Director in Hong Kong of Far East markets. He later returned to London as a specialist in Emerging Markets and finally returned to Hong Kong in 1989 and in 1991 started his own company called Investor Information Limited.

(ii) Mr. Richard Arthur Witts: Mr. Witts was originally a Chartered Accountant. From 1972-1981 he was Secretary and General Manager of the Hong Kong Stock Exchange. He has since been a Director of Jardine Fleming Securities and Schroder Securities. He is now the Managing Director of United Mok Ying Kie Limited. He has sat on the Council and the Listing Committee of the SEHK.

(iii) Mr. Alex Pang: As already mentioned Mr. Pang is now the Director of Enforcement at the SFC. He is a qualified accountant. He joined the office of the Commission of Securities and Commodities Trading in 1983 which became the SFC in 1989. At the time of these events (1993) he was in charge of the surveillance unit. His main duty was to monitor trading activities on the SEHK. In this particular inquiry he was not put forward as an expert in the same sense as the previous two witnesses.

3. The Main Issues:

No issue has arisen in this inquiry in relation to Mr. Y.C. Chow being a "person connected" to COAL. He is so by virtue of the fact he is a Director and the Chairman.

The issues which remain are:-

(i) Did the sales of the 28.18 million COAL shares come about as a result of Mr. Y.C. Chow "dealing" in those shares or "counselling or procuring another to deal". Counsel for Mr. Y.C. Chow concedes it is one or the other. Whichever it is, when did it take place?

(ii) What information was Mr. Y.C. Chow in possession of at the time of his dealing or counselling or procuring?

(iii) Does that information qualify as relevant information as defined by s. 8 of CAP 395?

(iv) If it was relevant information did he know it was relevant information?

(v) If the ingredients of s. 9(1)(a) have been proved by the evidence, should Mr. Y.C. Chow not be identified as an insider dealer by virtue of s. 10(3) of CAP 395?

Both counsel agree that these are the issues before the Tribunal and have dealt with the evidence under the same or similar headings. Our report therefore will do the same.

CHAPTER 2

PROCEDURE

1. The Tribunal

By a notice dated August 14th 1996 issued pursuant to s. 16(2) of the Securities (Insider Dealing) Ordinance CAP 395 ("the Ordinance") the Financial Secretary Mr. Donald Y.K. Tsang directed that a Tribunal be instituted to inquire into and determine:-

> "(a) whether there has been insider dealing in relation to Chevalier (OA) International Limited arising out of the dealings in the listed securities of that company by Mr. CHOW Yei-ching during the period from 26th April to 5th July 1993 (inclusive); and
>
> (b) in the event of there having been insider dealing as described in paragraph (a), the amount of any profit gained or loss avoided as a result of such insider dealing."

Pursuant to section 15 of the Ordinance the Tribunal was duly constituted as follows:-

Chairman : The Hon. Mr. Justice Michael Burrell

Member : Mr. Selwyn Mar. Mr. Mar is a Certified Public Accountant and is the managing partner of Charles Mar Fan & Company.

Member : Mr. Ian G. McEvatt. Mr. McEvatt is the Chief Executive of Indosuez Asset Management Asia Limited.

2. Legal Representation:

The Tribunal appointed Mr. Daniel Marash, instructed by the Attorney General's Chambers, as the counsel to the Tribunal. He was assisted by Miss Amy So, a Crown Counsel in the Civil Division of the Attorney General's Chambers.

Clause 16 of the Schedule to the Ordinance states:-

> "A person whose conduct is the subject of an inquiry or who is implicated, or concerned in the subject matter of an inquiry shall be entitled to be present in person at any sitting of the Tribunal relating to that inquiry and to be represented by a barrister or solicitor."

Mr. CHOW Yei-ching was represented by Mr. John Griffiths Q.C. leading Mr. Graham Harris and David Tsang of counsel, all instructed by Messrs. Fan & Fan, Solicitors.

3. "Salmon" Letters

The first task of the Tribunal and its counsel was to identify to whom "Salmon" letters should be sent. The purpose of a Salmon letter is to give any person advance notice that they may be affected by the inquiry. They are called "Salmon" letters after Lord Justice Salmon who was the Chairman of the Royal Commission on Tribunals of Inquiry in the United Kingdom in 1966. We decided, in keeping with a procedure recently adopted by the Hong Kong Insider Dealing Tribunal, to issue two different types of Salmon letters, which we have called Salmon "A" letters and Salmon "B" letters. Examples of each are at Annexure A of this Report. A Salmon "A" letter is sent to any person against whom a finding of insider dealing could, based on the material available before the commencement of the inquiry itself, be made. A Salmon "B" letter is sent to any person who, based on the same material, may be concerned in the subject matter of the inquiry but against whom there is, at the time of sending the letter, no suspicion of insider dealing. It is a feature of an inquisitorial function that, in the course of the inquiry, a suspicion against an individual may emerge where none existed at the outset. If that were to happen a Salmon "A" letter would be sent to such an individual as soon as the suspicion arose so that he could be legally represented if he had, hitherto, not been. In the Chevalier inquiry this did not arise.

The material which the Tribunal and counsel to the Tribunal considered when deciding to whom Salmon letters should be sent comprised the statements and documents gathered by the Securities and Futures Commission (the "SFC") as a result of its investigation into

possible insider dealing. We also read and considered the Report produced by the SFC at the conclusion of its investigation. The Report is a useful document in that it summarizes the material gathered in the course of the SFC investigation, we emphasize however, that it is not evidence.

We decided to serve a Salmon "A" letter on Mr. CHOW Yei-ching.

Salmon "B" letters were sent to:-

Mr. FUNG Pak-kwan : A Director of COAL (inter alia)
Mr. Norman KAN Ka-hon : A Director of COAL (inter alia)
Mr. Ronald HO Chung-leung : The Chevalier Group Financial Controller
Mr. CHOW Chien-hua : A friend of Mr. CHOW Yei-ching
Mr. David TUNG Wai : A stock broker and friend of Mr. CHOW Yei-ching
Mr. Lawrence Leung : A partner in the firm of accountants
Mr. Ida LAM Wai-ming : An Audit Manager in the same firm

A Salmon "B" letter would also have been sent to Mr. YU Shan-hua had his whereabouts been known. We comment on more than one occasion later in our report that his absence was regrettable. In view of the fact that he was described as a "relative" of Mr. Y.C. Chow's and a close employee of his at the material time the Tribunal was surprised that enquiries about him were totally fruitless. He had been interviewed by the SFC.

4. Preliminary Hearings

The Salmon "A" letter to Mr. Y.C. Chow was served on January 2nd 1997. Salmon "B" letters were served on January 3rd 1997. The information in the letters included the date of the first preliminary hearing which was held on January 23rd 1997. The main purpose of the first preliminary hearing was for the Chairman to make an opening statement and to discuss a future timetable.

In so far as the opening statement dealt with procedural matters we emphasized the following:-

i) The Tribunal's function is inquisitorial rather than adversarial. This is a fundamental distinction between an inquiry by a Tribunal and conventional litigation. The distinction gives rise to a number of consequences. For example, the Tribunal directs the inquiry - it is empowered to investigate new matters should they arise, provided they are relevant to the terms of reference. Also, the Tribunal may adopt flexible procedures as it sees fit. Rules relating to, for example, leading questions, hearsay, examination on previous statements and the scope of re-examination are not applied with the same strictness as in conventional litigation.

ii) The role of counsel to the inquiry is to present the evidence objectively, regardless of which way the evidence falls. He does not however have to remain neutral throughout. If he considers the evidence provides proof of insider dealing he should employ his skills of advocacy in the usual way to that end.

His role also involves a high degree of administration. For example, he is responsible for the attendance of witnesses, drafting notices to secure the attendance of witnesses, drafting notices to require the SFC to carry out further investigation, disclosing all relevant information to solicitors and counsel involved in the inquiry, and generally ensuring that the inquiry progresses as smoothly and fairly as is reasonably practicable. To this end, it is sometimes necessary for counsel to the Tribunal and the members of the Tribunal to meet in Chambers. Prior to the commencement of the inquiry this is inevitable. After the start of the evidence however, although it is necessary from time to time, it should be kept to a minimum.

iii) We emphasized also that we were conscious of the fact that the mere making of an allegation in a Salmon "A" letter could adversely affect a person's reputation. We stressed that the

making of an allegation is never evidence of the truth of the allegation. A person against whom an allegation is made may have a complete answer to it. There is no burden of proof on such a person (except by virtue of s. 10 CAP 395) and the Tribunal will make no judgment until all the evidence has been heard and submissions made.

iv) We noted that the costs of inquiries such as this can become very high. We stated that a balance between expediency and focussing on the main issues on the one hand and not proceeding at a pace which might prejudice the parties on the other was a balance to be aimed for. We asked for evidence to be agreed and put in writing whenever possible.

In addition to i) above we wish to add that the Tribunal is always conscious of the danger that an excess of flexibility could disadvantage an implicated person. Although it is important that the Tribunal retains its inquisitorial function and its inquisitorial powers, it should not lose sight of the fact that the recipient of a Salmon "A" letter is a person against whom serious allegations of wrongdoing have been suggested and against whom findings of such wrongdoings may be made. Accordingly, should counsel to the inquiry form a view that the evidence points to insider dealing by one or more persons then, inevitably, the proceedings take on the characteristics of adversarial litigation. When this happens this Tribunal would not wish to restrain counsel from conducting the case with skills that had been developed and honed in an adversarial atmosphere but on the other hand would not permit an excess of flexibility to be utilized to such an extent as might be regarded as unfairly prejudicing the implicated person. The need to be fair overrides everything.

The inquiry commenced on March 3rd 1997 when opening statements were made. The evidence started on March 10th and was gathered over 21 days thereafter. Final submissions were heard on May 20th-22nd inclusive.

5. Procedure during the Inquiry

In Lord Justice Salmon's Report of 1966 he lists 6 cardinal principles which should be followed in public inquiries. Principles 4-6 are:-

"(4) (The accused person) should have the opportunity of being examined by his own counsel and of stating his case in public at the inquiry.

"(5) Any material witness he wishes called at the inquiry should if reasonably practicable, be heard.

"(6) He should have the opportunity of testing by cross examination conducted by his own solicitor or counsel any evidence which may affect him."

Counsel to the Tribunal called ten witnesses. He examined them in chief. Counsel for the implicated party had the right of cross examination. Counsel to the Tribunal re-examined. The members of the Tribunal usually asked their questions prior to re-examination.

In the case of Mr. Y.C. Chow, Mr. Richard Witts and Mr. KUOK Hoi-sang, their evidence was led by Mr. John Griffiths and Mr. Marash cross examined.

CHAPTER 3

LAW

We here set out:

1) Those parts of CAP 395 which have direct relevance to the Chevalier inquiry. In this chapter we will not elaborate on them. We will refer to them in detail when we consider their application to each of the issues which we deal with in the subsequent chapters.

2) Some general legal principles which have been of particular importance in our decision-making process.

1. The Ordinance

Of the six different types of insider dealing which are set out in s. 9 of CAP 395 we are only concerned with s. 9(1)(a) which states:

"9. When insider dealing takes place

(1) Insider dealing in relation to a listed corporation takes place -

(a) when a person connected with that corporation who is in possession of information which he knows is relevant information in relation to that corporation deals in any listed securities of that corporation or their derivatives (or in the listed securities of a related corporation or their derivatives) or counsels or procures another person to deal in such listed securities knowing or having reasonable cause to believe that such person would deal in them;"

The ingredients of s. 9(1)(a) are further defined in CAP 395:-

(i) "connected with a corporation" is defined by s. 4:-

"4. "Connected with a corporation"

(1) A person is connected with a corporation for the purposes of section 9 if, being an individual -

(a) he is a director or employee of that corporation or a related corporation; or ...."

(ii) "Relevant information" is defined in s. 8

"8. "Relevant information"

In this Ordinance "relevant information" in relation to a corporation means specific information about that corporation which is not generally known to those persons who are accustomed or would be likely to deal in the listed securities of that corporation but which would if it were generally known to them be likely materially to affect the price of those securities."

The third ingredient which must be proved before a finding of insider dealing can be made is that the person "deals" in the listed securities or counsels or procures the dealing. Dealing is defined by section 6.

"6. "Dealing in securities or their derivatives"

For the purposes of this Ordinance, a person deals in securities or their derivatives if (whether as principal or agent) he buys, sells, exchanges or subscribes for, or agrees to buy, sell, exchange or subscribe for, any securities or their derivatives or acquires or disposes of, or agrees to acquire or dispose of, the right to buy, sell, exchange or subscribe for, any securities or their derivatives."

"Counselling or procuring" is not defined in CAP 395. We deal with its meaning in law in Chapter 5.

The final provision of CAP 395 which falls for our consideration is s. 10(3):-

"10. Certain persons not to be held insider dealers

(3) A person who enters into a transaction which is an insider dealing shall not be held to be an insider dealer if he establishes that he entered into the transaction otherwise than with a view to the making of a profit or the avoiding of a loss (whether for himself or another) by the use of relevant information."

This provides a defence to insider dealing. It arises only if a transaction has been proved to the required standard to have been an insider dealing. If so, once it is raised the burden of proof is on the person who seeks to rely on it and that burden is discharged on a balance of probabilities. If that burden is discharged the person will not be identified as an insider dealer.

2. General Legal Principles

A. Standard of Proof

Since the decision of Mr. Justice Stock in the "Success Holdings Limited" (SHL) Report the standard of proof adopted in subsequent inquiries has been proof "to a high degree of probability". We stated in our opening statement that subject to any submission to the contrary this would be the standard that would be applied in the Chevalier Inquiry. The SHL ruling adds that the degree of probability has to be "commensurate with the occasion" or "proportionate to the subject matter".

In the Parkview Inquiry the Tribunal reported as follows:-

> "The standard of proof should be simply stated and remain the same throughout. It is a high standard of proof - not the highest reserved for criminal allegations - but nonetheless high. It is not appropriate to say that within a given inquiry the more serious the allegation the higher the standard should be. The standard at all times is high. "A high degree of probability" refers to the top end of the civil standard. It is set high because the issues are serious. A finding of insider dealing against an individual is a finding of wrongdoing which will

> adversely affect his or her reputation. It carries with it penal sanctions and public obloquy."

In this inquiry Mr. Griffiths has submitted on behalf of Mr. Y.C. Chow that the standard of proof adopted in previous inquiries has been too low and that the proper standard to be adopted in Insider Dealing inquiries, and in particular in the Chevalier inquiry, is the criminal standard namely proof beyond a reasonable doubt.

Naturally, this Tribunal is not bound by decisions in earlier inquiries as to the standard of proof to be applied. We will therefore make a specific ruling for the purposes of this inquiry.

Mr. Griffiths has invited the Tribunal to regard insider dealing as being akin to criminal conduct by describing it as "essentially fraudulent conduct". He makes the point that an adverse finding would have grave consequences to Mr. Y.C. Chow, including damage to reputation in both the financial and charitable community, disqualification from directorships, heavy financial penalties and possible loss of honours. Mr. Griffiths referred us to a number of cases from both the United Kingdom and Hong Kong in which the issue of the standard of proof in Tribunal litigation was addressed. For example he referred to Lord Lane's remarks in In re a Solicitor [1992]2 W.L.R. at 562:-

> "It seems to us ... that it is not altogether helpful if the burden of proof is left somewhere undefined between the criminal and civil standards. We conclude that at least in such cases as the present, where what is alleged is tantamount to a criminal offence, the tribunal should apply the criminal standard of proof, that is to say proof to the point where they feel sure that the charges are proved or, put in another way, proof beyond reasonable doubt."

Lord Lane went on to quote with approval from a Canadian case:

> "When a complaint is made against a solicitor which may result in his suspension or disbarment, effect should not be given thereto unless the grounds of the complaint are

established by convincing evidence, and when the complaint involves a criminal act, by evidence establishing the grounds beyond a reasonable doubt."

The common feature of all the cases cited was that they were dealing with allegations which were mostly actual allegations of crime e.g. indecent assault by a doctor or theft by a solicitor or less often, allegations of conduct which was "tantamount to criminal misconduct".

This Tribunal does not wish to downgrade allegations of insider dealing in any way. Insider dealing is undoubtedly a serious allegation with serious consequences. The fact remains however that the legislation has decided not to make it a criminal offence and the sanctions at the Tribunal's disposal are not criminal sanctions. This simple fundamental fact is at the core of the reasoning in Mr. Justice Stock's ruling on the standard of proof in insider dealing cases in the Success Holdings inquiry. This Tribunal agrees that at the outset the standard of proof should be stated as proof to a high degree of probability and adds that that standard should be applied throughout the inquiry on every issue (regardless of the fact that one issue may have more dire consequences than another) and in respect of every implicated person (regardless of who he or she may be).

In addition it is desirable, although not essential, that there is consistency between one inquiry and another. In all previous inquiries under CAP 395 the standard adopted has been proof to a high degree of probability. We have not been persuaded that the proper standard is the higher one.

Of greater importance however, is not the phrase used to describe the standard but what the words actually mean in a practical sense. One person might conclude that a fact has been proved to a high degree of probability by the evidence whereas another person might not. Therefore what a phrase means and how it should be applied may vary from one person to another.

This Tribunal regards the expression "to a high degree of probability" as being the highest standard of proof short of proof beyond

a reasonable doubt. In civil litigation a judge can say he "prefers" one version of the facts to another on the balance of probabilities. In these proceedings it is not a question of preferring one version, even if it is highly preferable. In these proceedings the Tribunal makes a finding on the evidence only when the opposing version can be confidently excluded.

Save as already referred to (s. 10 Defences) no burden of proof lies on an implicated person.

B. Circumstantial Evidence and Inferences

It is more likely than not that proof that there has been insider dealing will depend to a large degree on the drawing of inference from proven facts. By its very nature insider dealing has conspiratorial characteristics. People who set about to make a profit by insider dealing do not do so openly. A person's "knowledge" or "intention" at a material moment is likely to be significant and requires strict proof.

We have therefore directed ourselves carefully on the proper approach when evaluating such evidence. We have directed ourselves in the following terms:

We may infer from any of the facts which have been agreed or proved before us the existence of some further fact. Such an inference must be a compelling one - the sort of inference that no reasonable man would fail to draw. It should be the only reasonable inference, which is not the same thing as the only possible inference, which may be drawn from the facts already agreed or proved to the required standard.

Lord Wright in Caswell v Powell Duffryn Associated Collieries Ltd. [1940] AC152 stated as follows:-

> "Inference must be carefully distinguished from conjecture or speculation. There can be no inference unless there are objective facts from which to infer the other facts which it is sought to establish. In some cases the other facts can be inferred with as much practical certainty as if they had been

> actually observed. In other cases, the inference does not go beyond reasonable probability. But if there are no positive proved facts from which the inference can be made, the method of inference fails and what is left is mere speculation or conjecture."

It is of note that the way in which the Tribunal has directed itself on the question of inferences is by adopting, almost to the letter, the approved direction to juries in criminal trials on the same subject. The fact that we adopt directions which are appropriate in proceedings where the criminal standard of proof applies is a measure of our approach to the question of the standard of proof generally, as set out in the preceding section in this chapter.

C. Good Character

The same observation applies to the question of "good character". Although, generally speaking, it is very unlikely that any implicated person in an Insider Dealing inquiry will be anything other than a person of "good character" in the sense that he or she has no criminal conviction recorded against him or her, any such person is nonetheless entitled to have their good character weighed in the balance in their favour in the same way as a defendant of good character in a criminal trial. Mr. Y.C. Chow's "good character" is a description of not only the fact that he has no previous criminal convictions but also the fact that he is highly regarded in the community. This is usually described as "positive good character".

Accordingly we direct ourselves that Mr. Y.C. Chow's positive good character is relevant in two ways. Firstly we take it into account in his favour when deciding the weight to be attached to the evidence he gave before the Tribunal. Secondly, he can rely on his good character as making it more unlikely than otherwise that he would be guilty of insider dealing.

D. Lies

Examining the credibility of a witness's testimony is a

fundamental part of any court or Tribunal's function. On important issues we must decide if the evidence given is true or false. If we conclude that false evidence has been given we emphasize that we would only rely on that evidence as evidence in support of an allegation against its maker in certain circumstances.

Accordingly our approach to the significance of "lies" in our decision-making process has been to follow to the letter the observations made at 4-28 (page 30) of the Public International Investments Limited Report which we cite herein in full:-

> "To the extent that we may decide that lies have been told to the SFC or to this Tribunal we are conscious of the fact that there may be reasons for lies consistent with absence of any wrongdoing, or of the particular wrongdoing alleged, and that it is only if we exclude such reasons that lies may support the allegation of that particular wrongdoing. We are also conscious of the fact that although a lie of itself proves nothing, save that the lie has been told, "lies can in conjunction with other evidence tend to support an inference of guilt in the sense that they can confirm or tend to support other evidence which of itself is indicative of guilt. ... we have ... borne well in mind the question whether a lie may have been motivated not by a realization of guilt of insider dealing, but by a realization of guilt of some other wrongdoing or by a conclusion or fear (whether justified or not) that certain conduct would be viewed by others as improper, or by a feeling that the truth was unlikely to be believed ... also that before a lie may be used to support a particular allegation, we have first to be satisfied that the lie was deliberate, and that it is material to the issue we have to decide".

E. Law/Fact

All matters of fact are decided by the Tribunal. All matters of law are decided by the Chairman (CAP 395 Schedule, paragraph 13). On matters of fact we have striven for unanimity at all times. In the absence of unanimity the Ordinance permits findings based on a majority

to 2 to 1. Where decisions on law are referred to as "the Tribunal's decision" it should be understood that it has been on the Chairman's direction.

In deciding matters of fact the Tribunal acts as a jury of three. One purpose of a Judge sitting with two members of the business and professional community of Hong Kong is for the two members to bring their experience and expertise into the decision-making process. Juries in criminal trials are often directed to use their common sense as men and women of the world. Tribunal members have the added dimension of being men and women of the financial and business world. We quote from Phipson on Evidence 14th Edition page 32:-

> "where a tribunal is composed of or includes specialists in the field wherein the litigation arises, and that situation is brought about by legislation specifically directed to that end, it may act on its own knowledge. Thus, the lay members of an industrial tribunal may use their own experience in assessing the evidence given by witnesses. If that leads them to take a different view to that of a witness, the witness should be given an opportunity of dealing with the view of the tribunal: but the tribunal are entitled to prefer their own opinion."

We accept one caveat to this extract from Phipson which Mr. Griffiths highlighted by reference to the words of Mr. Justice Talbot in Hammington v. Berker Ltd. E.A.T. 1980 I.C.R. at P. 252:-

> "The essence therefore of the use of such specialized knowledge and information and experience is that it is to be used, as can be seen from all these authorities, for the purpose of weighing up and assessing the evidence and if necessary interpreting it. What must not be done is to use that knowledge to substitute for the evidence given in Court, that derived from that knowledge; nor must it be used for producing some factor of evidence which is not evidence before the Court, with which the parties have not had an opportunity of dealing."

The knowledge and expertise which Tribunal members bring to an inquiry is considerable and, used judicially, is invaluable. Members can and should use their knowledge and expertise provided the use to which it is put is in evaluating the evidence not giving it.

In this chapter we have only outlined the main matters of law which have been relevant to this inquiry. As already referred to, we shall consider some of them in much greater detail in the following chapters.

CHAPTER 4

THE EXPERT EVIDENCE

Before we confront the specific issues which need to be answered before we can say whether or not insider dealing has been proved, it will be useful to consider the expert evidence which has been given.

The most significant feature of the evidence from the two experts, Mr. Toby Heale and Mr. Richard Witts, was that given the same material the two men, whose expertise was accepted and whose credentials were of the highest order, held opposing views.

There were four main issues upon which they gave evidence and opinions. Their opinions were closely examined by counsel and by the Tribunal.

(I) What message would the ordinary investor be able to glean from the publicly disseminated information?

(II) What was the effect of the Shougang rumour on the COAL share?

(III) What was the true value of the COAL share?

(IV) The validity of Mr. Y.C. Chow's reason for selling COAL.

(I) Interpretation of public information

The numerous press articles and public statements some of which are listed in Annexure C were read and considered by both experts.

Mr. Heale made the following observations:

(a) Comments by company representatives and reporters often made no distinction between the different companies within the Group.

On January 5th 1993 Mr. Y.C. Chow is quoted in the Sing Pao saying " the aggregate profits of *the Group* ...". He then identifies the source of profits but does not link the sources with the company names. The reader would have to know about the group structure to know where profits were coming from and where losses were coming from.

Similarly in articles on January 7th (H.K. Economic Journal) and January 9th (Ming Pao) questions are answered and comments made without reference to particular companies. Another example later in the year is found in the Sing Tao Daily on May 22nd 1993 in which a project is referred to as a "Chevalier" project when in fact the particular company involved is CDIL.

The short point is that the ordinary reader could read things about "Chevalier" without realizing that CDIL (for example) was very profitable and COAL was incurring big losses.

(b) It was Mr. Heale's opinion that rather than sending a clear message that COAL's second half performance was going from bad to worse the reader might interpret the press and company statements as a message of cautious optimism, the result of which might be year end figures no worse than double the half year results.

By way of example he referred, inter alia, to :

- Sing Pao 5th January 1993. "Competition still exists ... (Mr. Y.C. Chow) is confident that the Group will win the trust of its clients"

- Ming Pao 9th January. Mr. Y.C. Chow says that if they can double the number of customers for the cordless telephone they would recover their capital.

- South China Morning Post 11th January. Mr. Y.C. Chow described the number of customers as "a little below target". He also said he was "unconcerned" about the "crazy" price

cutting sales in the office equipment field.

- Interim Results - 13th January. Mr. Heale regarded the Chairman's statement under Business Review and Prospects as an unquantified and unqualified prediction of a loss for the year but added "performance would be better next year". In other words it will stabilize and then recover.

(c) By way of contrast he praises the statement made to the press on January 15th 1993 by Mr. P.K. Fung which he described as a very "professional statement". When talking about CT2 it refers to "fiercer competition", "business is less than satisfactory" and in relation to office equipment "COAL has no alternative but to reformulate its business strategies".

(d) Mr. Heale went on to look at the company representatives' comments to the public at around the time that the 10 and 11 month management figures would have been distributed to the Directors and the time when Mr. Y.C. Chow had given his instruction to Mr. C.H. Chow and Mr. David Tung to sell COAL i.e. March - May 93. It should be recalled that the half year loss of $17 million (April 92 - September 92) had doubled by December ($35 million - this was circulated to the Directors on March 2nd 1993) and nearly trebled by February ($47 million - this was circulated to the Directors on May 4th 1993).

- On March 12th COAL Director Mr. Norman Kan described COAL as an "average performer" (in comparison to CIHL or CDIL).

- May 27th Sing Tao Daily. Mr. Y.C. Chow said the Company would concentrate on expanding its telecommunication and office equipment business.

- Also at this time a statement was made by CIHL and CDIL confirming there were no price sensitive negotiations (in response to the Shougang rumour). Mr. Heale opines that the absence of COAL's name in this statement could have

been read as a positive factor. He notes also that there was a marked increase in turnover of COAL shares during this period suggesting speculation of involvement in the Shougang rumour.

Mr. Witts examined in some detail five key publications. (All in Annexure C.) Here we will concentrate on Mr. Witts' opinions and comments on them. They are:-

(a) The 1991/2 Annual Report on COAL:

Mr. Witts emphasized, both in the report itself and in newspaper articles about the report, the fact that substantial capital investment is being made in CT2 is made clear. The report adds that losses will be incurred at the start but there is the obvious hope that it will provide revenue in the future - but it does not say when in the future. It also makes no secret of the fact that the paging business profits will not be now (1992) but will be "in the coming years" and forewarns about the problems in the office equipment sector because of the "cut price campaign in the market".

In conclusion Mr. Witts states "the report makes it perfectly clear that in the short to medium term, the company is committed to very heavy investment which would inevitably result in substantial losses in the short or medium term".

(b) H.K. Economic Journal - December 30th 1992

Comments by the Chairman Mr. Y.C. Chow in this article such as "returns from the second generation of cordless phones are slow" and that the telecom projects will only "break even by next year" provide further confirmation, Mr. Witts states, that COAL has embarked on a major capital intensive project which they intend to see through but will take time and money. He also pointed to similar comments made at about the same time e.g. that CT2 was a "huge investment" in which the "pay-off would take 3-4 years" (Sing Pao January 5th 1993) and the emphasis placed on the difficulties in CT2 in a South China Morning Post article on January 11th 1993.

(c) The Interim Report - January 13th 1993:

It may be appropriate at this stage to remind ourselves what the SEHK Listing Rules state in relation to what a company should endeavour to disclose under its "Business Review and Prospects" heading in an Interim Report. Paragraph 11(2)m of Appendix 7 deals with this matter and it states:-

> "an explanatory statement relating to the activities of the group and profit or loss during the relevant period which must include any significant information enabling investors to make an informed assessment of the trend of the activities and profit (or loss) of the group together with an indication of any special factor which has influenced those activities and the profit (or loss) during the period in question, and enable a comparison to be made with the corresponding period of the preceding financial year and must also, as far as possible, refer to the prospects of the group in the current financial year;"

Mr. Witts, who has much experience in this area, told us that generally speaking such comments are encouraged to be vague rather than specific, constrained rather than over-ambitious.

He analysed COAL'S statement as "fairly gloomy". He said investors would take note of the fact that no interim dividend was declared. It makes unequivocal statements that CT2 losses cannot be offset by profits in other sectors, more expenses are being made (in China) and the directors expect losses because of high investment. It does not say the second half of the year will show any improvement in the situation.

He suggested that the two most significant figures that an investor would note from the interim reports are -

(i) The minority interest of $27.7 million. This is the joint venture partner's loss i.e. 49%. Therefore COAL's half year loss is over $28 million. COAL's full year loss will

exceed $56 million and the overall loss foreseen for CT2 would be more than $112 million.

(ii) The actual interim loss of nearly $17 million. This would be from a starting figure of a $4 million profit at the end of 1991/2 and so the actual turn around in that period was a $21 million loss.

Both (i) and (ii) Mr. Witts observes are simple arithmetic. He says that "alarm bells would ring in the mind of any sensible analyst" and the clear message was that "things are going to get worse before they get better".

(d) <u>H.K. Economic Journal - January 15th 1993</u>

This contains the interview with Mr. P.K. Fung which Mr. Heale described as "very professional". Mr. Witts agreed in the sense that the public is getting important information about the Company. The nature of that information, he said, is that "the black picture continues". He focused on remarks such as "(CT2) is at its peak investment period", "plans to set up sales networks in 25-30 cities in China", "CT2 business performed poorly" and the Company had been forced "to re-evaluate its business strategy" (because of the price war in office equipment).

Before moving on to the information which emerged at the time Mr. Y.C. Chow decided to sell his COAL shares (March - May 1993) we should observe the effect that the Interim Report had on the COAL share price. Frankly, it was very little. The price dropped by about 2 cents per share in the 2 days after the announcement. Even though 2 cents is 5% it is still only 2 cents. Furthermore for 5 weeks afterwards there was no interest in COAL in the market. Its trading each day was occasionally light but on many days, non-existent. It stayed at or about 38 cents for some time. This was therefore the price which the market perceived to be the right price for this share at that time.

(e) H.K. Economic Times - March 1st 1993

In this article the public can read negative comments from an in-house source. The most negative are "the number of CT2 subscribers is 50% less than the expected number", "subscribers are very disappointed" and "subscribers felt negative about CT2 after using it". On a more positive note however the source predicts "tremendous growth" in the long term.

Mr. Witts' conclusion is that, given the information available to the public, a prudent investor would make three observations:-

(i) In the 18 months prior to the interim announcement COAL has been losing money and the size of the loss was getting steadily bigger.

(ii) Even if the losses ceased to accelerate the year end losses would be double the half year losses.

(iii) A small amount of research would reveal that in COAL the second half yearly figures were likely to be worse than the first half year. Factors which would cause this were for example, the fact that there were more public holidays in the second half, the bonus wages month was in the second half, negative adjustments would be in the second half accounts but not in the first half and the downward slope had been steepening ever since CT2 was launched. Mr. Witts further noted that this first half/second half analysis was repeated in a number of COAL's subsidiaries which, he suggested, added weight to the correctness of the conclusion.

Each witness was asked to estimate what full year losses could have been predicted based on the publicly available information. In very round terms:-

Mr. Heale said $35 million
Mr. Pang said up to $45 million
Mr. Witts said over $55 million

Our findings as to what information Mr. Y.C. Chow was actually in possession of at the material time are contained in Chapter 6. The size of the difference between what Mr. Y.C. Chow actually knew on the one hand and what the ordinary COAL investor would have been able to predict on the other hand provides a crucial factor in deciding if the information is relevant or not.

We turn now to the second area of disagreement between the expert witnesses.

(II) The "Shougang rumour" and its effect, if any, on the COAL share.

The Shougang rumour started in mid April 1993. Between April 16th and April 22nd it was mentioned in six press articles. It is a fact that the rumour and any negotiations to which the rumour related concerned Shougang and CIHL. The press references were briefly as follows:-

> The Express (16th) reported that Shougang was rumoured to acquire a stake in Chevalier and urged readers to use caution when dealing in CIHL shares.
>
> Wen Wei Po (16th) - "Rumours have it that Shougang will again proceed with acquisition."
>
> H.K. Economic Journal (17th) reported that there had been preliminary talks with CIHL regarding a placement.
>
> Sing Tao Jih Pao (19th) confirmed speculation of on-going negotiations.
>
> H.K. Standard (20th) indicated that Shougang was proposing to take a stake in CIHL.
>
> H.K. Economic Journal (21st) reported that there would be "no deal" in the near future.

None of the reports mentioned COAL. There was considerable interest in the CIHL share at this time. It had a short but significant rise in heavy trading. The effect on COAL during the particular week was minimal. It went up 2 cents (from April 14th-16th) to 43.5 cents in above average trading but fell back to 40/41 cents the following week. However we see a more significant rise in the COAL share in the first week of May. It hit a peak of 54 cents on May 7th (from 43 cents at the end of April). This rise coincided with the time that CIHL and CDIL issued a statement through the SEHK that they were not involved in any price sensitive negotiations. The announcement excluded COAL.

Mr. Heale gives the following opinion:-

> "There may have been confusion over which group company was the possible target for the possible acquisition. Further, the market's reaction can be perverse. The rumour was strong in the market that Shougang would take a stake in Chevalier. Two of the group companies had denied there were any price sensitive negotiations but the third had not. The absence of the denial on May 5th may have focused investors' attention onto Chevalier (OA) Ltd."

He then poses the unanswered question:-

> "Was the omission of Chevalier OA from the May 5th statement to the Stock Exchange an oversight or was there a reason for it?"

Mr. Witts, on the other hand opines that there is "absolutely nothing" to be read into this omission. He agrees that "China fever" and "treasure hunting" were rife at the time and rumours and speculation about possible take-overs by Chinese companies of shell companies in Hong Kong were common place.

However he emphasizes the following matters when coming to his conclusion:-

(i) As a matter of fact no approach was ever made to COAL.

(ii) COAL is not a shell company and would be a very unlikely target anyway.

(iii) COAL was not requested by the SEHK to issue any denial so why should it.

(iv) There was nothing unusual about the COAL share price movement in April that would raise any eyebrows.

It is another 7 weeks before the COAL price really surges (to 64 cents on June 29th). Mr. Heale suggested that in the absence of any other information the COAL share was still reacting to the Shougang rumour. He said the "price was distorted by the Shougang noise".

Mr. Witts on the other hand described it as a "mystery". His research revealed that at exactly the same time there was a similar surge in 20-30 second or third line shares. He could see no reason for it other than "treasure hunting".

The Tribunal also is unable to come to any satisfactory finding about the cause of the sudden surge at the end of June when the vast majority of Mr. Y.C. Chow's COAL shares were sold. Mr. Alex Pang accepted that Mr. Y.C. Chow was fortunate and that the rise was not predictable. Even if it was still connected to the Shougang rumour no-one could have foreseen that the effect of the rumour would revive itself either in the way it did or at the time it did. In conclusion Mr. Heale was asked whether the speculation and increase in share price would still have occurred if the public had known about the forthcoming losses - in region of say $55 million? His answer was that there may have still been speculation but it would have been significantly dampened. It is not possible to quantify the amount by which it would have been dampened.

(III)<u>The valuation of the COAL share</u>:

A core fact in our inquiry is that Mr. Y.C. Chow gave

instructions in early April 1993 to sell COAL shares if and when they reached 50 cents a share. Bearing in mind that he had a time limit within which he had to raise the funds from the sale of COAL shares and bearing in mind that for most of the first part of 1993 the share had been at about 40 cents (and was 35 cents when he gave his instructions) it was necessary to ask - Was his trigger price of 50 cents realistic? In order to answer this question it was necessary to know how an analyst would assess the real value of the share. Once again our experts were not ad idem as to the proper method of doing this.

Mr. Alex Pang used the "Net Asset Valuation" method. At the time of the final announcement COAL's net assets were HK$240 million and there were 632 million shares in the market; therefore, the net asset value per share was 38 cents. This, he pointed out accorded almost exactly with the price of the share immediately after the announcement (37 cents). By the same method he calculated that a net asset valuation of 50 cents would only have resulted if COAL had made a profit of $12 million and not a loss of $84 million which, as we know, is what actually happened.

Mr. Heale did not favour the Net Asset Valuation method but nonetheless got the same result albeit by a different route. Mr. Heale's opinion was that in the final analysis the market price is always the right price. A share is worth what someone is prepared to pay for it. He said that provided the share is trading and provided all information is known then the market is the ultimate arbiter and the market price must be the right price. Mr. Heale's method was the one most favoured by the Tribunal.

Mr. Witts was particularly critical of the Net Asset Valuation method. In this case he described it as "entirely inappropriate". He directed our attention to a text on the subject stating:-

> "Net asset value measures what shares in a company would be worth if it was wound up. It is used in situation where a company seems in danger of going bust, or where assets are very important to the firm - particularly investment trusts and property shares. Net asset values are normally far below

share prices because investors are concerned with a company's ongoing business. They may not give a true representation of what a company would actually fetch if wound up."

In his opinion the best method would be the price/earnings ratio method. In addition he said an analyst would consider matters such as goodwill and future prospects of the company. He added that usually the Net Asset Valuation method produced a figure well below the market price and, in COAL's particular case the market value had, in its short history, rarely been reflected by its net asset value. Mr. Witts nonetheless conceded that at the time Mr. Y.C. Chow gave his instructions his target of 50 cents was indeed optimistic.

Given that the evidence is that the sudden rise in the price to over 50 cents and even over 60 cents in late June was unpredictable good fortune we cannot reject the suggestion that Mr. Y.C. Chow was driven by his heart and not his head when he gave his instruction.

(IV) <u>The validity of Mr. Y.C. Chow's reason for selling COAL</u>

Evidence was given from a number of sources that the sole reason for Mr. Y.C. Chow's sales of 28.18 million COAL shares was to raise funds to exercise warrants available to the Trust in CIHL. In particular, Mr. Y.C. Chow himself told the Tribunal that the decision was made at about Easter 1993 to exercise the warrants before the deadline date of September 22nd and any proceeds from the sales of COAL shares would be put to this use.

It is an agreed fact that the proceeds of sale were utilized to this end.

Mr. Y.C. Chow can only be identified as an insider dealer if the Tribunal finds that his motive was, at least in part, an intention to avoid the loss in value of the COAL share after the announcement of the final results on August 12th 1993. The making or otherwise of this finding depends on the application of s. 10(3) of CAP 395 which we deal with in Chapter 9. In this section we note what Messrs Pang, Heale and Witts say about Mr. Y.C. Chow's decision as to how to raise the money.

Viewed objectively the more valid the decision the more weight it lends to the credibility of his evidence.

Mr. Y.C. Chow's shareholding in all three companies - CIHL, CDIL and COAL was substantial. It was generally agreed that there was no logic in selling CIHL shares in order to raise funds to exercise CIHL warrants. The question was - why sell COAL? Why not sell CDIL?

In examination-in-chief Mr. Alex Pang put forward three reasons for selling CDIL rather than COAL. Firstly the CDIL shares price was higher (approximately $1.30 per share) therefore fewer CDIL shares would need to be sold to raise the money. Secondly the turnover in CDIL shares was greater than COAL so the money would be raised quicker. Thirdly, if Mr. Y.C. Chow sold CDIL his share holding in that company would reduce from 64% to 62% whereas in COAL it would reduce from 53% to 49%.

He finally suggested also that if COAL was to be the selling vehicle the sales could have been made after August 13th and before September 22nd to avoid any suspicion. However Mr. Pang conceded, in cross-examination that it would have been impossible to predict whether the turnover between August 13th and September 22nd would have been sufficient to dispose of 30-40 million shares. In hindsight it would not have been possible. He further agreed that such selling would have been perceived as "dumping" by the Chairman after disappointing results.

Mr. Heale did not deal with this particular matter in his report.

Mr. Witts described Mr. Y.C. Chow's choice of COAL as "perfectly sensible". He made the following observations in support of this comment:

(i) COAL had been listed in 1988 whereas CDIL was a much newer company. CDIL was listed in October 1991 some 17 months before the decision to sell was made. Mr. Witts thought that a large disposal of shares so soon after listing would be seen as

very adverse and would have a bad effect on the share price.

(ii) In answer to Mr. Pang's point that Mr. Y.C. Chow was left with only a 49% shareholding in COAL after the disposal, Mr. Witts commented that in fact his beneficial interest was reduced to 49.6%. In reality this would never subject him to a risk of a take-over and there were no rules preventing him form buying back a mere half percent to restore his majority shareholding had he wanted to. In effect, he was always in control.

(iii) Mr. Witts described the suggestion that Mr. Y.C. Chow should have waited until after the final announcement before selling as "reckless". He said that no prudent person would risk being able to raise such a large sum in such short time in an unknown market turnover. He made the further point that at the time the decision was made (mid-March) turnover was also low (daily average of about 400,000) and so it was sensible to spread the sales over the next four months.

In conclusion, on this sub-issue the question the Tribunal must address is - was it "perfectly sensible" for Mr. Y.C. Chow to decide to dispose of COAL shares in mid-March solely for the reasons put forward by him and supported by Mr. Witts or was it "perfectly sensible" because in addition to these reasons he knew he would also avoid the loss which he knew would come after the final announcement?

Mr. Alex Pang's evidence:

For the sake of completeness separate reference should be made to the evidence of Mr. Alex Pang. Mr. Pang is a conscientious member of the SFC team. He has worked for them for a long time, he has many years of experience and has been steadily promoted to his present high office. In this particular case he was not called as an expert. We think, rightly so, because it became apparent that in some important respects he had put an opinion in writing which did not stand up to close analysis.

In total he had made 4 statements. Broadly speaking the two latest were made to deal with the case in the light of either new issues or

old issues seen from a new angle. An example of this was highlighted by Mr. Griffiths in his cross-examination when Mr. Pang conceded that a particular paragraph in his most recent statement (which had been made after the inquiry had started) had never been made or alluded to before. In this paragraph Mr. Pang states "we expect (Y.C. Chow) would have some ongoing knowledge of the stock position of COAL ..." and (later) "it would not be unreasonable for COAL management to anticipate an increased stock write-off for 92/93". The newness of this observation is worthy of mention because it precedes an estimate made by Mr. Pang which was shown to be seriously flawed.

Mr. Pang made an estimate that the fully briefed COAL Director would have been able to predict a year end loss of about $79 million. He arrived at this figure by adding notional figures for stock write-off, bad debts and deferred charges to the February management account figure of $47 million losses. As a result of cross-examination he conceded that his notional figure for amortization of deferred charges should not have been included at all because, contrary to his initial understanding, amortization figures had been included in the monthly management accounts. He also accepted that a better notional figure for stock write-offs would be $3-4 million instead of $9.5 million. Ultimately therefore Mr. Pang's figure for an estimate of what the management would be able to predict was the same as Mr. Witts' figure for what the public would be able to predict i.e. about $55 million.

Mr. Pang's estimate of what the public would be able to foresee was "up to $45 million" He told the Tribunal that he had arrived at this figure by a reverse Net Asset Valuation method. In other words if the net asset valuation of the share was 40 cents the net asset value of the company would be a figure resulting from a $45 million loss for 92/93. Mr. Griffiths suggested to him that if the Net Asset Valuation method was inappropriate for the share valuation it was even more inappropriate for the loss calculation. He accepted that Net Asset Valuation method took no account of goodwill or prospects.

In addition to the above matters Mr. Pang also accepted the following propositions that were put to him by Mr. Griffiths:-

(a) that it was clear in early 1993 that COAL's decline was accelerating;

(b) that the second half of the year was going to be worse than the first half;

(c) that COAL's depending on Toshiba as a main supplier would contribute to the loss because of the strengthening of the Yen against the U.S. dollar in the first half of 1993;

(d) that negative adjustments would appear in the second half of the year and not the first half; and

(e) the dramatic 16 point austerity measures introduced in China on July 3rd 1993 was designed to cool down the PRC's overheating economy. Selling products in China had been more difficult than anticipated in the first half of 1993 and this made it even worse.

CHAPTER 5

"DEALING" OR "COUNSELLING OR PROCURING"?

It has never been an issue in this case that the disposal of 28.18 million COAL shares, the subject matter of our inquiry, were not Mr. Y.C. Chow's disposals. Paragraphs 4 and 47 of the Admitted Facts (Annexure B) so state. Paragraph 4 states - "The document at Bundle 1 pages 31-32 accurately records the sale of COAL shares registered in the name of Oklahoma Investments Limited ("Oklahoma") between April 26th 1993 and 5th July 1993, executed on the instructions of CHOW Yei-ching". Paragraph 47 states - "CHOW Yei-ching effectively controlled the Grace Hsin Ya Jen Trust between 26th April and 5th July and the Trustee thereof acted in accordance with his instructions in selling the 28,180,000 COAL shares between the aforesaid dates". In other words his effective control of the Trust amounted to the same thing as his control of the Trustee, Mr. Ng.

Also, no issue has arisen from the fact that the COAL shares were held by the Grace Hsin Ya Jen Trust of which Mr. Y.C. Chow was a beneficiary rather than by Mr. Y.C. Chow personally. He sensibly makes no attempt to hide behind the Trust in an attempt, which would have been forlorn, to absolve himself from the consequences of sales which took place between April 28th and July 5th 1993. Consequently the history of and chronology of relevant events concerning the Trust are set out in paragraphs 18-29 inclusive of the Agreed Facts.

The parties do not agree however, either the correct description of Mr. Y.C. Chow's conduct (was it actual dealing or was it counselling or procuring another to deal?) or whichever is correct, the material time that he either dealt or counselled or procured.

The two sides of the argument, briefly stated, are as follows. On behalf of Mr. Y.C. Chow it was submitted that his actions could not, as a matter of law, be regarded as dealing as defined by s. 6 of CAP 395 but only as counselling or procuring. The action which, it was conceded, does amount to either counselling or procuring (but not

dealing) was his discussion with Mr. Peter Ng before Easter 1993 which resulted in the decision that the Trust would dispose of its COAL shares in order to raise funds to exercise the CIHL warrants. The submission continues that once Mr. Y.C. Chow decided to counsel or procure the Trust to act and once he had taken the necessary steps to carry it out, namely by persuading Mr. Peter Ng as a Director of Capital Growth Limited - the Trustee, to agree to the disposal of the COAL shares, then, at that moment, the counselling or procuring is done. Consequently any future actions, such as approaching brokers and giving them instructions to sell, are merely the mechanics of carrying out the counselling or procuring and have no bearing on the act of counselling or procuring which has already taken place.

To complete the submission it is argued that as Mr. Y.C. Chow never owned the shares himself - it was the Trust who owned them - and as selling involves a change of ownership from one party to another, Mr. Y.C. Chow, who was neither party, could not be a party to a sale. Furthermore he did not hold them in his name as agent on behalf of the Trust. What in fact happened was that the Trust sold the shares as a result of an agreement that Mr. Y.C. Chow would instruct brokers on behalf of the Trust. The brokers then sold as agents for the Trust, not agents for Mr. Y.C. Chow. As evidence of what happened the Tribunal was reminded of Mr. Y.C. Chow's statement:-

> "I took the decision to sell COAL shares in March 1993 and so informed the company in writing of my intention, as was my duty. Shortly after making the decision I gave instruction to my friend, Chow Chien-wah, to set about selling of the order of 20 million COAL shares. I made it perfectly clear to him that it was only if he was unable to sell any COAL shares that he should contemplate selling CDIL shares for the reasons given in the last paragraph. Towards the end of April 1993, Mr. Chow had been unable to sell a single COAL share. In those circumstances, I agreed that he should start off by selling a limited number of CDIL shares but with the clear instruction that once he was able to sell COAL shares at 50 cents or above, CDIL shares should no longer be sold. Mr. Chow's progress in the sale of the COAL share was very slow and so I

> instructed a professional stockbroker, David Tung to embark upon the sale of COAL shares also ....
>
> My assistant at that time was Yu Shan-tung and I told Chow Chien Wah and David Tung to report sales to him so he could arrange for the SDI notices and be sure how many were sold. I then left it to them."

The consequence of the argument is that the Tribunal can only examine Mr. Y.C. Chow's state of mind, so as to discover what information he possessed, at the time of counselling and procuring and not subsequent to it. It is therefore submitted that what he knew at the time he gave instructions to Mr. C.H. Chow and Mr. David Tung to sell COAL if they reached 50 cents a share is irrelevant. It is irrelevant because instructing a broker is not part of "counselling or procuring another to deal". Brokers don't deal, they merely carry out instructions to deal.

At the time Mr. Y.C. Chow spoke to Mr. Peter Ng the latest monthly management statement which would have been placed on his desk was the one for December 1992 showing a loss of approximately $35 million. If however we decide that conversations with brokers instructing them to sell and monitoring transactions are not irrelevant to the question of Mr. Y.C. Chow's state of mind and possession of information, then there is evidence of such conversations in May 1993 at a time when the February 1993 figures would have been put on his desk which showed a loss of $47 million.

Mr. Marash on the other hand submitted that these later conversations were relevant. He submitted that Mr. Y.C. Chow's actions in April and early May when he spoke to Mr. C.H. Chow and Mr. David Tung were evidence of his dealing. (The passages in the transcript which refer to these conversations are at pages 282-283 and pages 329-330.) Even if it was not actual dealing and only counselling or procuring it was still relevant.

Thus the significant difference in the two arguments is not so much whether it was dealing or counselling or procuring but when it took

place. Did it end with the conversation with Mr. Peter Ng in March, as Mr. Griffiths submits or was he still either dealing or counselling or procuring in April or early May, as Mr. Marash submits?

If one breaks down the definition of "dealing" in s. 6 in so far as it is material to our case, we find that "deal" can mean one of four possibilities:- selling securities, agreeing to sell securities, acquiring or disposing of the right to sell securities and agreeing to acquire or dispose of the right to sell securities. Central to Mr. Marash's argument that Mr. Y.C. Chow was dealing as defined by s. 6 was the proposition that the Trust, to use his expression was "a sham". The expression caused ruffles of indignation in the Y.C. Chow legal camp. Mr. Marash however clarified his submission by assuring the Tribunal that he was not suggesting there was anything unlawful or improper about the legalities of the Trust. The thrust of his submission was that the Tribunal should not, as a matter of common sense, overlook the reality that the Trust was in the sole control of Mr. Y.C. Chow. There was evidence, not challenged, that the share certificates were in Mr. Y.C. Chow's physical possession. The other beneficiaries of the Trust were Mr. Y.C. Chow's relatives who, Mr. Peter Ng on behalf of the Trustee, Capital Growth Limited, did not consult before agreeing to Mr. Y.C. Chow's proposal to sell the Trust's shares. Put simply, the submission was that, for these reasons, when Mr. Y.C. Chow approached Mr. C.H. Chow and Mr. David Tung and said, in effect, "sell up to 20 million COAL shares for me", he was "dealing" in the sense intended by s. 6 of CAP 395. He was agreeing (because in truth only he exercised the power to do so) that the shares be sold.

The Tribunal finds this submission attractive but finds no need to decide the point for the following reason. The important matter is whether we consider Mr. Y.C. Chow's state of mind only when he spoke to Mr. Peter Ng "before Easter" i.e. in March or whether his knowledge in later April and early May (the times, according to the evidence, that he was still in conversations with Mr. C.H. Chow and Mr. David Tung about the sales) is also relevant. If we find that the later conversations are part of, and therefore relevant to, acts of "counselling or procuring" then it is unnecessary to define whether these conversations were evidence of his "dealing" or evidence of his "counselling or procuring".

In this case we make no distinction between the two in terms of gravity. We proceed therefore on the basis that Mr. Y.C. Chow "counselled or procured" the sales. When he was in contact with his "brokers" as late as early May he was still counselling or procuring and we will therefore, in the next chapter, be examining what information he in fact possessed at that time.

The basis of this ruling is simply that "procuring" (and this is a case more of "procuring" than "counselling") is defined as

> "To procure means to produce by endeavour your procure a thing by setting out to see it happens and taking the appropriate steps to produce that happening."
>
> AG's Reference No. 1 of 1975 per Lord Widgery L.C.J.

We reject Mr. Griffiths's argument that "taking the appropriate steps" finished once he had spoken to Mr. Peter Ng before Easter. It is worthy of note that, thereafter, Mr. Peter Ng, the person who had been counselled or procured, did nothing. It was Mr. Y.C. Chow who took the matter up and orchestrated what needed to be done to see the agreement through. In this sense the actions of the Trust and the actions of Mr. Y.C. Chow were one and the same. The shares were in his possession, they were registered in the name of Oklahoma Limited the Directors of which were himself and his right hand man at COAL, the then Deputy Managing Director Mr. FUNG Pak-kwan. Mr. Fung had no actual involvement in Oklahoma. He was not even aware that his co-Director was Mr. Y.C. Chow.

In the next chapter we therefore examine what information Mr. Y.C. Chow had in early May and prior thereto. It is common ground that information he acquired after that time is not relevant to the question of whether he dealt or counselled or procured dealing whilst in possession of relevant information.

CHAPTER 6

WHAT INFORMATION WAS MR. Y.C. CHOW IN POSSESSION OF AT THE MATERIAL TIME?

The Tribunal has approached this question in the following way. We have asked ourselves what was the minimum amount, in millions of Hong Kong dollars, that Mr. Y.C. Chow would have been able to predict in early May was going to be the year-end trading loss. He would only be able to have predicted an actual figure if he was aware of actual figures of the time. Thus the question sub-divides itself into - was he in possession of figures? and if so, what figures did he know?

In this case mere knowledge of a trend upwards or downwards would not suffice. When addressing the question of whether it was relevant information a mere trend could not be said to be "specific" and would therefore not qualify as "relevant".

There are two matters for consideration in relation to both the questions stated above. The two matters are:-

(I) Did he have knowledge of the contents of the monthly management financial statements of COAL? If so,

(II) By what amount would he have increased the figures on that statement, if at all, to reflect the likely year end loss figure?

(I) The monthly management accounts:

The document at Annexure D shows the dates on which the consolidated monthly accounts were circulated to COAL Directors. The document was prepared by Chevalier at the request of the SFC. We have proceeded on the assumption that it is accurate. It was accepted by the SFC as accurate without any further enquiries being made. Annexure E is one example of the documents which were actually circulated. They consisted of a top sheet which is the profit and loss account for that month followed by 5 pages of detailed figures for

turnover, expenses and net profit for each of the companies within COAL. The example we have included is for the month of February 1993 which was circulated to the Directors on May 4th 1993. These were the figures after 11 months of trading in the financial year 1992/3 and the last accounts Mr. Y.C. Chow could have seen before the "early May" time to which we have referred in the previous chapter.

It can be seen from that document that the loss attributable to shareholders as at 28th February 1993 was $46,993,000. According to Annexure D the figures for the 12th month were not circulated to the Directors at all. The date of "27/7/93" appears on the document. We understand that this is the date when the preparation of the 12th Month figures were completed.

The accumulating losses for the previous months in the 2nd half of the year were:-

October 1992 (circulated to Directors on 16.1.93)	$24.66 million
November 1992 (circulated to Directors on 9.2..93)	$28.91 million
December 1992 (circulated to Directors on 2.3.93)	$35.60 million
January 1992 (circulated to Directors on 1.4.93)	$43.90 million

In short, "the management" were apprised of the fact that the half yearly loss of $17 million had doubled in the space of 3 months and increased by a factor of 2.8 in 5 months. Of course, evidence that the figures were circulated or delivered to Directors (and therefore to Mr. Y.C. Chow) does not prove to a high degree of probability that he saw them, read them and digested them.

When questioned by the SFC about this Mr. Y.C. Chow said as follows:-

"Q. Did you receive the monthly consolidated management account of Chevalier regularly?

A. Yes I received it every month ....

Q. Did you know that Chevalier was incurring a loss when you started to sell Chevalier shares on 26th April?

A. I didn't think of it. I have never linked up the loss was being incurred by Chevalier with my selling COAL shares. I receive COAL management accounts regularly. But I would only glance at it to know the brief situation. Actually I knew Chevalier was incurring a loss very early. Two or three years ago, when I invest in CT-2 project, I already know I will lose money. I expected it. CT-2 will not break even until May next year. (i.e. 1994)"

In a nutshell, it was Mr. Y.C. Chow's case that he was unaware of the actual amount of the loss each month. He said he was not concerned with matters of detail, only trends. He said that if he did look at the monthly accounts (and he could not remember at the time of giving evidence whether he had or had not) he did not read them in detail or study them in detail.

In support of this general position a number of points were made.

Firstly, there was evidence given by other COAL Directors and employees that the day to day running of COAL was in the hands of its Managing Director Mr. P.K. Fung. Telecommunications and related areas were the field of Mr. Fung whereas Mr. Y.C. Chow's field was in lift engineering which was the original business of Chevalier. Mr. Y.C. Chow's statement contains the following passage:-

> "The development of the business of COAL over these years was the result of P.K. Fung's expertise, commitment and hard work, and I learned to have much trust and total confidence in him and his team. By 1992/1993, and indeed long before, P.K. Fung was running the business of COAL as his major responsibility, and though I was still the managing director I

left that mostly to him. Of course if a major problem arose, he would come and discuss it with me, but otherwise I left the management almost entirely to him."

And Mr. P.K. Fung himself said in evidence:-

"Q. Who had the expertise in these three fields as far as COA was concerned: the computers, the paging and the CT-2?

A. From the beginning up to now it's basically myself who handle the business.

Q. And do you have a good knowledge of those businesses, a better knowledge of those business than Mr. Chow?

A. Yes, my involvement in this area is much greater than Mr. Chow."

Secondly, the Tribunal received evidence that although executives of COAL met approximately once a week and although Mr. Y.C. Chow's regularity of attendance at those meetings was over 50% matters of detailed finances and in particular the contents of the consolidated monthly accounts were not discussed at those meetings. A number of witnesses dealt with this issue. We quote just one piece of evidence, from Mr. P.K. Fung:-

"The agenda of the meeting would normally be on the policy, overall policy, business development and overall situation because the meetings are not for one specific company. We have the meeting for the entire Group so because of the limited time the discussion would be on the overall strategy and development and things like that. According to my recollection at those regular meetings, so far we have not discussed any figures or anything about concrete figures."

Mr. Y.C. Chow added that his Directors never came to see him to discuss the deteriorating figures in COAL. Thus, not only did he not assimilate the figures from the documents sent to him but neither was he

informed about them by word of mouth:-

> "Of course there are times that we meet and chat. I would know and they would tell me that the present stocks are going very slowly, are moving very slowly or the competition is very keen or may be at that moment CT2's subscription is good or not so good, or if there's any major events such as if we have won a Government tender, compared to the bigger events whether it's good or not they would mention it to me but seldom do they have the actual figures for me."

Thirdly, we were invited to examine Mr. Y.C. Chow's management style within COAL and the multiplicity of his other activities outside COAL as evidence in support of the contention that he did not know the extent of the COAL loss as disclosed in the February 1993 accounts.

Mr. Norman Kan, the Finance Director said in evidence:-

> "Mr. Chow is a very ambitious person in his style but on the other hand he is stable and conservative. To his subordinates, once he has established a mutual trust, Mr. Chow will place total trust on that staff and will allow that staff to handle those business with a free hand ...."

and later:-

> "As far as the daily operation is concerned, the staff responsible for that area, if there's something happening, will take the initiative to discuss with Mr. Chow but if there is, on the other hand, if there is a new development Mr. Chow may take the initiative or may give suggestions."

and Mr. Y.C. Chow's own statement stated:-

> "A very large number of papers crossed my desk each week which I did not always have time to read, and I relied upon the above reporting system, rather than reading paper, for my

system of management of the business. I was also frequently away from Hong Kong on business."

Travel records show that in 1993 he was away from Hong Kong in January for 8 days, February 7 days, March 4 days, April 5 days, May 8 days, June 9 days and July 14 days.

His other activities were undoubtedly extensive. The Tribunal was shown his "C.V.". It lists 3 International Decorations (which of course are not time consuming) 3 Academic Honours and Degrees (all since 1995) and 21 Public Services such as being a member of the Board of Director of the Community Chest and President of the Zhoushan Residents Association. Of the 21 mentioned he was only involved in 9 of them in 1993. Even so, we acknowledge Mr. Y.C. Chow was a busy businessman and well respected in the community.

Having briefly stated Mr. Y.C. Chow's case, the totality of the evidence is far from being all one way. Factors, gleaned from the evidence which go against Mr. Y.C. Chow must be carefully considered and weighed in the balance. We of course acknowledge that it is not for Mr. Y.C. Chow to prove that he did not know the actual amount of the trading loss, the Tribunal must be satisfied on the whole of the evidence that it is highly probable that he was in possession of that information.

The submission in support of the contention that Mr. Y.C. Chow was not concerned with detailed figures and delegated such matters and was very busy with other things is based on an analysis of comments made in evidence by fellow Directors and Mr. Y.C. Chow himself. It has to be said that the Tribunal detected understandable element of loyalty to the Chairman when such evidence was given by his Directors and an understandable desire to distance themselves from matters of detail when evidence was given by them.

Viewed more objectively we note the following factors:-

(a) Mr. Y.C. Chow was and always had been both the Chairman and the Management Director of COAL in 1992/3. His other two companies were performing well and he knew that COAL was

not and why it was not. Such huge investment into CT2 would be a reason for him to keep a more careful eye on COAL rather than a less careful eye.

(b) Mr. Y.C. Chow did not give the Tribunal the impression that he was a "hands-off" type of Chairman or a remote figurehead. We accept he placed great trust in his fellow Directors but we did not conclude that this trust involved turning a blind eye to important matters of detail such as the monthly accounts of an arm of his empire into which a vast amount of money had been invested on a new telecommunications project.

(c) When interviewed by the media his extensive knowledge of his own businesses is apparent (See Annexure C).

(d) The monthly accounts were, in fact, sent to him. He also received regular written reports specifically on the joint venture project with Telstra. It is simply not realistic to proceed on the basis that, in effect, he paid no attention to them. The extent to which he appreciated their full significance in the context of relevant information as defined by s. 8 is another matter which we deal with in Chapter 8.

(e) Mr. Y.C. Chow has never denied receiving them. Thereafter, it is submitted, there is a vagueness about what he did with them. Words such as "glanced at", "looked at", "reviewed" were all used at various stages of the investigation and in the inquiry. There was debate also as to the correct translation of the Chinese words used in this context.

(f) Mr. Y.C. Chow was always in Hong Kong on the dates on which the monthly accounts were circulated. All the Directors got them, was the "boss" the one person who did not read them?

On the question of possession simpliciter we are satisfied that he received the accounts, he read the accounts and he became better informed as a result of reading the accounts. The Tribunal has concluded on the whole of the evidence, unanimously, that in early May

1993 Mr. Y.C. Chow was in possession of information that the interim loss of $17 million (approx.) had increased to $46.99 million as at February 28th 1993 as disclosed in the monthly management accounts which were distributed to him on May 4th 1993.

(II) By what amount, if any, would Mr. Y.C. Chow know that the final loss would be greater than the trading loss in the monthly accounts?

The answer to this question involves consideration of the evidence in relation to the issue in the inquiry which was referred to "year end adjustments". In the final announcement provision was made under 3 heads which contributed to the final dramatic loss of $84 million. They were provision for bad debts, obsolete or slow moving stock and amortization of deferred charges particularly arising out of the "setting-up" expenses of the CT2 project.

Although considerable time was spent in the inquiry on these and related accounting and auditing matters we do not propose to cover them in any great detail in this report for reasons which will become apparent.

There is no doubt that Mr. Y.C. Chow was not involved in auditing matters. There is no doubt either that the important part of the audit work was done in June and July 1993. There is no doubt either that the increased provisions proposed by Mr. P.K. Fung which were over and above the provisions suggested by the auditors were not agreed until late July or early August. Thus the size of the adjustments was not known until well after the period of time we are investigating in deciding what information Mr. Y.C. Chow had.

Therefore on the subject of old stock we take no account of the fact that a figure of $21 million was ultimately provided for in the final accounts.

Also on the subject of amortization we agree that it is not appropriate to add any figure to the trading loss because Alex Pang finally conceded the figures for amortization were included in the monthly accounts. His original calculations and estimates had been

based on the mistaken assumption that they had been excluded.

However we do not ignore the question of "adjustments" completely. A cursory examination of previous annual reports makes it abundantly clear that some adjustments are made to the final accounts each year. This fact could not possibly escape the Chairman's notice. Given the general trends of COAL's business which Mr. Y.C. Chow concedes he was well aware of it would be known to him, and we find was known to him, that a figure would have to be included in the 1992/3 accounts at least equivalent to the same amount which was included in the 1991/2 figures.

This simple conservative approach commends itself to the Tribunal. The 1991/2 figures for stock write-offs and bad debts certainly had been in Mr. Y.C. Chow's possession. There was no prospect of COAL's financial position being any better in 1992/3 therefore Mr. Y.C. Chow cannot claim no knowledge of similar figures at least. To be fair to him he, through his counsel, does not seek to do so. It was submitted on his behalf in the following terms:-

> "Whilst we do not accept for one moment that Mr. Y. C. Chow was in any way involved in the year-end adjustment procedures, we are minded to acknowledge that he may very well have had at the back of his mind the previous year's figures for bad debts and stock adjustment."

A total figure of $5 million was then proposed. If, however, one extracts the actual figures from the previous year's accounts one finds, in round terms, $4 million for stock write-offs and $3 million for bad debts.

The Tribunal therefore attributes to Mr. Y.C. Chow as at early May 1993, possession of information that the loss for the year would be $7 million greater than the figures in the monthly statement.

In conclusion, therefore, the Tribunal's answer to the question posed in the first paragraph of this chapter is $54 million. We add that the SFC investigation might have resulted in a similar conclusion had

they examined the whole of Annexure E and not just the top sheet. Not a little time would have been saved in the inquiry itself had they done so. The suspicion of insider trading therefore was launched on the mistaken assumption that Mr. Y.C. Chow may have known the full amount of the forthcoming loss.

CHAPTER 7

WAS THE INFORMATION IN MR. Y.C. CHOW'S POSSESSION RELEVANT INFORMATION AS DEFINED BY S. 8 OF CAP 395?

Before we can answer this question in the affirmative the evidence must satisfy us to a high degree of probability that knowledge of a year end loss of not less than $54 million was

(A) specific information about COAL and

(B) information which was not generally known to those persons who were accustomed or would be likely to deal in COAL shares and

(C) information which was likely materially to affect the COAL share price if it were generally known.

(A) Specific ?

Specific information is knowledge of major, even dramatic matters which will have a significant effect on the Company. In this case the specific information is the size of a forthcoming annual loss. Whether or not the size of the loss is specific or not depends on the answers to questions (B) and (C) below.

There is no force in the argument that the monthly trading figures are merely information about the day-to-day running of the business and therefore not specific and therefore not relevant. Such information is without doubt potentially "relevant". It falls outside matters contemplated by the expression "knowledge of day-to-day running of the business" because it is confidential and, depending on the size of the loss, potentially major information, even dramatic. In our case, the mere fact of a forthcoming loss would probably not be specific but its size may well be.

In order to answer question (B) we must ask ourselves what information was generally known to COAL investors and then examine the difference between what was generally known and what was not generally known. First of all however one must ask - who are the COAL investors?

(B) Generally known to COAL investors?

i) Who are the COAL investors? - More specifically who are "those persons who were accustomed or would be likely to deal in COAL shares"?

Mr. Richard Witts in the course of his evidence was asked to give an opinion on this. He had examined the list of shareholders of COAL and said: - "perhaps we do indeed have a fairly sophisticated shareholder profile" and later, "It is not the sort of speculative third line company as some are and can be. I would suggest it attracts a rather sort of mature thinking individual as an investor."

Based on this evidence the submission was then made that the more sophisticated or mature the COAL investors the more they would take note of and respond to and analyze the information on COAL which was in the public domain. The submission continues that the more they analyzed the public information the more likely it is that they would realize that COAL's performance was as the management, and in particular Mr. Y.C. Chow, knew it was. The smaller the gap between what Mr. Y.C. Chow actually knew and what the COAL investor would have known the weaker the contention that Mr. Y.C. Chow's information was relevant.

The success of this submission therefore depends on the correctness of Mr. Witt's assessment of the COAL investor. Counsel to the Tribunal suggested that the COAL investor was nearer to street level than Mr. Witts had thought. We agree. We have concluded that Mr. Witts credited the ordinary COAL investor, as at mid 1993, with a level of sophistication and maturity which flattered him. The more realistic view was a shareholder profile of a small time speculator who was more rumour led than analysis led. A number

of factors support this conclusion:-

(a) Mr. Heale described COAL as a small public stock traded by small time private investors.

(b) We attach little value to the documents produced to the Tribunal listing the registered holders as at 30th September 1993. The list does not take account of shares which may have changed hands without changing the registered owner's name. Most were in the name of nominee companies which tell us nothing about the actual identity of the share owner. Finally Mr. Griffiths painstakingly went through the list of over 1,100 names of registered shareholders and of those non-corporate shareholders he prayed in aid the very high percentage who described themselves as "merchants". We take the view that in Hong Kong this description does not help to clarify the true profile - in fact, it tends to do the opposite.

(c) We must define "the COAL investor" as at the material time i.e. mid 1993. In view of the publicly known information about the company a stockbroker would be more likely to be selling it than buying it. There can be no doubt that the bigger players in the market such as banks and other institutional investors would have no interest in it.

(d) The "mature or sophisticated" investor would tend to concentrate on shares about which some analytical research was available. In the case of COAL in 1993 virtually none was available. With the exception of one "Wardley's card" neither Mr. Heale nor Mr. Witts was able to find any.

(e) The behaviour of the share itself is not typical of there being a thoughtful investor behind it. There were times when it attracted no interest at all and other times when it was highly volatile moving dramatically up in a sudden huge turnover along with many other shares in similar sized companies for no obviously discernible reason.

Having now established how the Tribunal views the "persons accustomed etc. ... to deal in COAL shares" we address the question what did they generally know. Only when we have decided what they did know can we work out what they did not know.

ii) What did the COAL investor generally know?

Because we have assessed the COAL investor as someone who was not particularly mature or sophisticated or analytical we think that it would be unrealistic to try and work out a figure (whether exact or approximate) representing what the COAL investor would have predicted as a final loss for the year. He or she would not have done that so we won't either.

Much of the evidence given in the inquiry centred around an examination of press reports and documents in the public domain. We have already referred to a number of them in previous chapters and the more significant ones are at Annexure C. Both expert witnesses in their evidence and both counsel in their submissions have sought to put a different gloss on the overall effect of this information on the COAL investor. We do not propose to go into great detail about what was said, by whom and when. It is common sense to state that not every report would be read by every investor - nor even would it be read by every analyst or broker. Mr. Y.C. Chow on the other hand is entitled to say, for example, "but there it is - it is public because anyone can read this newspaper or that journal. It is information which is not private." These are the two extreme positions; one is - unsophisticated investors don't read financial journals therefore the information in them is not "generally" known to them; the other is - if information is available to any reader then it should be taken into account when deciding what is "generally" known.

The truth is that it is necessarily a very inexact exercise and the realistic approach is simply to acknowledge that not everything that has been published will contribute to what the COAL investor generally knew but at the same time avoid the temptation of saying that a sophisticated press report would have no influence on an unsophisticated investor. It is because we think that this inexact

approach is the right one that we will not come up with a figure in millions of H.K. dollars as representing what a COAL investor knew or would have been able to work out.

We therefore now refer to the more obvious things that were reported about COAL over the relevant period.

(a) The price war in the Computer Business. This attracted fairly extensive coverage in the press and was specifically referred to in the Company statements. The 1991/2 COAL annual report stated:-

> "The computer division, especially the personal computer passed a difficult year and faced cut-price campaign in the market. Losses were in as a result of reducing the stock on hand."

The H.K. Economic Times on March 10th:-

> "The biggest headache for the computing industry is that the price war is extending beyond desktop personal computers .... Prices for printers, laptops, workstations and mainframes were also dropping ... price wars always did hurt."

Advertisements for very cheap equipment abounded. At the same time however, shareholders and others were told of the company's intention to diversify into exciting new projects and put in substantial capital investment which would be a pointer to the Company's confidence in the future.

(b) A similar story emerges in the office equipment field. The big discounts and "crazy sales" were well publicized. Mr. Heale commented that this general trend could be seen as an opportunity to increase the volume of business whereas Mr. Witts highlighted the consequent reduction in profits in the immediate term as a result of reduced margins which would harm the second half year results in 1992/3.

(c) The Paging Business was a relatively new venture (started in April 1991). Whether or not the COAL investor would be affected by news on progress in the paging business is hard to say. Reports were generally optimistic although no one tried to hide the fact that profits were not just around the corner. In short, there was nothing to suggest it was inflicting serious wounds on the Company.

(d) The major project, as we know, was the CT2 venture. The project itself was newsworthy and was the subject of significant interest by the press. The Company always emphasized the fact that substantial capital investment was required. The reader of the interim report would see that the cost to the "minority interest" (i.e. Telstra's 49% interest) was over $27 million for the half year. COAL's was therefore over $28 million. The well-informed reader of an interim announcement would not only see this but would also see, on the other hand, the fact that once CT2's loss are taken out of the equation the Company's performance in all the remaining business was better than in the previous year.

So the fact that CT2 was expensive and long term would be generally known but this must be balanced against the Company's obvious and understandable statements of confidence and cautious optimism. We quote two examples:-

Mr. P.K. Fung, just after the interim announcement, on January 5th 1993 -

> "During an interview yesterday, Fung said that the company's telecom business was at its peak investment period, while market expectation for CT2's functions had been too high. His opinion was that it usually took a while for telecom products to be accepted in the market."

and, a little later in the year the Marketing Manager of

Chevalier Telepoint, Mr. Wu Qin said -

> "However, people still have doubt on the development of CT2 as the number of CT2 subscribers in Hong Kong is about fifty thousand only by now, which is about 50% less as compared to the expected number when CT2 was first introduced into the market (i.e. 100,000). In addition, there are only two out of the four CT2 licensed companies who have carried out CT2 business. Though the situation seemed unfavourable for CT2 development, the writer thinks that it is just a temporary phenomenon and CT2 still has great potential for further development in Hong Kong."

CT2 was very new. The COAL investor would detect a certain nervousness in the Company due to the size of the investment into a new project which was somewhat experimental but would also read about the Company's determination to make it succeed and become a big revenue earner in due course.

Having highlighted some of the things which the COAL investors would very likely see for themselves we now mention some things which, although advanced by Mr. Griffiths as being information in the public domain which COAL investors would generally know, are things which the Tribunal has concluded, on the evidence, would have little impact on the minds of the COAL investors.

(a) <u>The Yen</u>: It was suggested that the COAL investor would take note of the fact that business was made harder by the appreciating Yen against the U.S. (and therefore the H.K.) dollar. COAL's main supplier was the Japanese company, Toshiba. Supplies would be more expensive. This issue, which only emerged in the course of the evidence, gave rise to further comments and evidence about whether or not the company had a currency hedging policy and whether it was the Company itself or their agents who would bear the brunt of this

particular problem. The Tribunal was confident that only the analyst would address his mind to such matters and even he might not get the right answers.

(b) New Shops: The point was made that Chevalier was expanding by setting up new shops in Hong Kong and also new sales networks in several cities throughout China. It was argued that the investor would again be alerted by this and would realize that a lot of money was going out before it could start to come in. Again the Tribunal sees little merit in this particular argument.

(c) The second half of the year: We have included this issue in the list on those things which would have little impact on the mind of the COAL investor not because it would have no impact but because too much emphasis has been placed on it by both those giving evidence and those making submissions on behalf of Mr. Y.C. Chow. The Tribunal is satisfied that the COAL investor would neither know nor would it occur to him to think about whether COAL paid double pay for Chinese New Year and annual bonuses in the second half of the year or whether such payments were factored in throughout the year. Neither would they examine the annual statements for previous years and estimate a percentage by which the second half year loss would exceed the first half year loss. Even if they did no obvious trend would emerge from the previous three years trading.

We doubt also whether the fact that large negative year end adjustments would have been made in the final audit is a matter which comes under the heading of things "generally known" to COAL investors. They would not be completely blind to this possibility and it would contribute to the particular class of investor we are considering saying to himself that the second half is not going to be an improvement on the first half. In our judgement however it would not cause them to be in the same position as Mr. Y.C. Chow when we compare what each of them knew.

When cross-examined about these matters generally, Mr. Alex Pang made certain concessions as follows:-

"Q. Now putting all those factors together each one of which you have agreed, people in the financial sector would know, it would be quite clear to the informed investor who was studying COAL that COAL was going to have a difficult second half year?
A. Yes.
Q. And the more difficult half than first half.
A. Yes.
Q. And that accordingly in the second half, the losses would likely to be increased.
A. Yes.
Q. ... and increased considerably.
A. Yes. In my statement I expect the total year's losses amount to $35 to 45 million so I'm also expecting a worse second half than the first half."

Neither did Mr. Heale challenge the general propositions put to him by Mr. Griffiths on this issue but qualified his agreement (as did Mr. Pang) by saying "to a financial analyst ... or informed investor ...."

> "I think to a financial analyst, an accountant, professional stockbroker, someone who is a market watcher or informed investor or whatever he may be, all sort of bells may ring and examination of the industry which is what an analyst would do. .... He may well be in a position as a result of his analysis to make very cautious projections but that's what an analyst is paid for, that's how they can assist."

To conclude the Tribunal finds that what the COAL investor generally knew was significantly less than what we have found Mr. Y.C. Chow actually knew. The COAL investor would be influenced by the tones of cautious optimism in the public

statements. He would realize that losses were going to continue but he would see a steady downward graph not a steepening gradient. We see no reason to infer that the COAL investor would add large amounts to the second half year loss over and above the first half year loss. A small amount may be, for ordinary and easily predictable matters (e.g. some negative adjustments, some second half extra expenses) but no more. We find therefore that the difference between what Mr. Y.C. Chow knew and what the COAL investor knew is significant. This significant difference (which we do not quantify) is what was "not generally known to those investors ... likely to deal in" COAL shares.

We emphasize here an important point before moving on to the final matter of whether or not the difference in knowledge was material. We emphasize that since the SFC first embarked on its investigation the size of that difference has got smaller and smaller. Mr. Griffiths has with his usual skill endeavoured to persuade the Tribunal that it has disappeared. We do not go that far. A significant difference remains but it has been heavily diluted since the suspicions of insider dealing were first noted. Had they been diluted any further the Tribunal may well have said that the ingredient that the information in Mr. Y.C. Chow's possession was "relevant" may not have been proved. This underlines the fact that the Tribunal has found this a difficult and borderline case.

(C) Was the information (which Mr. Y.C. Chow had but the COAL investor did not have) likely materially to affect the COAL share price?

Put a little more fully, the question we here address is:- If, between April 26th and July 5th, the COAL investor had known that the final loss would be not less than $54 million would that knowledge have materially affected the share price?

We know that the interim loss of $17 million caused a drop of about 5% in the share price (in monetary terms just over 2 cents). We know that the final loss of $85 million resulted in a fall from 40

cents at the close on August 11th to 31 cents ten trading days later on August 25th.

Each expert witness was asked to give his opinion on the hypothetical question -

> What would have happened to the share if a forthcoming final loss of (say) $55 million was publicly known?

Mr. Heale's answer was:-

> "Q. If the public had known that it was going to be a $55 million loss between 26th April and 5th July, are you able to give a view of what impact that might have had against the press announcement coming out on the share price?
>
> A. This is where the share price is absolutely distorted by the noise, the noise being the possible takeover by Shougang and I think that was an overriding consideration in investors' minds. Had they known that the losses were going to be larger, it may not have stopped them speculating but I think they'd certainly be speculating on a more cautious basis. They were looking for the company to be bought out, taken over, have reverse listing, assets injected, whatever they were looking for, I don't known, but it could be one of those. Yes, I think it would have dampened the level of speculation certainly.
>
> Q. So do you think it would have had a material effect on the share price, that knowledge to the public?
>
> A. Oh certainly."

Mr. Witts on the other hand found it more difficult to express an opinion. His first response to the hypothetical question was "difficult to comment". He conceded however that there would have been a reaction but a more subdued reaction than to the news

of a $85 million loss. He agreed that there would have been a fall but not as big a fall. He did not go so far as to say that the fall would materially affect the price.

What does "materially" mean? Synonyms include considerably, substantially, significantly. Authority on the meaning is sparse. In the Lafe Holdings Limited inquiry (a Hong Kong Insider Dealing Inquiry heard in 1989) the following definition was proposed:-

> "Thus information that would be likely to cause a mere fluctuation or a slight change in price would not be sufficient; there must be the likelihood of change of sufficient degree in any given circumstances to amount to a material change."

We quote also with approval the words of SDJ Foenander in Public Prosecution v Alan Ng Poh Meng [1990] 1 MLJ (a Malaysian case):-

> "Information that is likely materially to affect the price is information which may well materially affect the price. Put another way, it is more likely than less likely that the price will be affected materially .... It may be that what is a material price increase in one case may not necessarily be a material price increase in another case. It all depends on the share and the circumstances obtaining at the time. However, the standard by which materiality is to be judged is whether the information on the particular share is such as would influence the ordinary reasonable investor, in deciding whether or not to buy or whether or not to sell that share. A movement in price which would not influence such an investor, may be termed immaterial. Price is, after all, to a large extent determined by what investors do. If generally available, it is the import of the information on the ordinary reasonably investor, and thus on price, which has to be judged in an insider dealing case."

When gauging materiality it is obviously more helpful to look at percentages than actual cents. In the accountancy profession a movement up or down of 5% or more is deemed to be material.

What percentage is deemed to be "material" or "significant" or "substantial" in an insider dealing case may vary and it would be dangerous to lay down any hard and fast or arithmetic test.

Mr. Griffiths invited us to test "materiality" by an arithmetic approach. He argued that if one adopted Mr. Pang's Net Asset Valuation method of ascertaining the real value of the COAL share the difference then between the net asset value of the share with say a $45 million loss as against a $55 million loss would be minimal (less than 2 cents). We must remember however that the Net Asset Valuation method was the subject of much criticism (including from Mr. Griffiths). The Tribunal preferred Mr. Heale's "market valuation" method. This method suggests that once all the information about COAL is public the share is worth about 38 cents (because the market says so).

At the end of the day we can only hazard an educated guess as to how the market would have reacted. We concede that this is not a case where the reaction to Mr. Y.C. Chow's information, had it been generally known, would have been dramatic or startling. However the test is not that high. We have concluded that the share price would have been materially affected. Our conclusion is supported by the following analysis:- The true value of the share was about 38 cents (Mr. Heale's valuation). On two occasions between April 26th and July 5th it surged above its true value to over 50 and over 60 cents. All the evidence satisfied us that that would not have happened if all the information had been "outside" (to repeat Mr. Heale's evidence "speculation would have been dampened"). Therefore what was "inside" would have materially affected the price.

In conclusion we find that all the ingredients of "relevant" information as defined by s. 8 of CAP 395 have been proved to the required standard.

CHAPTER 8

DID MR. Y.C. CHOW KNOW THAT THE INFORMATION IN HIS POSSESSION WAS "RELEVANT INFORMATION" AS DEFINED BY S. 8 OF CAP 395?

The material time of his knowledge, which we now examine, is the time he dealt or counselled or procured another to deal, namely "early May" and prior thereto but not later.

Before reviewing the evidence and submissions on this issue the Tribunal considers it right to disclose the following matter. From here on the Chevalier Tribunal has not been unanimous in its findings. Up to now we have striven for and achieved unanimity. It goes without saying that a unanimous decision is preferable to a majority one particularly when the fact finding body comprises of only three individuals. On key issues however, after lengthy consideration of all the evidence, we have agreed to differ. We will state the dissenting view but we will not identify its holder.

When answering the question posed in this chapter we remind ourselves first of all that we are seeking to establish what Mr. Y.C. Chow actually knew or genuinely appreciated about the information in his possession, not what he ought to have known or should have realized. It is a subjective test not an objective one.

We therefore must address the same three questions as in the previous chapter but with the added prefix "did he know that it was ..." instead of "was it ...". In shorthand the questions therefore become:-

(I) Did he know the information was specific and

(II) Did he know the information was not generally known to COAL investors and

(III) Did he know that if it had been it was likely to have materially affected the price?

Again, the question is answered, in this case, by addressing (II) and (III). The evidence must prove to a high degree of probability that both answers are Yes before a finding of insider dealing can be made.

The majority decision of the Tribunal is that the evidence does prove that Mr. Y.C. Chow knew, at the material time, that the information, which we have found was in his possession, was relevant information.

This finding is based on the drawing of inferences from proven or agreed facts. The conclusion can be summarized in the following way - the only reasonable inference to be drawn from the way in which Mr. Y.C. Chow embarked on his decision to sell COAL shares made in March 1993 and the way in which he followed up on that decision during April and early May 1993 is that he knew he had information which was not generally known to COAL investors and which would materially affect the share price if it was known.

The combined effect of matters, such as the following, have led to this conclusion.

(i) Mr. Y.C Chow paid scant regard to the interests of the beneficiaries in his family trust when he discussed the sale of the Trust's shares with Mr. Peter Ng. The trustee should have appointed a stockbroker to sell the shares. In fact Mr. Y.C. Chow took over and made the arrangements himself. Furthermore, the total proceeds of sale of COAL shares amounted to $14.09 million and the total proceeds of sale of CDIL shares amounted to $1.15 million. The total sum raised therefore to exercise the CHIL warrant was $15.24 million. In fact only $14.77 million of this sum was actually spent on the warrants and there is no evidence that the balance of $470,000 was repaid to the trust.

(ii) Mr. Y.C. Chow first of all instructed a friend, Mr. C.H. Chow, who was not a stockbroker, to sell the shares. Mr. C.H. Chow traded through accounts in the names of three of his relatives in

Macau and used two different stockbrokers (Mr. C.H. Chow said in evidence that Mr. Y.C. Chow had no knowledge of these accounts). However it demonstrates an early desire to keep the sales, if not actually secret, at least low key and away from public scrutiny.

(iii) Mr. C.H. Chow's early sales (in late April and May) were all at below 50 cents. This conflicts with Mr. Y.C. Chow's evidence concerning his 50 cents limit.

(iv) Mr. David Tung, the stockbroker, was brought in to sell shares, after Mr. C.H. Chow. The majority view of the Tribunal is that Mr. Y.C. Chow decided to bring in Mr. Tung, a professional broker, because Mr. C.H. Chow's early efforts had been unproductive. Mr. Tung's demeanour as a witness was unimpressive. His evidence did not assist the Tribunal's search for the whole truth as much as it might have done.

(v) The "Oklahoma" account was opened on April 15th. There was no obvious reason or need to do so. Its effect was to further distance Mr. Y.C. Chow from involvement with the selling.

(vi) Mr. Y.C. Chow's involvement in the transactions throughout the relevant period was greater than he had admitted to the Tribunal. On April 15th he said to David Tung that there might be some selling at over 50 cents. Did he know that? The majority of David Tung's transactions started the day after Mr. Y.C. Chow left for a 3 week Mediterranean cruise and all his further dealing was done whilst he was away. The majority of the Tribunal finds it impossible to accept that he was wholly unaware of these transactions.

(vii) Mr. Y.C. Chow's reasons for not selling CDIL shares were unconvincing. Furthermore a small number CDIL shares were in fact sold in late April sometimes at the same time as COAL shares. Was Mr. Y.C. Chow really not involved in the transactions or was he orchestrating them from a distance behind

numerous smoke screens such as the Trust, the Oklahoma account, Mr. C.H. Chow's Macanese relatives, the missing Mr. Yu and being in Europe when the price shot up?

(viii) The selling suddenly stopped whilst Mr. Y.C. Chow was still on holiday. No witness was able to give a satisfactory explanation of how or why the selling stopped. When the selling stopped more funds were still required for the trust to purchase 100% of the CHIL warrants. If this was the only reason for the sales why didn't the selling continue?

We now set out the minority view. The dissenting view is based on two matters. Firstly, that the circumstances surrounding the initial decision to sell and the way in which it was done, whilst obviously suspicious does not provide grounds for concluding that the only reasonable inference is that Mr. Y.C. Chow knew he had relevant information. The suspicious manner clearly raises questions but the evidence does not prove that the answers to those questions are consistent with Mr. Y.C. Chow being guilty of insider dealing.

Secondly, a consideration of the evidence which specifically relates to the two questions posed [namely (II) and (III) on page 74 supra] does not result in both answers being Yes. That consideration in relation to each of those questions is as follows:-

(A) Did he know that a forthcoming loss of not less than $54 million was not generally known to COAL investors?

It is not possible on the evidence to disprove the contention that Mr. Y.C. Chow honestly believed that what he knew was also known by those members of the public who were likely to buy or sell COAL shares. The fact that his belief may have been unreasonably or unrealistically held makes no difference.

The evidence does not suggest that Mr. Y.C. Chow regarded information of a $54 million final loss as special or alarming to the extent that he would appreciate that he knew something which was price sensitive. Some weight must be attached to two factors.

Firstly, there are many press reports and public statements which put the investor on notice of losses in the short term. It is crediting Mr. Y.C. Chow with too much subtlety to think to himself along lines of "I know the approximate size of the forthcoming loss (in March/April 1993) but the people who deal in my company's shares won't be able to predict it therefore I will set in motion a complicated and optimistic scheme so as to get the benefit of my privileged information".

Secondly, there is considerable evidence about the key players' (Chairman and Directors) attitude to the accumulating losses in the monthly statements. This aspect of the evidence was also canvassed on the question of whether or not Mr. Y.C. Chow was in possession of information. On that issue we decided unanimously that even if the Directors and Chairman were not concerned about the information it did not follow that they didn't have it. Here however the issue is different. Here, the issue is did he appreciate the significance of the information he had? Of course he would have known the actual figure of $47 million in the February monthly statement was not generally known but its confidentiality for the purpose of insider dealing disappears if he also believed that the investors in his company would have had a similar picture in mind.

It is not necessary to burden the reader of this report with extracts from press reports yet again. The point is simply that if there is enough information available to lead Mr. Y.C. Chow to conclude (rightly or wrongly) that the losses which were predictable to the investors were of the same order that he knew about, then the answer to the question posed in this section has not been proved to be Yes.

(B) Did he know that if the information he had had been generally known the share price was likely to have been materially affected?

Strictly speaking if the answer Yes to question A has not been proved then it is unnecessary to consider question B. However, as this part of the report is merely setting out a dissenting opinion we

will nonetheless highlight those parts of the evidence which have caused one member to conclude that the answer to this question has also not been proved to be in the affirmative:-

(i) Knowledge that the February accounts were price sensitive is inconsistent with his instructions to sell only at 50 cents or above. It was accepted by all that his target of 50 cents was unrealistic at the time he set it and the evidence further suggests that the fact it did hit 50 cents was both unpredictable and good fortune.

(ii) If he knew the February monthly accounts were price sensitive and he had possession of them in early May why did he not authorize sales immediately. There were virtually none for six weeks.

(iii) There is little evidence of any actual involvement or interest by Mr. Y.C. Chow himself in the actual transactions as they occurred. The evidence suggested that the "brokers", Mr. C.H. Chow or Mr. David Tung, reported the sales to the missing Mr. Yu.

(iv) There is evidence to suggest that Mr. Y.C. Chow was not a man who took a daily interest in the movements of his companies shares. It seems he was not a person who monitored the price on a regular basis either before May 1993 or after. If true, it is less likely than otherwise that he would be a person who know what would cause a material change in the price and what would not.

(v) Finally, in order to decide what was in his mind about the materiality of the information he possessed it is reasonable to pose the question - If he was insider dealing what was the quantum of loss avoidance that he was likely to achieve at the time he insider dealt?

For the purpose of this exercise we ignore the unexpected surge in the price in late June. Mr. Y.C. Chow could not

> have predicted it. If it had never happened Mr. Y.C. Chow would have had to do one of three things to raise money to exercise the CIHL warrants - sell COAL at the market price in June or sell CDIL or use private funds. If he had still sold COAL what loss was he trying to avoid? In January the interim loss produced a reduction in value of 5%. In August the final loss of $85 million produced a reduction in value of 20% for a short period. If the final loss had been the same as his inside information in May ($54 million) the reduction might have been less than 10% or in cash terms under $1 million. Thus, would the ends have justified the means? If the likely result of the whole exercise would have been relatively insignificant then it is a fair argument to say that the information which prompted the exercise could not have been specially significant or material either.

To conclude this chapter the Tribunal's majority decision is that Mr. Y.C. Chow's sales contravened s. 9(1)(a) of CAP 395. It will be plain to the reader that it has been a difficult decision.

CHAPTER 9

DID MR. Y.C. CHOW SELL COAL SHARES OTHERWISE THAN WITH A VIEW TO AVOIDING A LOSS BY THE USE OF THE RELEVANT INFORMATION? [CAP. 395 S.10(3)]

Once the ingredients of s. 9(1)(a) have been proved to a high degree of probability the person who dealt will avoid being identified as an insider dealer if the evidence establishes on a balance of probabilities that the dealing was otherwise than with a view to making a profit or avoiding a loss by the use of the relevant information.

S. 10(3) of CAP 395 which sets out this defence has been the subject of legal argument in both this and earlier Insider Dealing Inquiries.

The question which has prompted most debate is the question of secondary motives. Is it sufficient for the person to prove that the avoidance of loss was not his primary motive or must he go further and prove that the avoidance of loss played no part at all in his motivation? Our consideration of the evidence is based on the latter contention being the correct interpretation of s. 10(3).

In previous (now repealed) legislation [Securities Ordinance CAP 333 s. 141c(3)] the law was stated as follows:-

> "A person who enters into a transaction which is an insider dealing ... may be held not culpable if his purpose is not, or is not primarily, the making of a profit or the avoiding of a loss."

The words "or is not primarily" have been taken out of the new Ordinance in s. 10(3). Had the legislators intended that the defence should apply in cases where there were mixed motives the words would have been included as before.

The very fact that a person's share transactions have caused him

to be before the Tribunal in an inquiry indicates that a loss has in fact been avoided or that a profit has in fact been made. The avoidance of a loss is therefore already a consequence of the dealing. The individual must satisfy the Tribunal that it was purely an incidental consequence and that it did not contribute to the reason or motivation for the sales. If his reason for selling was partly to avoid a loss and partly to raise funds to exercise the warrants in CIHL the defence fails even if the former reason was only secondary to the latter.

Again the Tribunal has not reached its decision on this issue unanimously. In the previous chapter the majority decision went against Mr. Y.C. Chow - on this issue however it is in his favour. By a majority of 2-1 this Tribunal has concluded that Mr. Y.C. Chow on a balance of probabilities, did not use the information in his possession in order to avoid a loss. We have decided that his sales were otherwise than with that motive in mind. Bearing in mind it is the lower standard of proof which applies we find on the whole of the evidence that, when he made the decision to sell in March and made the necessary arrangements in April and early May he was intending to raise funds legitimately and was not bent on exploiting confidential information so as to "steal a march" on the ordinary investor. The majority is satisfied that the latter played no part in his decision to sell.

The combined effect of a number of matters which we have carefully considered have caused us to reach this decision, albeit, not unanimously:-

(i) <u>Admitted Facts</u>

(a) Paragraph 10 of the Admitted Facts records the fact that all Mr. Y.C. Chow's dealings were reported to the SEHK in the correct form and within the proper time limits.

(b) Paragraph 49 of the Admitted Facts states that once the funds were raised from the sales of COAL shares they were in fact applied to the purpose which Mr. Y.C. Chow has always stated was the true purpose.

(c) The wisdom of exercising the CIHL warrants held by the Trust has never been challenged. It was an undeniably sensible decision to exercise them prior to September 22nd to gain the maximum benefit of the dividends. The document by which Mr. Y.C. Chow disclosed his intention to dispose of COAL shares to his fellow directors during the following six months (Annexure H) is dated precisely six months before September 22nd, on March 22nd. It has never been suggested that this is anything other than a genuine document. It supports the contention that in March Mr. Y.C. Chow was thinking ahead about the warrants deadline and not about COAL's final announcement.

(ii) The decision to sell COAL rather than raising funds in other ways

We have already dealt with this issue in earlier chapters. With hindsight it might have been better to raise funds in a different way. From his own bank account would have been the safest. However the reasons given for selling COAL are valid. There is no evidence upon which we can safely say that the choice of COAL was a bad choice in the sense that the choice alone adds fuel to the suspicion of insider dealing. On balance the evidence goes the other way. The fact that it was a logical choice at the time lends support to the submission that Mr. Y.C. Chow has been telling the truth when giving evidence about his reasons for selling COAL.

(iii) Mr. Y.C. Chow's credibility

The burden of proof on Mr. Y.C. Chow is not so onerous that he must satisfy the Tribunal that he was forced to sell or had no choice or was compelled to sell. In the circumstances of this case the Defence succeeds if he satisfies the Tribunal to the required standard that the decision, at the time it was made was only for the reasons given and those reasons were valid and honestly held and they were unconnected with any desire to avoid a loss.

The Tribunal has spent much time considering Mr. Y.C. Chow's credibility. It will be plain from our findings in earlier chapters

that we have not accepted everything that he and indeed other witnesses have told us. It is open to us, of course, as in any legal proceedings, to accept some evidence and reject other evidence. On these final and crucial issues in Chapter 9 his credibility has not been so dented as to result in a finding that he be identified as an insider dealer.

The dissenting opinion is that, on the balance of probabilities, the desire to avoid a loss cannot be wholly excluded and must have been, although not the main motive, nonetheless a secondary one and therefore Mr. Y.C. Chow cannot rely on s. 10(3) to avoid being identified as an insider dealer. A key factor upon which this opinion is based is the fact that Mr. Y.C. Chow did not have to sell COAL shares in order to raise the funds. He had alternative sources of money which he could have but chose not to use.

CHAPTER 10

CONCLUSIONS AND COMMENTS

A. Conclusions

In answer to the Financial Secretary's Notice under section 16(2) of CAP 395 dated 14th August 1996 the Insider Dealing Tribunal of Hong Kong finds, by a majority decision (pursuant to paragraph 13 of the Schedule of CAP 395) that dealings in the listed securities of Chevalier (OA) International Limited by Mr. CHOW Yei-ching between April 26th 1993 and July 5th 1993 were in breach of s. 9(1)(a) of CAP 395.

However, the Tribunal has further found, also by a majority decision, that those dealings fall within the provisions of s. 10(3) of CAP 395 and accordingly Mr. Y.C. Chow is not held to be an insider dealer.

B. Comments

(i) That this was a borderline case is plain to see. Strong suspicions were rightly raised and reasonable allegations were properly made.

(ii) In certain areas the SFC could have widened the scope of their investigation. In particular we were surprised that the only people at Chevalier who were interviewed and who gave evidence were people of high rank i.e. fellow directors of Mr. Y.C. Chow. Mr. Y.C. Chow's role within Chevalier and his style of management was always going to be an important issue and we feel a fuller picture could have been ascertained if more people had been interviewed. In saying this we appreciate that the SFC's resources are not boundless and that in 1993/4 they were conducting a number of investigations at the same time. We also appreciate that it is open to the Tribunal to direct further

inquiries if it thinks fit. However certain inquiries can only realistically be made at the material time and not 4 years later when the Tribunal is sitting.

(iii) Another example, to which we have made reference earlier in our report, is that incorrect assumptions were made about the monthly management statements because only the top-sheet summary was considered. The fuller correct picture was revealed in the 5 page report which went with it. These matters were clarified by Mr. Y.C. Chow's legal representatives.

(iv) We repeat our regret that attempts to even locate the missing witness Mr. Yu, were unsuccessful.

(v) The case highlights the need for a higher level of awareness by the Chairman and Directors as to when it is safe to deal in their own companies' securities. Lack of this awareness leads to what has happened in this case, namely leaving oneself open to the risk of being seen or perceived as an insider dealer. It is simply imprudent to embark on major transactions when to do so could even hint at impropriety. In this case, cautious professional advice would have been to raise the funds for the warrants privately. Mr. Y.C. Chow would have taken that advice if it had been given but he didn't ask. It is another example of a man who has built up a very successful business creating, at the same time, substantial personal wealth but who fails to appreciate the increasingly stringent regulations which control what he can and cannot do.

ACKNOWLEDGEMENTS

The Tribunal expresses its thanks to two groups of people who in their different ways have all made important and helpful contributions to Chevalier enquiry.

1. Legal representatives:

   Mr. Daniel Marash, counsel to the Tribunal assisted by Ms Amy So.
   Mr. John Griffiths Q.C. leading Mr. Graham Harris and Mr. David Tsang all instructed by Messrs Fan and Fan on behalf of Mr. Y.C. Chow.

2. Tribunal staff:

   Mr. Patrick Chung Chan-yau, Secretary to the Tribunal
   Miss Mary AU Lai-chun, Secretary to the Chairman
   Ms LEUNG Yim-foon, Clerical Officer II
   Mr. Michael WONG Kam-chiu, Office Assistant

The Tribunal also thanks verbatim reporters, for their usual speed and efficiency in producing the transcript of the proceeding, and the various interpreters.

Finally, the Chairman would like to add his personal thanks to the Tribunal members, Mr. Selwyn Mar and Mr. Ian McEvatt.

Their assistance both in the examination of witnesses and during discussions in Chambers has been invaluable. Tribunal members play a vital role in Insider Dealing inquiries and Hong Kong is fortunate to be able to enlist the services of people of such calibre.

The Honourable Mr. Justice Burrell
Chairman

Mr. Ian McEvatt
Member

Mr. Selwyn Mar
Member

July 10th 1997