REPORT OF THE
INSIDER DEALING TRIBUNAL
OF HONG KONG

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

INDESEN INDUSTRIES COMPANY LIMITED
(NOW KNOWN AS CENTRAL CHINA ENTERPRISES LIMITED)

in July 1997 and on other
related questions

Introduction

By a notice pursuant to section 16 of Securities (Insider Dealing) Ordinance Cap. 395 (the Ordinance) dated 20 February 2001, The Hon. Donald Tsang, the then Financial Secretary of the Hong Kong Special Administrative Region, requested the Insider Dealing Tribunal to conduct an inquiry.

The notice reads as follows:

> *'Whereas it appears to me that insider dealing (as that term is defined in the Ordinance) in relation to the listed securities of a corporation, namely, the Indesen Industries Company Limited (now known as the Central China Enterprises Limited) ('the company') has taken place, the Insider Dealing Tribunal is hereby required to inquire into and determine:*
>
> *a) whether there has been insider dealing in relation to the company arising out of the dealings in the listed securities of the company by Mr. Huo Sheng Pu in July 1997;*
>
> *b) in the event of there having been insider dealing as described in paragraph (a) above, the identity of each and every insider dealer; and*
>
> *c) the amount of any profit gained or loss avoided as a result of such insider dealing.'*

In compliance with the notice, the Insider Dealing Tribunal, comprising of The Hon Mr Justice Lugar-Mawson as Chairman and Mr. Joseph Hui Sik Wing and Mr. John Ng Chi Wing as members, heard evidence and submissions from counsel and solicitors on Wednesday, 10 and Thursday, 11 October 2001.

We now have pleasure in submitting the report on our findings.

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Chapter 1

In this chapter we summarise the facts giving rise to the inquiry, none of which were disputed at the hearing before us. References to dollars ($) are to Hong Kong dollars.

The company

Indesen Industries Co Ltd (Indesen) (on 22 May 1998, the name was changed to Central China Enterprises Limited) was listed on the Stock Exchange of Hong Kong (the Stock Exchange) on 18 August 1992; its principal activity is the manufacture and sale of VHS videocassettes and VHS videocassette housings.

Between 2 January 1997 and 28 February 1997, Indesen's share price moved within a range between $0.26 and $0.365. The average daily turnover of Indesen shares on the Stock Exchange in that period was about 2,567,100 shares.

Indesen's share price in February to August 1997

On 5 March 1997, the share price closed at $0.49, an increase of $0.19, or 63% from the closing price of $0.3 on 28 February 1997.

In announcements dated 4 and 5 March 1997, Indesen's board noted the recent increases in the share price and stated they were not aware of any reason for them. The board stated that there were no negotiations or agreements relating to intended acquisitions or realisations discloseable under paragraph 2 of the company's Listing Agreement. However, an article in the Hong Kong Daily News for 5 March 1997, reported market rumours that Indesen would be sold as a shell company due to its continuous losses and, if the rumours were true, Indesen's share price would rise sharply. Another article in the Hong Kong Economic Times for 6 March 1997, reported that Indesen's share price had risen sharply on rumours that a PRC enterprise would acquire Indesen's shell at $0.6 per share.

In an announcement dated 7 March 1997 and published on 10 March 1997, Indesen's board announced a proposal to reduce the nominal value of its shares and stated that the directors may consider increasing the company's capital base by way of a rights issue and/or a placing.

In another announcement, dated 11 March 1997 and published the next day, Indesen's board disclosed past and current connected transactions between its

subsidiaries and SKC Ltd, a major supplier, and SKC Ltd's capital injection into one of its a subsidiaries.

From 1 April 1997 to 11 April 1997, Indesen's shares traded within the range of $0.35 to $0.455. The closing price rose from $0.37 on 1 April 1997 to $0.425 on Friday 11 April 1997. The average daily turnover was about 7,000,000 shares.

On Monday, 14 April 1997 Mr. Lam Kong Yin, a director of Indesen, was quoted in an article in the Sing Po as saying that there was a need for the company to raise capital for expansion by means of rights issue. And that he was confident about Indesen's future performance after the capital injection agreement with SKC Limited announced a month earlier. The article had little impact on the share price and the share price moved down slightly from $0.43 on 14 April 1997 to $0.42 on 16 April 1997, with an average daily turnover of about 13,000,000 shares.

Indesen's share price started to rise steeply on 17 April 1997, doubling from $0.37 on 11 April 1997 to $0.73 on 7 May 1997, despite repeated announcements by the board that they were unaware of any reason for the increase.

On 8 May 1997, the share price suddenly jumped 26.03% to $0.92, with daily turnover increased tenfold from 4,574,000 shares to 44,234,000 shares. On the subsequent trading day, 9 May 1997, Indesen's share price jumped another 26.09% to $1.16, before trading in the shares was suspended at 11:27 a.m. The turnover was 32,554,000 shares.

Indesen resumed trading on Monday, 12 May 1997, when the board announced that they were considering a rights issue and diversifying its business into other areas. The automobile repair and maintenance industry was identified as a potential development area.

Profit taking was seen on 12 May 1997 with the share price closing down 25.86% at $0.86, turnover was 18,960,000 shares.

Over the subsequent 2 weeks, Indesen consolidated at around the $0.8 level.

On the morning of 23 May 1997, Indesen announced its final results, reporting a net loss $18,582,000 for the year ended 31 March 1997, compared with a net loss of

$16,715,000 for the same period in 1996. A proposed rights issue on the basis of 4 rights shares for every share, at $0.2 per rights share, was announced on the same morning to raise $200 million. This was to finance, among other things, an expansion into the automobile repair and maintenance business in the Mainland. Despite the apparent bearish news, the share price of Indesen rose 25.84% to finish the morning session at $1.12. The half-day turnover was 33,824,000 shares. At Indesen's request, trading in its shares was suspended in the afternoon of 23 May 1997.

Indesen resumed trading on 27 May 1997. On the same morning the board made an announcement about its basic fundamentals, giving a pro forma net tangible asset value of $0.175 per share after the rights issue. In spite this the shares closed the day up 16.07% at $1.30, on a turnover of 42,684,000 shares.

The price continued to rise a further $0.3, or 23%, to end at $1.60 on 2 June 1997.

On 3 June 1997, Indesen dealt on an ex-rights basis. Its share price closed at $0.67, up 40% from a theoretical ex-rights price of $0.48. Turnover was 18,584,000 shares. The momentum in Indesen's shares remained strong thereafter, rising 18% from $0.67 on 3 June 1997 to $0.79 on 18 June 1997, reaching a high of $0.98 on 5 June 1997. The average daily turnover was about 15,000,000 shares.

On 19 June 1997, the share price jumped 34.18% to $1.06, with a turnover of 25,720,000 shares. Despite announcements, made on the following morning, that the board was unaware of any reason for the price increase, Indesen's shares rose steeply in the subsequent 4 trading days to end at $1.75 on 25 June 1997, with an average daily turnover of about 43,000,000 shares. In just five trading days the share price had jumped by 122% to $1.75, while the Hang Seng Index rose 862 points, or 6%, from 14,203 to 15,065. The board made repeated announcements that they were not aware of any reason for the rise. Market commentators attributed the increases to rumours that a company controlled by the Henan Provincial Government intended to acquire a controlling stake in Indesen and was contemplating a takeover. There were also rumours that COSCO Pacific Limited would buy a stake in Indesen.

From 26 June 1997 to 4 July 1997, the share price consolidated, closing lower from $1.66 on 26 June 1997 to $1.39 on 4 July 1997. The consolidation was short-lived

and the share price started rising again on 7 July 1997, rising 17.99% to finish the day at $1.64. In the subsequent 2 trading days, the price rose further, reaching $1.82 on 9 July 1997.

Trading in Indesen shares was suspended on 10 July 1997. Overall, the share price had almost tripled from the ex-rights price of $0.67 on 3 June 1997 to $1.82 on 9 July 1997. During the same period the Hang Seng Index decreased 57 points to 14,703.

On 17 July 1997, during Indesen's suspension period, its board announced that it had entered into a conditional agreement to purchase an 80% equity interest in Henan Motor Car Repairing Co. Ltd. (Henan Motor Car) from Henan Hongkong Enterprises Ltd. (Henan Enterprises) for a consideration of RMB38,000,000 (approximately $35,510,000) Henan Enterprises was a Hong Kong incorporated company, beneficially owned by the Henan Municipal Government.

Indesen resumed trading on 30 July 1997, after making an announcement in the same morning reminding the investing public about its pro forma net tangible asset value of $0.176 per share, and urging shareholders and investors to note the business track record of the company and its underlying net asset value, as well as its future prospects.

On 9 July 1997 its closing share price was $1.82; 10.4 times more than the pro-forma adjusted net tangible assets value per share of $0.176. Reacting to the development, the share price closed 30 July 1997 up 9.89% from a pre-suspension close of $1.82 to $2, with a turnover of 142,340,000 shares.

On 31 July 1997, the next trading day, the share price rose a further 15% to close at $2.3 with a turnover of 82,092,000 shares.

On 1 August 1997, at the request of Indesen’s board, trading in its shares was again suspended. The suspension lasted from 1 to 25 August 1997.

On 22 August 1997, during the suspension period, Indesen announced that, on 14 August 1997, it had agreed to acquire the 100% equity interest of Henan (Tai Wu) Electric Power Co., Ltd. (Henan Tai Wu) from Henan (Hong Kong) Finance Ltd, a wholly-owned subsidiary of Henan Enterprises, for a consideration of RMB130,000,000 (approximately $121,495,000). Indesen's major shareholders, Mr.

Ali Simin, Ms Li Sau Mei and Mr Ko Yee Shing had agreed, also on 14 August 1997, to sell their interest in about 20% of Indesen's issued share capital to Fulham Associates Ltd, another wholly owned subsidiary of Henan Enterprises at a price of $1.28 per share. The total consideration was $337,024,000.

Henan Tai Wu was a limited company established in the Mainland. Jiyuan Power Plant Company, a company owned by the Jiyuan Shi People's Government, was constructing the electric plant and was to be responsible for its management. Jiyuan Power had provided a guaranteed fixed rate of return of 17 per cent per annum of Indesen's investment equal to US$2,662,650. The Jiyuan Shi People's Government had undertaken to procure Jiynan Power to fulfil and perform its obligations.

Indesen gave reasons for the acquisition; stating that, as keen competition had adversely affected its core business in recent years, the board had been exploring opportunities to diversify its business and strengthen its earning base. To this end, they had decided to acquire Henan Tai Wu, considering that it would provide a steady income for the group and be in line with the group's plan to strengthen its earnings base.

A copy of the announcement that appeared in the English language 'Hong Kong Standard' is at annexure 3.

Indesen resumed trading on 26 August 1997. In the same morning, the board announced a placing to independent professional and institutional investors of about 263,226,000 new shares, at a price of $1.68 per share, to part-finance the acquisition. This represented 20% of its existing share capital, or 16.67% of its enlarged share capital. The $1.68 placing price was at a 27% discount on Indesen's closing price of $2.30 and a discount of about 3.23% on the average closing price of $ 1.736 for the ten trading days up to 31 July 1997.

Reacting to the announcements made on 22 and 26 August 1997, Indesen's closing price shot up 88.04% from $2.30 (its pre-suspension price) to $4.325 on 26 August 1997, with a turnover of 107,220,000 shares. During the same period the Hang Seng Index dropped 818 points, or 5%, to 15,547.

On the 2 subsequent trading days, the price of Indesen's shares rose a further $0.50 or 11.56%, to end at $4.825 on 28 August 1997, finally finishing the month of August 1997 at $4.725, an increase of about 105% from its pre-suspension price of $2.30.

Annexure 1 shows the trading volume, intra day high and low, and the closing prices of Indesen's shares, together with the Hang Seng Index, for the period 31 December 1996 to 31 December 1997. Annexure 2 is a graph showing the daily closing price and turnover of Indesen's share during the same period.

In 1997 Mr. Huo Sheng Pu was a director of Henan Finance, Henan Tai Wu and Henan Enterprises. On 9 July 1997, he purchased, 6,350,000 Indesen shares in his own name. On 30 July he purchased 458,000 Indesen shares, again in his own name. On 26 August he sold 1,642,000 Indesen shares. On 27 August he sold 400,000 Indesen shares. On 26 August 1997 he bought an additional 800,000 Indesen shares. He made further disposals on subsequent dates. All transactions were done through his securities trading account with Wardley Securities Ltd

Chapter 2

In this chapter we deal with the constitution of the Tribunal and the procedures we followed.

The Tribunal's constitution{ XE "constitution of the Tribunal" \b }

As a result of the trading in Indesen's shares in July 1997, described in Chapter 1, the Securities & Futures Commission conducted an investigation. This led to the then Financial Secretary requesting the Insider Dealing Tribunal to conduct this inquiry. We have quoted the terms of his notice in the introduction.

Pursuant to Section 15(2) of the Ordinance, The Hon Mr. Justice Lugar-Mawson was appointed the Chairman of the Tribunal and Mr. Joseph Hui Sik Wing, and Mr. John Ng Chi Wing were appointed as members. Mr. Hui is a self-employed Certified Public Accountant. He has sat as a member of the Insider Dealing Tribunal on an earlier inquiry. Mr. Ng is also a Certified Public Accountant and works as a senior executive in an insurance company. He has not sat as a member of the Insider Dealing Tribunal before.

The inquisitorial process

The provisions of Part III of the Ordinance envisage an inquisitorial process not an adversarial one. In the inquisitorial process the judges are given a greater role, as it is believed that, thereby, it will be easier for them to arrive at the truth. The Tribunal, therefore, directs the inquiry; the witnesses called are the Tribunal's witnesses. The Tribunal has a broad discretion to receive and consider relevant material, whether by way of oral evidence, written statements, documents or otherwise. Neither is the Tribunal bound by the conventional rules of evidence that apply in adversarial proceedings.

The sending out of the 'Salmon letters'{ XE "Salmon' letters" \b }

Paragraph 17 of the Schedule to the Ordinance provides that it is for the Tribunal to identify the persons whose conduct is to be the subject of the inquiry, or who are implicated, or concerned, in the subject matter of the inquiry. These persons are referred to by the descriptive term 'Implicated Persons'. There is no statutory definition of the term given in the Ordinance; indeed it is not a term used anywhere in the Ordinance.

As there are no pleadings or charges in an Insider Dealing Tribunal inquiry the way of notifying the implicated persons of the fact that the Tribunal has identified them as such is to send them a letter informing them of that fact and giving them advance notice that their conduct will be one of the subject matters of the inquiry. These letters are commonly described as 'Salmon letters'**{** XE "Salmon' letters" \b **}** after Lord Justice Salmon**{** XE "Lord Justice Salmon" \b **}** who in 1966 sat as Chairman of the United Kingdom's 'Royal Commission on Tribunals of Inquiry'**{** XE "Royal Commission on Tribunals of Inquiry" \b **}**. Again, there is no statutory definition of the term 'Salmon letter' and no statutory prescription of the form one should take, or what it information it should contain. And, likewise, the term 'Salmon letter' appears nowhere in the Ordinance.

The 'Salmon letters' have annexed to them a case synopsis outlining the allegations made against the recipient. They stress that the synopsis is no more than a guide and that the Tribunal is free to investigate whatever matters it considers relevant in the light of the evidence led at the inquiry. They also **{** XE "Salmon' letters" \b **}** inform the recipient**{** XE "implicated persons" \b **}** that copies of the witness statements and documentary evidence from which the case synopsis has been compiled are available to them.

Based on information available at the start of the hearings, we identified only Mr. Huo Sheng Pu, the person named in the Financial Secretary's notice of 20 February 2001 as the implicated persons and served 'Salmon letters' on him on 4 July 2001. A copy of that letter (which does not include the case synopsis) is at annexure 4.

Legal representation{ XE "Legal representation" \b }

Under the provisions of paragraph 18 of the schedule to the Ordinance we appointed Mr. Peter Davies, Senior Assistant Law Officer and Mrs. Winnie Ho Ng Wing Yee, Government Counsel, both from the Department of Justice, as counsel to the Tribunal.

The counsel to the Tribunal are not prosecutors, neither are they counsel for the Securities & Futures Commission. Their function is to present relevant evidence to the Tribunal objectively, regardless of which way that evidence falls. It may be in support of, or against, an allegation of insider dealing. The counsel to the Tribunal, however, are not constrained to remain neutral throughout the inquiry. Where

appropriate, they are entitled to employ their advocacy skills to test and probe evidence.

Paragraph 16 of the schedule to the Ordinance provides that any person whose conduct is the subject of an inquiry or who is implicated or concerned in the subject matter of an inquiry is entitled to be legally represented before the Tribunal. At the inquiry, Mr Mac Imrie assisted by Mr. David Goh, solicitors with Messrs. Herbert Smith represented Mr. Huo.

The Preliminary meeting

We held a preliminary meeting of the Tribunal on Wednesday, 29 August 2001 in the courtroom of the Tribunal in Tower 2 of the Lippo Centre, Queensway, Hong Kong. At that meeting the date of the commencement of the Inquiry was fixed for Wednesday, 10 October 2001.

We pointed out at the preliminary meeting that counsel to the Tribunal would, of necessity, be involved in a large amount of administrative work, such as arranging for the attendance of witnesses and, when appropriate, ensuring that steps were taken to secure new evidence. To this end it was said that the counsel might from time to time have to meet with the Chairman and the Tribunal members in chambers. However, it was anticipated that once the inquiry commenced, such meetings would be kept to the minimum necessary to ensure the orderly progress of the inquiry. We place on record that once the inquiry commenced there was no need for any private meetings between counsel to the Tribunal and the Chairman and the Tribunal members.

At the preliminary meeting we were informed that a substantial part of the evidence was in the process of being agreed and that it was likely that Mr Huo would make a full written admission of insider dealing in relation his purchase of Indesen's listed securities July 1997.

The length of the inquiry{ XE "length of the inquiry" \b **}**

The Inquiry commenced, as scheduled, on Wednesday, 10 October. The evidence was completed and all submissions made by the following day, Thursday, 11 October 2001.

The Tribunal's proceedings were recorded and transcribed by Lindy Williams Ltd. A transcript of each day's proceedings was ready by the morning of the following day. The transcripts were transmitted by e-mail to counsel to the Tribunal and Messrs. Herbert Smith as soon as they were ready.

The evidence led at the { XE "Witnesses called" \b }inquiry

On 10 October 2001, Mr. Imrie informed us that his client, Mr. Huo, did not challenge any of the statements placed before us by counsel to the Tribunal and the opinions of the expert witnesses, Mr. Alex Pang Cheung Hing, contained in his statement in so far as they were relevant to our inquiry into, and determination of, questions (a) and (b) in the Financial Secretary's section 16(2) notice. He placed before us a statutory declaration made by Mr. Huo on 9 October 2001, in which he accepted that he had engaged in insider dealing in relation to Indesen's listed securities in July 1997. This statutory declaration, together with its exhibits and an English translation, is at annexure 5.

Based on the evidence before us Mr. Davies submitted that Mr. Huo's admissions were consistent with a breach of section 9(1)(a) of the Ordinance and that there was sufficient evidence for us to make such a finding. He further submitted that there was no evidence available to indicate that any person other than Mr. Huo had engaged in insider dealing in Indesen's listed securities in July 1997.

As we had spent a considerable time reading the statements taken by the investigators from the Securities & Futures Commission before the commencement of the inquiry and thereby had the opportunity of considering the evidence carefully, and as Mr. Huo's admissions were clear and unequivocal, we were able to make the following findings on that day (10 October 2001):

> *'The Insider Dealing Tribunal is satisfied that it has been provided with sufficient evidence to enable it properly to prepare and issue a written report in accordance with section 22 of the Securities (Insider Dealing) Ordinance, Cap. 395, in answer to questions (a) and (b) of the notice received from the Financial Secretary under section 16(2) of that Ordinance dated 20 February 2001.*
>
> *The Tribunal has now considered that evidence and heard submissions thereon. Before proceeding to hear further evidence in relation to*

question (c) of the Financial Secretary's notice, and also to determine the appropriate penalties pursuant to section 23 or section 24 of the Ordinance which would follow our findings pursuant to sections 16(3), (4) or (6), we now announce in brief what those findings will be.

Our report will make a determination that insider dealing took place in July 1997 arising out of the dealings in the listed securities of Indesen Industies Co Ltd., now known as Central China Enterprises Ltd by Mr.Huo Shen Pu.

Our report will only identify Mr. Huo Sheng Pu as an insider dealer, in breach of section 9(1)(a) of the Ordinance.'

Our reasons for these findings are set out in Chapter 4 of this report.

We adjourned the proceedings to Thursday, 11 October 2001 to hear submissions on the issues raised in paragraph (c) of the Financial Secretary's notice and the penalties we should impose.

In short, a full inquiry that might have taken up to one month involving the examination of possibly 12 witnesses became unnecessary. The combination of the unchallenged evidence and the statutory declaration from Mr. Huo was sufficient to enable us to make a full inquiry and a fair determination on all issues in accordance with the Financial Secretary's request within a short period of time.

Chapter 3

In this chapter we deal with the law. It is divided into two parts. Part 1 deals with the relevant provisions of the Ordinance. Part 2 deals with the general legal principles that we found to be of relevance in the course of our deliberations.

Part 1

Section 9(1) of the Ordinance**{** XE "Ordinance:section 9" \b **}** provides 6 instances of when the civil wrong of insider dealing takes place; one is relevant to this Inquiry, it is as follows:

Under section 9(1)(a) insider dealing in relation to a listed corporation takes place:

> *'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 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 word *'corporation'* is defined in section 2(1) of the Ordinance (the General Definitions section) as:

> *' "corporation" means any company or other body corporate or an unincorporated body, incorporated or formed either in Hong Kong or elsewhere.'*

For insider dealing to be proved the Tribunal must be satisfied, to the requisite standard, of 4 matters. They are:

1. The securities must be those of a *'listed corporation'*.

There is no dispute that Indesen was at the material time (July 1997) a listed corporation as defined in section 2(1) of the Ordinance; that is, a corporation whose shares and other issued securities are listed on the Stock Exchange of Hong Kong**{** XE "Hong Kong Stock Exchange" \b **}**.

2. The person dealing in the securities must either be *'connected'* to the corporation,

or have received information relating to them from a person whom he knows is connected to the corporation.

The second condition has no application in this case, the first does. The relevant parts of section 4 of the Ordinance provide:

> *'4. 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 …*
>
> *(d) he has access to relevant information in relation to the corporation by virtue of his being connected (within the meaning of paragraph (a)…with another corporation, being information which relates to any transaction (actual or contemplated) involving both those corporations or involving one of them and the listed securities of the other or their derivatives or to the fact that such transaction is no longer contemplated;…'*

3. The connected person must *'deal in'* the securities, or else counsel or procure another person to deal in them.

Section 6 of the Ordinance**{** XE "Ordinance:section 6" \b **}** defines dealing in securities as being:

> *'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…acquires or disposes of, or agrees to acquire or dispose of, the right to buy, sell, exchange or subscribe for, any securities….'*

4. And, at the time of dealing, the connected person must be in possession of information, which he knows to be *'relevant information'*.

Section 8 of the Ordinance**{** XE "Ordinance:section 8" \b **}** defines the phrase *'relevant information'* as:

' "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.'

For information to be *'relevant information'* it must posses 3 elements, each of which must be proved to the Tribunal's satisfaction; they are:

1. The information is known only to a few and is not generally known to the market; that is, to those individuals and institutions accustomed or likely to deal in the securities of the company

2. It must be *'specific information'*. Specific information is information which possesses sufficient particularity to be capable of being identified, defined and unequivocally expressed[1].

3. And it must be information of the kind, which, if it were known to the market, would be likely to materially affect the price of that company's listed securities.

The test of price sensitivity has to be applied at the time the alleged insider dealer's transaction took place. The exercise of determining how general investors would have behaved on that day, had they been in possession of that information, is, of necessity, an assessment.

Section 10 of the Ordinance provides for 7 statutory defences to an allegation of insider dealing. The defences only arise if the Tribunal is satisfied to the required standard that a transaction was an instance of insider dealing. If that is so, once any of the defences are raised, the burden of proof is on the person who seeks to rely on them and is discharged on a balance of probabilities. If that burden is discharged the person will not be identified as an insider dealer. No statutory defences have been raised in this inquiry.

So far, in dealing with the law under this Part, we have used the phrases employed in the Ordinance: *'securities'* and *'listed securities'.* Section 2(1) of the Ordinance defines the phrase *'securities'* as meaning (among other things) *'shares'*. In this

[1] See the dicta of the Singapore High Court in **Public Prosecutor v. GCK Choudrie (1981) 2Co. Law 141**

inquiry we have only been concerned with Indesen's shares traded on the Stock Exchange of Hong Kong. From now on we use the word *'shares'* rather than the tautologous phrases *'securities'* and *'listed securities'.*

Part 2

The general legal principles that we found to be of relevance in this inquiry are:

1. The standard of proof to be applied to all findings of fact is proof to a high degree of probability.[2] We have applied this standard to all our decisions on the issues before us. Whenever in this report we say that we were *'satisfied'* about an issue, it should be taken that we were satisfied about it to a high degree of probability.

2. Paragraph 13 of the Ordinance provides that the 3 members of the Tribunal decide all questions of fact, but that the Chairman alone decides all questions of law. All our findings of fact in this report were made unanimously. Any reference in this report to the Tribunal making a decision on a question of law is to be read as being a decision made at the Chairman's direction.

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

[2] See the decision of Stock J (Chairman) in **Success Holdings{ XE "Success Holdings" \b } Limited 1994**.

Chapter 4

In this chapter we give our Reasons for the determinations, delivered in open court on 10 October 2001, in relation to questions (a) & (b) in the Financial Secretary's notice.

The matters to be proved

In order for Mr. Huo to be identified as an insider dealer in relation to his 2 purchases of Indesen's shares in July 1997, we had to look at each purchase separately. In respect of each purchase, we had to be satisfied to a high degree of probability that the evidence proved the following elements:

1. That at the time of the purchase, Mr. Huo was a person connected with Indesen, as that term is defined in section 4 of the Ordinance.

2. That his purchases amounted to dealing in those shares, as that term is defined in section 6 of the Ordinance. [3]

3. And that, at the time of such dealing, he was in possession of relevant information, as that term is defined in section 8 of the Ordinance, and that he knew that it was relevant information.

It was open to us to find those elements proved in respect of both, or one, or neither of the 2 purchases.

A person connected

In his statutory declaration Mr. Huo admitted that in 1997 he was a director of Henan Finance, Henan Tai Wu and Henan Enterprises; that, on 15 July 1997, Henan Enterprises had agreed to sell Indesen an 80% equity interest in Henan Motor Car and, on 14 August 1997, Henan Finance had agreed to sell Indesen its 100% interest in Henan Tai Wu.

Mr. Xie Sui An the Managing Director of Henan Hong Kong Holdings and the head of the Henan Group of companies, told the Securities & Futures Commission's investigators in his statement that Mr. Huo was responsible for Henan Tai Wu before it was sold to Indesen. In his interview with the Securities & Futures Commission's

[3] See Chapter 3 of this Report.

investigators, conducted on 6 September 1999, Mr. Huo admitted that he was in charge of Henan Tai Wu.

In that interview, Mr. Huo said the following, at questions and answers 13 to 15:

> *'13. Q. Please state in detail the information you were aware of earlier than the public and when you learnt of it.*
>
> *A. The decision of the board of Henan Hongkong (Group) to sell Taiwu Electric to Indesen. As I was in charge of Taiwu Electric, the board informed me of this decision.*
>
> *14. Q When did you know that Henen Hongkong (Group) would sell Taiwu Electric to Indesen?*
>
> *A. It was definitely before I first bought the shares of Indesen. I can't recall the exact date but it was definitely a few days before 9 July 1997. I learnt of that in early July 1997.*
>
> *15. Q. Who of Henan Hongkong (Group) told you about the decision of selling Taiwu Electric to Indesen?*
>
> *A. Mr. Xie. Xie Shian, because he was the only one who could decide on this.'*

In paragraph 10 of his statutory declaration Mr. Huo acknowledged the correctness of his answers given in the course of that interview.

It is clear from his answer to question 14, that Mr. Huo was aware of Indesen's purchase of the 100% equity interest in Henan Tai Wu before he made his first purchase of Indesen's shares on 9 July 1997.

As we were satisfied that the information Mr. Huo admitted receiving from Mr. Xie before 9 July 1997 concerning the sale of the entirety of the Henan Tai Wu shares to

Indesen was relevant information - an element we deal with shortly – we are satisfied that Mr. Huo was a person connected with Indesen by virtue of section 4(1)(d) of the Ordinance both at the time of the purchase on 9 July 1997 and the purchase on 30 July 1997, as he admitted to having access before either of those 2 dates to information relating to a transaction involving Henan Tai Wu, a company of which he was a director, and Indesen.

Possession and knowledge of relevant information

We again refer to questions and answers 13 to 15 in Mr Huo's interview with the Securities & Futures Commission's investigators conducted on 6 September 1999 quoted above. Mr Huo went on to say the following:

At question and answer 16:

> *'16. Q. Why did you buy the shares of Indesen because of this decision?*
>
> *A. It was because when the news that Henan Hongkong (Group) would sell Motor Car Company (i.e. Henan Motor Car Repairing Co., Ltd.) to Indesen was spread, the share price of Indesen already rose. It was around June 1997. Therefore, when I knew that Henan Hongkong (Group) had decided to sell Taiwu Electric to Indesen, I foresaw another rise in the share price of Indesen, so I bought the shares of Indesen in my own name. At that lime I had not considered any other factors.'*

At question and answer 21:

> *'21. Q. What effect did you think Henan Hongkong Enterprises's acquisition of the shares held by the major shareholder of Indesen would have on the share price of Indesen?*
>
> *A. I had not thought of this issue at that time. I bought the*

shares of Indesen because I knew that Taiwu Electric itself was making profits and selling it to Indesen would definitely have a positive effect on the share price of Indesen because Indesen itself was running at a loss. However, I really did not know then that doing so was against the laws.'

We had to be satisfied that these admissions of fact constitute knowledge and possession of relevant information as a matter of law.

The evidence that we accepted and took into account in deciding that the information Mr. Huo had constituted relevant information, and that he knew it to be relevant, at the time of both of his share purchases in July 1997, is:

1. Mr. Huo's own admissions in the 9 September 1999 interview that he foresaw that the sale of the Henan Tai Wu shares to Indesen would cause a rise in the latter's share price.

2. Paragraph 10 of his statutory declaration (which we note was given after receiving legal advice from Messrs. Herbert Smith) admitting that his Indesen share purchases on 9 & 30 July 1997 constituted insider dealing as defined by section 9 of the Ordinance.

3. And the unchallenged expert evidence of Mr Alex Pang Cheung Hing the Senior Director of Enforcement at the Securities & Futures Commission.

Mr. Pang's evidence was to this effect: that in late 1996, it was fashionable for Mainland bodies, including provincial or municipal governments (some of which were already listed on the Stock Exchange) to take strategic stakes in other Hong Kong listed entities for synergistic[4] or diversification purposes.

Entering 1997, the investing public was in an even more bullish mood about the Hong Kong market, as many believed that the Central Peoples' Government

[4] Synergistic - a factor cooperating with, or enhancing, the effect of another. (The New Shorter Oxford English Dictionary)

was ready to propel the Hang Seng Index to a new record high to herald the return of Hong Kong to the motherland in July 1997. Under this so called 'dye red' ('yim hoong' in Cantonese) phenomenon, investors rushed into the target stocks when rumours surfaced concerning impending acquisitions, causing huge increases in the price and trading volume of those stocks. The companies chosen were subsequently re-rated with handsome price premiums as investors chased their stocks.

In 1997 shares of second and third line listed companies that were acquired through placements (i.e. less than 50% of their issued capital) by parties connected or related to the Mainland ('China Enterprises'), generally out-performed that of the stock market as a whole. To demonstrate this, Mr. Pang produced a table summarising the share price performances of 11 second/third line companies that became targets of China Enterprises in the period from January to August 1997. It was the market view at that time that any involvement with a China Enterprise would greatly increase the company's attractiveness and hence it's rating to the investing public. The average increase in share price for all the 11 shares was about 33.37%. Most of them recorded increases as a reaction to the release of an announcements of a proposed transaction between the target company and China Enterprises, save for minor decreases in only two cases.

The investing public's euphoria towards the 'dye red' phenomenon was so overwhelming that if there was a whiff of information that a listed entity was about to undergo the 'dye red' process, the investing public would chase the stock in a frenzy, resulting in sharp jumps in the stocks' prices. Thus, anyone in possession of information that a listed entity was about to undergo the 'dye red' process ahead of the public announcement would be assured of huge profits if they bought that stock.

There is no reason to doubt that the 'dye red' phenomenon applied to Indesen's shares in respect of the series of proposed transactions between Indesen and the companies beneficially owned and controlled by the Henan Provincial Government.

Dealing in Indesen's shares

The evidence gathered by the Securities & Futures Commission's investigators shows that the purchase of 6,350,000 Indesen shares on 9 July 1997 and 458,000 Indesen shares on 30 July 1997 was done through Mr. Huo's securities trading account at Wardley Securities Limited. This is supported by the documentary evidence and confined in an uncontested statement from Miss Alice Wu Ka Ping the account executive at Wardley, and by Mr. Huo himself both in his interviews with the investigators and in his statutory declaration.

It is clear from the documentary evidence that those purchases were funded by the premature withdrawal of funds from 4 time deposit accounts maintained by Mr. Huo. He, in his interview of 6 September 1999, admitted that he had arranged for funds to be deposited with Wardley for those share purchases by withdrawing funds from the 4 time deposit accounts.

As for the ownership of those funds; although the time deposit accounts were held in Mr. Huo's name, he told the investigators that only a small proportion of the money in them belonged to him and that 2 of his friends in the Mainland China, Mr. Gu De Shan and Mr. Tian Yuan, had placed the remainder of the money in those funds in his custody, as part of an arrangement under which he helped them transfer their money out of the Mainland.

In his statement to the Securities & Futures Commission's investigators, Mr. Gu confirmed the general pattern of that arrangement, but was unable to provide any record, or have any specific recollection, of the amount of money involved, or the dates of the transfers. It appears that the investigators never interviewed Mr. Tian. And, although stating that most of the money used in the share purchases was not his own, Mr. Huo admitted to the investigators that the shares belong to him solely and that he was the beneficiary of all the profit made as a result their sale. His questions and answers on this point (questions and answers 31 to 36 of the 9 September 1999 interview) are:

'31. Q. Did the profit made from selling the Indesen shares you bought on 9 July and 30 July 1999 all belong to you yourself?

A. *The profit made all belonged to I myself. It was only that I gave some of it to my mainland friends who had lent me money, but that was a separate issue.*

32. Q. *Did your mainland friends know that the money they lent to you was for the purchase of the Indesen shares?*

No, they only knew that it was related to my Hong Kong business.

33. Q. *What are the names of your mainland friends who lent you the money?*

A. *Most of it was lent by Gu Deshan. The rest was (lent by) Tian Yuan.*

34. Q. *How did Gu Deshan and Tian Yu Yuan lend the money to you?*

A. *They lent me renrninbi in the mainland which I remitted here through different channels. The majority of it became my fixed term deposits, but as to the details of the amounts, I can't recall exactly.*

35. Q. *Do you have any record of the amount you borrowed from Gu Deshan and Tian Yuan and the*

repayments?

A.

No, we are close friends.

36. Q.

When did you ask Gu Deshan and Tian Yuan to lend you the money?

A.

Around 1996. At the time I asked them to lend me money, it was not for the purchase of the Indesen shares. The money was borrowed for another business. Originally I intended to buy a property but later did not dare to make that acquisition. At that time I had no intention to buy any shares. It was only due to the subsequent decision of Henan Hongkong (Group) of selling Taiwu Electric to Indesen that I used the money borrowed to buy the shares of Indesen.'

Apart from that, there is no evidence which suggests that Mr. Huo was trading as a nominee for others in July 1997.

In his statutory declaration Mr. Huo unequivocally stated that he purchased the shares because he regarded them, and Indesen, as 'a good long term investment.'

We were satisfied that Mr. Huo dealt in Indesen shares as defined in section 6 of the Ordinance when he made share purchases on both 9 & 30 July 1997.

That only Mr. Huo be identified as an insider dealer

No evidence was placed before us indicating that any other person possessing relevant information dealt in Indesen's listed securities in July 1997, the material time.

CHAPTER 5

In this chapter we answer item (c) in the Financial Secretary's section 16(2) Notice.

The relevant part of section 23 of the Ordinance provides (among other things) that where a person has been identified by the Tribunal as an insider dealer it may, at the conclusion of the inquiry, or as soon as is reasonably practicable thereafter, make an order that he pay to the Government an amount not exceeding the amount of any profit gained, or loss avoided, by him as a result of the insider dealing.

Mr. Huo's statutory declaration contained no admission as to the amount of profit he made from his insider dealing. We therefore heard evidence from Mr. Alex Pang, and submissions from both counsel to the Tribunal and Mr. Imrie on the issue.

Details of the Henan Tai Wu acquisition were made known to the public on 22 August 2001 and trading in Idensen's shares resumed on 26 August 1997. On that day, Mr. Huo sold 1,642,000 of his 6,808,000 Indesen shares acquired through his insider dealing on 9 & 30 July 1997, retaining a balance of 5,166,000. His actual sale proceeds received in respect of that transaction were $7,072,319. On the next day, 27 August 1997, he sold a further 400,000 of those shares. His actual sales proceeds received in respect of that transaction were $1,817,462. He retained the balance of 4,766,000 and sold them on subsequent dates.

The Court of Final Appeal in **Insider Dealing Tribunal v. Shek Mei Ling [1999] 2HKC 1**, a decision which is binding on us, held that the approach to be adopted by the Tribunal, where there is a part-disposal of shares acquired through insider trading, is to treat the relevant profit in respect of the retained shares as being a notional figure representing the gain made by the insider dealer on an estimated date. That estimated date is calculated by taking the date on which the information was made public (a known date) and then, if necessary, projecting forward over a number of days until the Tribunal arrives at a date on which it is satisfied that the market had a reasonable opportunity to digest the information. The gain is to be measured by reference to the market value of the retained shares at that date. At that date the amount of the insider dealer's profit in respect of the unsold shares, is deemed to fixed once and for all. An allowance is made in respect of notional transaction costs. The relevant profit in respect of the shares that are sold on, or before, the estimated date is the profit the insider dealer actually made (i.e. proceeds of sale less transaction costs) when he sold those shares.

Changes in the share's price after the actual date on which the information was made public are irrelevant for the purpose of the section 23 calculation, because they are not regarded as flowing from the original improper purchase of the shares. Rather, they flow from the insider dealer's decision to retain the shares at a time when the effect of the misuse of the confidential information had become spent and the insider dealer was on an equal footing with every other investor.

Similarly, purchases of new shares in the same company by the insider dealer on, or after, the date on which the information was made public are irrelevant for the purpose of the section 23 calculation. This means that we can take no account of Mr. Huo's purchase of an additional 800,000 Indesen shares on 26 August 2001, which we referred to in the final paragraph of this report.

The estimated date is not drawn out of thin air; it must be arrived at from the evidence. The Tribunal will normally have details of the share's trading record. The date on which the information became known to the market is usually capable of precise determination and the trading statistics on, and after, that date will normally show the effect the information had on the market. If a significant increase in volume or value, or both, is seen on a day, or a number of days, within a reasonable period of time after the release of the information it is not unreasonable for the Tribunal to accept that day as being the estimated date. In appropriate circumstances, it may well be the actual date on which the information was made public.

It was not disputed before us that the date on which the information about the Henan Tai Wu acquisition was made public was 22 August 1997, 4 days before trading in Indesen's shares resumed. The argument before us centred on what period of time after that date we should take as being a reasonable opportunity for the market to digest the information and thus arrive at the estimated date.

We have also considered the basis of the valuation of the retained shares on that estimated date.

WHEN DID THE MARKET DIGEST THE INFORMATION?

Mr. Pang characterised Indesen as a 'third liner stock'; we have no reason to doubt that description. He was of the view that a period of 3 days after 26 August 1997, the date trading resumed, should be taken as being a reasonable opportunity for the

market to digest the information and thus arrive at the estimated date. His reasons were:

> *'Hong Kong is a mature market and investors usually react quite rapidly and efficiently to any information which may have (an) effect on the share price. Usually, on the first trading day when the price-sensitive information is disseminated to the public, it would significantly hit the market and the investors would react to that piece of information rapidly and directly. If the shares are second or third liner shares in which less institutional investors are interested, some of the retail/nonprofessional investors who are used to deal in that stock would probably take another one to two days to absorb, digest and react to that information.'*

Although we respect Mr. Pang's argument, we have to say that we take a different view. We have decided that evidence supports a finding that the market digested and reacted to the information on 26 August 1997, the very day on which trading in Indesen's shares resumed.

We agree with Mr. Pang's view that Hong Kong is a mature market and that investors usually react quite rapidly and efficiently to any information which may have an effect on a share's price. The trading statistics in fact show that investors reacted to the information immediately. On 26 August 1997, 107,220,000 Indesen shares were traded. Their price shot up to a high of $4.5 against a pre-suspension closing price of $2.3, an 88.04% increase. The day's low price was $3.2 and the closing price was $4.325.

On 27 August 1997 51,266,000 Indesen shares were traded, this is less that half the volume on 26 August. The high price was $4.75, the low price $4.375 and the closing price $4.675; 8.09% up on the previous day's close.

On 28 August 1997, the last day of Mr. Pang's 3 day period, 38,538,000 Indesen shares were traded, just over one-third of the volume on 26 October. The high price was $4.975, the low price $4.675 and the closing price $4.825; 3.219% up on the previous day's close.

In September 1997, the highest closing price of Indesen's shares was $4.625, on 12 September. The lowest was $3.6 on 24 September. Volume in September was at a high of 39,036,000, on 12 September and at a low of 7,863,943 on 29 September. The closing price on that day was $4.050. Volume exceed 30,000,000 on 3 out of 20 trading days in September (2,3 & 12 September) and only dropped below 10,000,000 on 4 days (8, 22, 26 & 29 September).

The picture that emerges from the statistics is that the trading results on 28 August marked the start of a period of relative stability in Indesen's share price.

We are aware that the statistics show that Indesen out-performed the Hang Seng Index on 26, 27 & 28 August, but the enormous jump, both in volume and price, on 26 August persuades us that it is realistic to accept that the investing public positive had digested and acted on the information released on 22 August 1997 by close of trading on 26 August 2001.

THE BASIS OF VALUATION OF THE RETAINED SHARES

As to the basis of the valuation of the retained shares on 26 August 2001, the Court of Final Appeal in **Insider Dealing Tribunal v. Shek Mei Ling** said that the gain is to be measured by reference to the market value of the retained shares at that date. Shares, of course, vary in price throughout a trading day. We have decided to take their closing value as the basis for calculating their value, as by close of trading on a particular day the price for that day is crystallised for all time. The closing price on 26 August was $4.325.

THE PROFIT CALCULATION

We calculate the net profit in respect of both the sold and retained shares to be $16,540,124. Details of the calculation are set out in annexure 6.

Chapter 6

In this chapter we deal with the basis for our orders and penalties.

Under section 23(1) of the Ordinance we may make any or all of the following orders against a person whom we find to be an insider dealer:

(a) An order that that person shall not, without the leave of the High Court, be a director or a liquidator or a receiver or manager of the property of a listed company or any other specified company or in any way, whether directly or indirectly, be concerned or take part in the management of a listed company or any other specified company for such period (not exceeding 5 years) as may be specified in the order;

(b) An order that that person pay to the Government an amount not exceeding the amount of any profit gained or loss avoided by that person as a result of the insider dealing;

(c) An order imposing on that person a penalty of an amount not exceeding three times the amount of any profit gained or loss avoided by any person as a result of the insider dealing.

In Chapter 5, when calculating the amount of the profit gained in order to answer question (c) of the Financial Secretary's section 16(2) notice, no consideration was given to the mitigation advanced on Mr. Huo's behalf. Mitigating factors are relevant to the question of penalty; they are not relevant to the question of how the profit should be calculated.

We deal with section 23(1) in the following order - (b), (c) and (a).

Section 23(1)(b) - Payment of profit to the Government

The order to be made under this subsection need not necessarily be the same as the amount of profit gained; it could be less. The subsection says an amount *'…not exceeding ... the profit.'*

Whereas mitigation is highly relevant to the orders under subsections (a) and (c), we do not believe that it has any application to orders under subsection (b). The

subsection requires a disgorgement of the profits actually, or theoretically, made. The circumstances in which it might be appropriate to award a lesser sum than the profit gained might be the individual's lack of means, but not the mitigating factors.

For the reasons we set out when discussing the order under subsection 23(1)(c), we are satisfied that Mr. Huo has the means to pay the profit gained. We therefore order, under subsection 23(1)(c), that he pay $16,540,124 to the Government.

Section 23(1)(c) - A penalty of up to three times the profit gained

This is a penalty not a fine. Orders under subsection 23(1)(c) are frequently reported, wrongly, as fines. A fine is a criminal sanction. Insider dealing in Hong Kong is not a crime.

The maximum that could be ordered under this subsection is $49,620,372[5]. When added to the order under subsection 23(1)(b) and the expenses order under section 27, the total amount could be very high.

We accept that mitigating factors must be considered in our determination under this subsection, as must the insider dealer's ability to pay the penalty.

Mr. Imrie advanced the following mitigating factors.

1. Mr. Huo made a full and frank admission at an early stage. He explained his actions and apologised for them (see paragraphs 10,11 & 12 of his statutory declaration).

2. Mr. Huo's insider dealing was not sophisticated and, in all the circumstances, is at the lower end of the scale of culpability. He did not embark on a scheme of deceit and secrecy. His purchases were conducted through accounts held in his own name.

3. It is unlikely that the integrity of the market was compromised. There was no damage done to the investing public.

[5] Profit gained $16,540,124 x 3 = $49,620,372.

4. Mr. Huo's decision to buy was his own. Apart from his borrowing, he did not recruit the assistance of any other person, which might have jeopardised their position, or unwittingly involved them in allegations of insider dealing.

5. Mr. Huo was not entirely aware of the implications of his actions. Although ignorance of the law is no defence, Mr. Huo's conduct was not in deliberate disregard of the law governing securities trading.

6. Mr. Huo was neither a director, nor an officer of Indesen. He did not set out to acquire the information which caused him to deal. And, having received the information, he made no efforts to gain more information before dealing. He dealt on what he knew and on what Mr. Xie told him.

7. Our finding that he is an insider dealer will have a detrimental effect on Mr. Huo's reputation and future livelihood. He may lose his employment. The case has been hanging over his head for nearly 4 years. And he has expressed his genuine remorse over his wrong-doing.

As to Mr. Huo's means and ability to pay, Mr. Imrie argued that we must be satisfied that the penalties we impose are fair and can be met – a proposition we accept. Mr. Huo is a man of modest income and habits. The only way for him to meet a significant order is for him to sell his share portfolio. Beyond the proceeds available after that sale, his ability to repay depends on his continued employment. It would be unfair to impose a penalty that strips Mr. Huo of his life savings and leaves him in a position where he is unable to continue to assist his parents and his daughter.

We accept, without comment, that items 4 & 6 are mitigating factors.

While we accept that Mr. Huo's insider dealing was unsophisticated and that he did not embark on a scheme of deceit and secrecy (item 2). We do not think that a scale of culpability can be determined; all that we can say is that this was not one of the most blatant examples of insider dealing.

We do not accept that Mr. Huo was not entirely aware of the implications of his actions (item 5). Mr. Huo on his own admission has been involved in the business world since 1982; he has risen to the position of director of 3 major Mainland controlled companies. He has been resident in Hong Kong and conducted business

in here since 1992. Insider dealing is not a new phenomenon; the law has proscribed it since 1984. Previous decisions of the Tribunal have received extensive publicity. All members of the business community, including Mr. Huo, must be aware that insider dealing is prohibited by law.

Neither do we accept that it is unlikely that the integrity of the investing market was compromised, nor that no damage was done to the investing public (item 3). Insider dealing involves the deliberate exploitation of information by dealing in securities, to which the information relates, having obtained that information by virtue of a privileged relationship, or position. In other words, insider dealing involves taking advantage of an opportunity to profit, which is not available to others, and from whom, directly or indirectly, the profit will be taken.

It is generally recognized that stock markets are efficient in allocating capital. For them to operate effectively and without inhibition, they require confidence and respect both from people within their own area of operation and the international community. They require all investors to have confidence in their fairness. Those who involve themselves in insider dealings engage in the process of destroying that confidence. Any notion that insider dealing is victimless is nonsense. Insofar as it undermines the proper functioning of the markets, it harms all those who have a direct or indirect interest in the efficiency of the markets - in other words, it harms everyone.

Although we accept that Mr. Huo made a full and frank admission of insider dealing in his interview with the Securities & Futures Commission's officers of 6 September 1999, (item 1), this followed 2 interviews in which he sought to deny his wrongdoing. As we have already said, we do not accept that Mr. Huo was not entirely aware of the implications of his actions at the time he engaged in insider dealing. We, however, accept that an admission, which saves the Tribunal, the Securities & Futures Commission and the Financial Services Branch of the Government, the expense of a contested inquiry is powerful mitigation and, in itself, can be taken as an expression of remorse.

That the case has been hanging over him for nearly 4 years and our finding will have a detrimental effect on Mr. Huo's reputation and future livelihood, and may cause him to lose his employment (item 7) counts for little by way of mitigation. These

consequences should have been in his mind when he engaged in insider dealing. They are a logical consequence of detection and a risk the insider dealer chooses to take. That said, we are not insensitive to Mr. Huo's predicament and have taken these matters as affording him some mitigation.

As to Mr. Huo's means, in his statutory declaration he admits to having an annual salary of $308,000, a credit of $284,264.92 in a Hongkong & Shanghai Banking Corporation account and a share portfolio worth around $17,800,000 at current prices (the details are at appendix 5 of his statutory declaration at annexure 5). He claims to be the sole breadwinner of his family and to be responsible for the maintenance of his elderly parents in the mainland and the education, and support of his daughter. We were told that she is a university student in Australia. He estimates that it cost him $200,000 a year to support her.

While we have no reason to doubt the figures given to us and accept that Mr. Huo's regular source of income is his salary, and that he does not come from a wealthy family, we do not accept that he is as impecunious as he claims to be. The value of his share portfolio indicates that he must have access to other funds. He was able in mid-1997 to lay his hands on $12,783,539 in order to buy the Indesen shares that we are concerned with. Whatever the personal worth of the insider dealer, such an outlay on unlawful dealing on the Stock Exchange of Hong Kong can only be regarded as a very large sum. Further, the Wardley Securities Ltd dealing report annexed to the statement that Ms. Alice Wu Kar Ping gave to the Securities & Futures Commission's investigators shows that, as well as dealing in Indesen shares in 1997, he was also dealing in HSBC Holding Ltd and China Telecon (Hong Kong) Ltd shares.

We are mindful of the fact that the purpose of an order under section 26(1)(b) is to impose a penalty on the insider dealer over and above the order for disgorgement of the unlawfully gained profit. It is intended to be real penalty to bring home both to him and others who may be minded to engage in insider dealing, that insider dealing is prohibited by law.

We are also mindful of the fact that Mr. Huo committed a blatant act of insider dealing, with personal profit as his only motive.

With these matters in mind, had Mr. Huo no mitigating factors in his favour and taken the issue to a full hearing, we would have adopted a multiplier of one and a half of the profit gained in order to determine the penalty under section 26(1)(c). This would have resulted in a penalty of $24,810,186. After careful consideration of what we find to be the mitigating factors, we have determined that a discount of one third on that figure is appropriate. Our order under subsection 26(1)(c), therefore, is that he pays a penalty of $16,500,000. In terms of multipliers, this is equal to the profit gained rounded down by $40,124.

As we appreciate that it will take Mr. Huo some time to put funds together to pay the amounts ordered against him under sections 26(1)(b) and 26(1)(c), we give him a period of 4 months from the date of this report to pay them.

Section 23(1)(a) - Disqualification

There are many possible variations of disqualification orders under subsection 23(1)(a). The subsection permits disqualification from one or more of a number of different positions relating to a company - director, liquidator, receiver, manager of property or a person taking part in the management of a company. It can be directed at a listed company or a specified private company, or both. It can prohibit both direct and indirect involvement.

We appreciate that the making of an order under subsection 23(1)(a) is discretionary. However, only in unusual and exceptional circumstances would no order be made following a finding of insider dealing.

Mr. Imrie argued that it would be inappropriate to make a disqualification order against Mr. Huo because he was not a director of Indesen, or any other public listed company. The private companies of which Mr. Huo is a director were not involved in the insider dealing, and as Mr. Huo' s future employment might well be terminated, the punitive effect of a disqualification would be compounded.

With respect, we do not agree. We have already said that it is only in unusual and exceptional circumstances that no order would be made, following a finding of insider dealing and we find nothing in Mr. Huo's circumstances that are either unusual, or exceptional. The maximum period of disqualification permitted by Section 26(1)(a) is 5 years. This compares favourably with the maximum period of 15 years' disqualification given to the High Court in section 168E of Companies Ordinance,

Cap 32 in the case of company directors found guilty of indictable offences involving fraud or dishonesty in connection with the promotion, formation, management, or liquidation of limited companies (or their property).

We agree with the comments made in the Success Holdings report (page 98) dealing with the principles the Tribunal should consider when deciding whether or not a disqualification order should be made in respect of listed companies:

> *'In determining whether to disqualify an insider dealer from holding office as a director of a listed company, one has to consider the need, if any, to ensure the integrity of the securities market is maintained; to protect the public from further abuse by that person of any privileged position of trust which that office carries; to deter others from breaching that trust; and to mark the disapproval of the investment community with the conduct of the insider dealer;…'*

We are satisfied that a disqualification order should be made against Mr. Huo in respect of listed companies.

As to whether or not the order should extend to specified private companies, the Tribunal in Success Holdings went on to say, following the passage cited above:

> *'In determining whether to disqualify an insider dealer from holding office as a director of a private company, one should have regard to the connection, if any, of the company with the insider dealing, and any relationship between the insider dealer and the private company, and the impact upon the individual of such a disqualification.'*

There certainly was such a connection: Mr. Huo misused information received as a director of Henan Tai Wu to deal in Indesen's shares. However the impact upon Mr. Huo of an order disqualifying him from being a director of Henan Tai Wu or of any other private company in the Henan group of companies would be to deprive him of his livelihood (assuming the those controlling those companies allow him to remain a director). And if he is deprived of his livelihood the chances of him being able to meet the penalties imposed on him under section 26(1)(b) & 26(1)(c) are diminished, which would be self-defeating. We have therefore decided that his disqualification should only extend to listed companies.

As to the length of the disqualification, had there been no mitigation we would have ordered it to last for the maximum permitted period of 5 years. Because of the mitigation we reduce that period by 1 year to 4 years.

The disqualification prohibits Mr. Huo, without the leave of the High Court, from being a director, or a liquidator, or a receiver, or manager of the property of a listed company, or from, in any way, whether directly or indirectly, being concerned in, or taking part in the management of any listed company for the period of 4 years.

Expenses order

Section 27 of the Ordinance provides that the Tribunal may order any person whom it has identified as an insider dealer to pay to the Government such sums as it thinks fit in respect of the expenses of, and incidental to, the inquiry and any investigation of his conduct or affairs made for the purposes of the inquiry. We have decided that Mr. Huo shall pay $315,695 in respect of such expenses. Annexure 7 gives details of the calculation. He is given 4 months from the date of this report to make payment.

Orders

Pursuant to our determinations in answer to the Financial Secretary's notice under section 16(2) of the Ordinance as set out in Chapters 4 and 5 of this report, we make the following orders:

1. Pursuant to subsection 23(1)(a) of the Securities (Insider Dealing) Ordinance Cap. 395, Mr. Huo Sheng Pu shall not, without leave of the Court of First Instance of the High Court be a director, or a liquidator, or a receiver, or a manager of the property of a listed company for a period of 4 years with effect from the date of this order.

2. Pursuant to subsection 23(l)(b) of the Securities (Insider Dealing) Ordinance Cap. 395, Mr. Huo Sheng Pu shall pay to the Government the sum of $16,540,124, being the amount of profit gained as a result of the insider dealing as determined in Chapter 5 of this report.

3. Pursuant to subsection 23(1)(c) of the Securities (Insider Dealing) Ordinance Cap. 395, Mr. Huo Sheng Pu shall pay a penalty of $16,500,000.

4. Pursuant to section 27 of the Securities (Insider Dealing) Ordinance Cap. 395, Mr. Huo Sheng Pu shall pay $315,695; being the expenses of and incidental to the inquiry and the investigation of his conduct or affairs made for the purpose of the inquiry.

5. The sums ordered to be paid under subparagraphs (2), (3) & (4) above shall be paid by Mr. Huo Sheng Pu to the Government of the Hong Kong Special Administrative Region of the Peoples' Republic of China within 4 months of the date of this order.

Acknowledgements

The Chairman wishes to thank the two Tribunal members, Mr. Joseph Hui Sik Wing and Mr. John Ng Chi Wing for their invaluable assistance during the Inquiry and in the preparation of this report.

The Tribunal wishes to thank Mr. Davies & Mrs. Ho Ng (counsel to the Tribunal) Mr. Imrie & Mr. Goh (Mr. Huo's solicitors) and Mr. Alex Pang (the expert witnesses). Their assistance was highly professional and thorough.

We are grateful also for the reliable and efficient support rendered by the Tribunal's staff, Lindy Williams Ltd (the court reporters) and the interpreter.

Signed:

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The Hon Mr. Justice Lugar-Mawson
Chairman

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Mr. Joseph Hui Sik Wing
Member

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Mr. John Ng Chi Wing
Member

Dated: Friday, 2 November 2001