REPORT OF THE

INSIDER DEALING TRIBUNAL

OF HONG KONG

On whether insider dealing took place
In relation to the listed securities of

CHINESE ESTATES HOLDINGS LIMITED

Between November 19-21 1996 (both days inclusive)
and on other related questions

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CHAPTER ONE

INTRODUCTION

a. *A brief historical perspective*

At all times relevant to this report Chinese Estate Holdings Limited ('Chinese Estates{ XE "Chinese Estates:share capital" \b }') was a public company listed on the Stock Exchange of Hong Kong with an issued share capital of 1,925,696,293 shares. As its name states, it was a holding company conducting business through its various companies within the group. In this report, however, for convenience, the group activities will be described as those of Chinese Estates.

While Chinese Estates{ XE "Chinese Estates:business" \b } was engaged in the business of securities investment and, to a lesser degree, money lending, its principal business, both here in Hong Kong and on the Mainland, was that of property investment, property development and property management. It was this field of commercial endeavour which constituted the company's core business and which generated greatest revenue.

The Chairman and an executive director of Chinese Estates was at all material times Joseph LAU Luen-hung ('Mr. Joseph LAU{ XE "Joseph LAU:executive director" \b }') who in the company's annual report of 1995 was described in the following terms :

> "Mr. LAU directed the development of the Group from a manufacturing company in 1985 to a real estate development and investment holding company. He has over 20 years of experience in corporate finance, property investment and development."

Mr. Joseph LAU's younger brother (by 2 years) was Thomas LAU{ XE "Thomas LAU:executive director" \b } Luen-hung ('Mr. Thomas LAU'). He was also an executive director of Chinese Estates, having been directly involved in the management of the company since the mid-1980s. It appears that by late 1996 Mr. Thomas LAU had for some time assumed principal responsibility for the day-to-day management of Chinese Estates, the final decision on strategic decisions being left to Mr. Joseph LAU.

In or about July 1993, Chinese Estates completed the redevelopment of a site owned by it in Hong Kong's central business district. The new property built on that site was called Entertainment Building{ XE "Entertainment Building:central business district" \b }. It was a commercial building of accepted architectural distinction which, above basement level, contained a 6-level retail podium and 26 floors of office space. According to Chinese Estates, the 'historic cost' of acquiring the site and redeveloping it had been approximately $453.6 million.

Entertainment Building{ XE "Entertainment Building:historic cost" \b } constituted one of the major 'investment properties' in Hong Kong of Chinese Estates. Together with Windsor House{ XE "Windsor House" \b }, Evergo House{ XE "Evergo House" \b }, Harcourt House{ XE "Harcourt House" \b } and the Silvercord Shopping Arcade{ XE "Silvercord Shopping Arcade" \b } it generated 'the core recurrent income'[1] of the group. Indeed, for the year ending 1996, rental income from these major 'investment properties' contributed 93.4% of the company's total rental income. It should be added that Entertainment Building was the company's only major 'investment property' in Central.

Property *investment* had always formed the most substantive part of the business of Chinese Estates. But in the company's 1995 annual report, in his Chairman's Statement, Mr. Joseph LAU wrote that Chinese Estates planned to increase its property *development* activities and to this end, when appropriate, would continue to dispose of its 'non-core' properties[2].

It appears that a number of professional stock market analysts were aware of this change of business direction. In September 1996, in a document that was circulated to clients, research analysts at Credit Lyonnais Securities{ XE "Credit Lyonnais Securities" \b } (Asia) Limited commented that Chinese Estates had raised a substantial amount of cash by disposing of, among other things, certain floors in one of its major investment properties, Harcourt House{ XE "Harcourt House" \b }. Two months later, on 15th November 1996, in the first draft of a similar research circular written after a

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1 See : Chinese Estates annual report for 1995, page 14.

2 See : Chinese Estates annual report for 1995, page 16.

visit to Chinese Estates, the same analysts commented :

> "… the company has also begun to extend its tentacles into the realm of residential property development. The company is making the transformation from a property investor to an amalgamated property company. With the outlook for office leasing remaining at best neutral to mildly positive, the company is capitalising on the buoyant sentiment in the sales market to lock in the capital gains on its properties. Not only will such disposals shore up profits in the financial year 1996 and financial year 1997, the enhanced financial position will enable the company to boost its development landbank."

Drawing inferences from what had been said during the company visit, the analysts thought it proper to make the following additional comment :

> "With the outlook for the office market likely to be clouded by the expected pick-up in supply post-97, a significant breakthrough in rents is unlikely. Management has expressed its willingness to further sell down its investment properties, including landmark property Entertainment Building, in order to invest in higher-yielding projects."

As an inference, it proved to be prophetic. On 22nd November 1996, a week later, Chinese Estates announced in the press that it had entered into a provisional sale and purchase agreement for the sale of the entire issued share capital of its subsidiary company which owned Entertainment Building**{** XE "Entertainment Building:sale and purchase" \b **}**. The purchaser was another public company listed on the Hong Kong Stock Exchange**{** XE "Hong Kong Stock Exchange" \b **}**, Hysan Development Company Limited ('Hysan**{** XE "Hysan:purchaser" \b **}**'). The cash consideration was $3,640 million, consisting of an initial deposit of $50 million paid upon signing of the agreement, a further deposit of $310 million to be paid on 3rd December 1996 and the balance due upon completion which was stipulated to be 20th May 1997. In terms of that agreement, therefore, Chinese Estates had disposed of Entertainment Building**{** XE "Entertainment Building:tenancy" \b **}** as an entire unit. It is not disputed that at that time in Hong Kong the sale of an entire building of such physical magnitude in such a prime location was unusual and, as such, stirred market interest.

For Chinese Estates the sale of Entertainment Building constituted a discloseable transaction under the Listing Rules of the Hong Kong Stock Exchange{ XE "Hong Kong Stock Exchange" \b }. Accordingly, a press announcement was made which, in part, stated that an explanatory circular would be sent to shareholders. A copy of that announcement is attached to this report as Annexure A.

On the basis of a professional property valuation made on 31st December 1996, Entertainment Building constituted some 15.1% of the total value of Hong Kong investment properties owned by Chinese Estates.

Hysan at that time considered that it had made a good buy. In its board resolution of 25th November 1996 approving the acquisition at the price of $3,640 million, the management explained the motive for the purchase in the following terms :

> "With the redevelopment of the Lee Garden approaching completion, there is few sizeable investment opportunity available in Causeway Bay. In order to maintain growth of the Group, investment opportunities in other locations have to be considered …
>
> The acquisition is a rare opportunity which timely fits with our long-term investment strategy. Entertainment Building provides us with a unique opportunity to acquire an exquisite building at a prime location where the investor can acquire en-bloc and have control on the management of the building."

As for the price paid, the following was said :

> "The total gross floor area of the building is 211,129 square feet and the consideration is equivalent to about HK$17,000 per square foot. As the gross floor area includes a portion of retail space within the Building, the average consideration for the office space is about HK$15,000 per square foot and HK$24,000 per square foot for the retail area."

The management of Hysan considered the price paid to be justified because of the building's prime location, its excellence of design, its recent

construction and because the price paid for the office area was comparable to recent strata sales in another Central building{ XE "Central building" \b }; namely, 9 Queen's Road Central.

In respect of Hysan{ XE "Hysan:notification of purchase" \b } it should be mentioned that on 22nd November 1996 it sent notification of its acquisition to the Hong Kong Stock Exchange{ XE "Hong Kong Stock Exchange" \b }. The letter concluded with the following paragraph :

> "The Board of Directors of Hysan has exercised its due care to ensure that the transaction is kept strictly confidential and does not consider the transaction to be price sensitive information."

Of course, assuming for the moment that in respect of Hysan the information was not price sensitive, it does not necessarily follow that the same would apply in respect of Chinese Estates, the vendor.

The sale of Entertainment Building was the single event which has been at the centre of this inquiry. Information concerning this sale has been alleged to constitute the inside information which should have prohibited trading by those in possession of it before it came into the public domain. Concerning the sale, in addition to the vendor and the purchaser, one other party was intimately involved; namely, the broker who brought the parties together. The broker in this case was a man named Johnson LAM{ XE "Johnson LAM:Nation Properties Ltd" \b } Yee-ming ('Mr. Johnson LAM') who, together with his wife and one brother, was the director of a limited liability company called Nation Properties Limited.

Mr. Johnson LAM entered the property field in the early 1980s as a salaried employee but later went into business for his own benefit. Although modesty prevented him from making any such admission, it appears that he had prospered in the highly competitive field of property broking. He was respected as an effective operator. During the course of the inquiry, one witness referred to him as being 'famous'.

According to the uncontested evidence, prior to November 1996, Mr. Johnson LAM had had no business dealings with Chinese Estates nor with either of the LAU brothers, Joseph and Thomas. They were, however,

known to each other by reputation and there appears to have been some nodding acquaintanceship by reason of earlier introductions at social functions. Mr. Johnson LAM was better known to LEE Hon-chiu ('Mr. H.C. LEE{ XE "H.C. LEE:chairman and director" \b }'), the Chairman and Managing Director of Hysan. He had in the past assisted a relative of Mr. H.C. LEE to sell a property and had, in addition, put a number of property-related proposals to him but without success.

Although the chronology of events will be considered in detail later in this report, in broad terms it appears that, at or about the end of October 1996, Mr. Johnson LAM spoke on the telephone to Mr. Thomas LAU and during the conversation asked if the Chinese Estates was considering or would consider the sale of Entertainment Building. Mr. Thomas LAU indicated that a sale would be considered if the price was right. A week or so later Mr. Johnson LAM obtained information on Entertainment Building including a tenancy schedule. He then began to exploit his connections in an attempt to find a buyer. Initially, however, he was not successful.

By reputation at least - rightly or wrongly - Hysan was considered by some in the market at that time to be a conservative company concerned essentially with properties in its traditional geographical area of business; namely, the environs of Causeway Bay. According to Mr. Johnson LAM, he shared this view. He did not consider Hysan a likely purchaser of Entertainment Building. For this reason, it was only on the afternoon of 18th November 1996 that he contacted Mr. H.C. LEE to ask if Hysan may be interested in the acquisition of Entertainment Building at a price in the range of $3,500 to $3,600 million. Mr. H.C. LEE indicated that Hysan was interested but would require more information about the building - such as a detailed tenancy schedule - in order to consider the matter. That same evening Mr. Johnson LAM faxed a tenancy schedule to Hysan.

The following morning; that is, on the morning of 19th November 1996, Hysan began seriously to consider the purchase of Entertainment Building. Negotiations then ensued with Mr. Johnson LAM taking an active role as broker. At this time Hysan believed (erroneously, it seems) that there were other interested purchasers in the market. This may be one of the reasons to explain why the negotiations proceeded at such a brisk pace.

During the evening of the following day – 20th November 1996 – the respective negotiating teams met at the offices of Messrs. Sit, Fung, Kwong & Shum, the solicitors acting for Chinese Estates, and at around midnight or into the early hours of 21st November a provisional agreement for the sale and purchase of the physical building (as opposed to the issued share capital of the proprietary company) was signed. Mr. Thomas LAU signed on behalf of the vendor; Mr. Joseph LAU was not present. The agreed purchase price was $3,600 million.

In circumstances which will be considered later in this report, it was then agreed that negotiations would take place later in the working day (21st November) to see if the nature of the agreement could be changed to one in terms of which the issued share capital of the proprietary company would be purchased together with directors' loans. As indicated earlier, those negotiations were successful and a second provisional agreement was signed during the afternoon of 21st November. The formal announcement (Annexure A) was published the following day.

b. ***The interest of the Securities and Futures Commission***

By January 1997 the Securities and Futures Commission ('SFC{ XE "SFC" \b }') was actively investigating the dealings in the securities of Chinese Estates which had taken place during the several days leading up to the formal announcement to the public of the sale of Entertainment Building. The SFC investigations came to focus on two persons : Mr. Joseph LAU, the Chairman of Chinese Estates, and Mr. Johnson LAM, the broker. To understand why this should be so it is necessary in brief terms to look at the relevant securities dealings of these two gentlemen.

(i) *The share dealings of Mr. Joseph LAU{* XE "*Joseph LAU:*share dealing" \b *}*

History reveals that in respect of the listed securities of Chinese Estates, from 1994 through until early 1998, Mr. Joseph LAU was a consistent purchaser rather than a seller. In this regard he caused listed securities to be purchased in his own name but also in the name of companies wholly owned and/or controlled by him.

In particular, he caused listed securities to be purchased in the name of Golden Game Overseas Limited{ XE "Golden Game Overseas Limited" \b }, a private limited company incorporated in the British Virgin Islands. Golden Game Overseas Limited was the holding company of Golden Game Limited{ XE "Golden Game Limited" \b }. Mr. Joseph LAU was a director of Golden Game Overseas Limited which itself was the trustee of a trust incorporated essentially for ultimate the benefit of himself and family members. Mr. Joseph LAU's interests in these and associated companies and trusts was regularly declared, in terms of the Securities (Disclosure of Interests) Ordinance{ XE "Securities (Disclosure of Interests) Ordinance" \b }, Chapter 396, in the annual reports of Chinese Estates.

The annual report of Chinese Estates for the year ended 31st December 1996 revealed that, either personally, or through his corporate interests or through his interest in the family trust, Mr. Joseph LAU held 1,139,672,327 shares of the company together with 388,120,000 covered warrants issued in respect of the company. It is not disputed that this then represented 59.19% of the company's total issued share capital.

The fact that at the material time there were in issue various covered warrants became a matter of considerable significance during the course of the inquiry. More will be spoken of them later in this report. At this juncture, however, it should be said that in November 1996 (the month in which Entertainment Building was sold) there were four separate covered warrant{ XE "covered warrant:stock code 1725" \b }{ XE "covered warrant:stock code 928" \b }{ XE "covered warrant:stock 901" \b }{ XE "covered warrant:stock code 560" \b } issues in existence. They may be summarised as follows :

(i) Credit Lyonnais Financial Products (Guernsey) Limited (stock code 560) – 520 million warrants with an exercise price of $5.44 expiring on 31st January 1997.

(ii) Merrill Lynch International & Co. C.V. (stock code 901) – 975 million warrants with an exercise price of $5.84 expiring on 31st January 1997.

(iii) Peregrine Derivatives Limited (stock code 928) – 600 million warrants with an exercise price of $6.20 expiring on 16th June 1997.
[This issue of covered warrants contained a 'cash option' in terms of which Peregrine was entitled to give to warrant holders either Chinese Estates shares or their equivalent in cash.]

(iv) Merrill Lynch International & Co. C.V. (stock code 1725) – 580 million warrants with an exercise price of $5.44 expiring on 12th July 1997.

What then of Mr. Joseph LAU's trading in the listed securities of Chinese Estates in the weeks leading up to the sale of Entertainment Building and the public announcement of that sale?

The records indicate that from 26th September until the close of the Stock Exchange on 28th October 1996 Mr. Joseph LAU, who previously had been a regular purchaser, did not trade in any listed securities of Chinese Estates. It is not disputed that, having taken legal advice, he refrained from doing so in order to comply with the rules of the Hong Kong Stock Exchange**{** XE "Hong Kong Stock Exchange" \b **}**. This period of inactivity preceded the detailed announcement on 29th October 1996 of the company's separate listing of Evergo China which became the corporate vehicle for the company's Mainland property and investment activities. More will be said of what has been called 'the Evergo spin-off**{** XE "*Evergo spin-off*" \b **}**' later in this report. However, so that its broad concept may be understood, the following is a statement made in the 1996 annual report of Chinese Estates :

"The Group believes that the separate listing on the Stock

> Exchange of its PRC [Mainland] property interests through Evergo China provides investors with a clear alternative investment choice reflecting the different investment risks and return profile of the Group's Hong Kong and PRC [Mainland] property interests respectively."

From 29th October (when he was no longer prohibited from trading) until 22nd November 1996 when the announcement of the sale of Entertainment Building was made public, Mr. Joseph LAU was a purchaser only of securities in Chinese Estates. He made no sales. He purchased Chinese Estates shares but (for stated reasons to be considered later in this report) he also purchased the 2 covered warrants due to expire on 31st January 1997; namely, the Credit Lyonnais warrants (stock code 560) and the Merrill Lynch warrants (stock code 901). All purchases were made through Golden Game Overseas Limited**{** XE "Golden Game Overseas Limited" \b **}**.

A table detailing Mr. Joseph LAU**{** XE "Joseph LAU:daily share trading" \b **}**'s daily purchases during this time is attached to this report as Annexure B. The total of each day's trading is shown as a percentage of market turnover for that day.

On the basis that it was on 18th November 1996 that Mr. H.C. LEE of Hysan first expressed an interest to Mr. Johnson LAM in acquiring Entertainment Building the SFC**{** XE "SFC" \b **}** focused its attention on Mr. Joseph LAU's trading activities from that date until the close of the Stock Exchange in the evening before the public announcement of the sale of the building. During those 5 days Mr. Joseph LAU's purchase of the listed securities of Chinese Estates may be summarised as follows :

Date	Shares	Warrants (560)	Warrants (901)
18.11.96	-	17,720,000	28,680,000
19.11.96	-	28,800,000	20,440,000
20.11.96	9,356,000	42,560,000	35,800,000
21.11.96	-	61,120,000	126,160,000
Total	**9,356,000**	**150,200,000**	**211,080,000**

As for the movement of the price of the shares and the 2

covered warrants purchased by Mr. Joseph LAU between 18th and 21st November 1996, the SFC{ XE "SFC" \b } investigators noted a significant rise in both price and volume when compared with the previous months of that year.

In order to show the trading movements of the 3 listed securities, the following graphs and statistics are attached to this report :

Annexure C : Trading statistics of Chinese Estates shares from 1st April 1996 to 31st January 1997.

Annexure D : Graph of closing prices and daily trading volume of Chinese Estates shares from 1st April to 30th November 1996.

Annexure E : Graph of closing prices and daily trading volume of Chinese Estates shares for the months of October and November 1996 only.

Annexure F : Trading statistics of Credit Lyonnais warrants (#560) from 15th February 1996 to 30th January 1997.

Annexure G : Graph of closing prices and daily trading volume of warrants (#560) from 1st April to 30th November 1996.

Annexure H : Trading statistics of Merrill Lynch warrants (#901) from 28th February 1996 to 30th January 1997.

Annexure I : Graph of closing prices and daily trading volume of warrants #901 from 1st April to 30th November 1996.

An analysis of the statistics has revealed the following :

a. On 29th October 1996, when detailed proposals for the 'Evergo spin-off{ XE "*Evergo spin-off*" \b }' were made public, the price increased by only 2.84%, closing at $7.25.

b. After a dip, on 13th November the price began to rise. On that day it rose 20 cents to $7.20 with a turnover of 3,600,000 shares.

c. On 14th November there was a large increase in turnover to 19,230,000 shares. The price closed at $7.50.

d. Over the next 3 trading days the price increased. It closed on 19th November at $7.95. During these 3 days the average daily turnover was approximately 13,000,000 shares.

e. On 20th November the price increase by a further 3.77% to close at $8.25. Turnover was 19,800,000 shares.

f. On 21st November, the day before the sale of Entertainment Building was announced to the public, the price increase by a further 9.7% to close at $9.05, the largest one-day rise that year. On that day turnover increased to 36,000,000 shares.

g. In summary, from 13th to 21st November the price had increased 29.29% from $7.00 to $9.05.

For a broader views of market movements between 18th and 26th November 1996 (inclusive) a comparative graph is attached marked Annexure J. This shows the percentage change in the price of 5 property stocks, in addition to Chinese Estates, and also the movement of both the Hang

Seng Index{ XE "Hang Seng Index" \b } and the Hang Seng Property Index over that period of 7 days.

It became apparent during the inquiry that the 2 critical days under consideration were 21st and 22nd November 1996, the day before the announcement of the sale of Entertainment Building and the day of the announcement. The movement of Chinese Estates shares on those 2 days was analysed on a 5-minute basis. Graphs showing this analysis are attached as Annexures K (for 21st) and L (for 22nd).

The 5-minute graph of the share movement on the day of the actual announcement of the sale of Entertainment Building (Annexure L) shows that the price that day reached a high of $9.30 but then fluctuated for the rest of the day in the range of $9.05 to $9.20. As for the covered warrants, the daily trading statistics reveal that #560 actually fell 13.64% on that day (having risen 41.94% the previous day) while #901 fell 10.26% (having risen 44.44% the previous day). These statistics do not of themselves show a unanimously enthusiastic response by the market to the formal announcement of the sale of Entertainment Building.

However, the investigating authorities were of the view that the impact of the news had already been absorbed by the market on the day before the formal announcement; that is, on 21st November 1996, when news of the sale leaked to the market.

Expressed in the broadest terms, counsel to the Tribunal submitted on the basis of the SFC{ XE "SFC" \b } investigations that during the period from 18th to 21st November 1996 (inclusive) Mr. Joseph LAU must have been aware of the progress of negotiations for the sale of Entertainment Building, he must have been aware that the price to be achieved would set a new benchmark for properties in Central, that it would realise significant capital gains, indeed capital gains that were exceptional for Chinese Estates, and that if news of the impending sale was therefore known it would influence the ordinary reasonable investor who was accustomed or likely to deal in the securities of Chinese Estates to

buy those securities. As such, his knowledge of the impending sale constituted inside information and his continued purchasing constituted insider dealing.

(ii) *The share dealings of Mr. Johnson LAM{* XE "*Johnson LAM:*share dealing" \b *}*

Factually, the investigation into the share dealings of Mr. Johnson LAM fell within a much more simple compass. One set of dealings only was in issue.

It is not disputed that by November 1996 Mr. Johnson LAM had been an active trader in the Hong Kong share market for a good many years. He kept a monitor in his office to keep abreast of stock prices. The consultant through whom he had placed his orders for several years described him as a speculator in the market, a person who kept his shares for a limited period and then sold. It is not a description with which, in the main, Mr. Johnson LAM would take exception. In the latter part of 1996 at least, like many others, he maintained a margin account with the investment company through whom he dealt, that company being Sun Hung Kai Investment Services Limited.

Mr. Johnson LAM had not dealt in the securities of Chinese Estates for a considerable period of time, certainly not that year. However, on 19th November 1996, the day after he had spoken to Mr. H.C. LEE and had been requested to supply Hysan with information concerning Entertainment Building, he instructed Sun Hung Kai Investment Services to purchase for him one million Chinese Estate shares. Trading records indicate that he placed the orders at about 2:30 in the afternoon. The purchases were made at an average price of $7.95 per share. Trading records further indicate that on the afternoon of 22nd November 1996, the day of the formal announcement to the public of the sale of Entertainment Building, he sold those one million shares at a price of $9.10 per share. He thereby realised a profit of some $1,150,000.

Expressed again in the broadest of terms, counsel to the

Tribunal submitted on the basis of the SFC{ XE "SFC" \b } investigations that Mr. Johnson LAM must have been in possession of information unknown to the general market when he made his purchase; namely, information concerning the sale of Entertainment Building to Hysan, that he must have known that it was price sensitive information and must have made his purchase in light of that knowledge.

c. ***The constitution of the Tribunal{*** XE "***constitution of the Tribunal***" \b ***}***

On 26th September 1998, in light of the investigations carried out, the Financial Secretary{ XE "Financial Secretary" \b }, Donald Y.K. TSANG, required the Insider Dealing Tribunal to conduct on inquiry in order to determine whether in November 1996, insider dealing had taken place in relation to the listed securities of Chinese Estates. The notice from the Financial Secretary was issued pursuant to section 16(2) of the Securities (Insider Dealing) Ordinance{ XE "Ordinance:section 16(2)" \b }, Chapter 395 ('the Ordinance') and gave the following directions; namely, to inquire into and determine :

> "(a) whether there has been insider dealing in relation to Chinese Estates Holdings Limited arising out of the dealings in the listed securities of the company by (or on behalf of) Messrs. Joseph LAU Luen-hung and Johnson LAM Yee-ming during the period from 19th November 1996 to 21st November 1996 (both days inclusive);
>
> (b) In the event of there having been insider dealing as described in paragraph (a), the identity of each of every insider dealer; and
>
> (c) the amount of any profit gained or loss avoided as a result of such insider dealing."

In terms of the Ordinance, the 3 original members of the Tribunal were the following persons :

Chairman : The Hon. Mr. Justice Michael Hartmann{ XE

"Justice Michael Hartmann" \b **}**

Member : Felix CHOW Fu-kee (Hong Kong Certified Public Accountant, fellow of the Hong Kong Society of Accountants, Past President of the Hong Kong Society of Accountants, member of the Australian Society of Certified Public Accountants, fellow of the British Institute of Management) an alternate director and consultant to the Managing Director of First Shanghai Investments Limited and

Member : Eric NG Kwok-wai**{** XE "Eric NG Kwok-wai" \b **}** (Hong Kong Certified Public Accountant, fellow of the Hong Kong Society of Accountants, member of the Hong Kong Institute of Company Secretaries) practising professionally under the name of Eric Ng & Company.

Regrettably, on 7th January 1999, after the preliminary hearing had taken place but before the commencement of the inquiry itself, Mr. Felix CHOW Fu-kee was forced to tender his resignation**{** XE "resignation:Felix CHOW Fu-kee" \b **}** by reason of ill health. In his place, pursuant to paragraph 8 of the Schedule to the Ordinance, the Chief Executive, on 16th January 1999, appointed a temporary member; namely :

Simon LAM Siu-lun**{** XE "Simon LAM Siu-lun" \b **}** (Hong Kong Certified Public Accountant, Associate member of the Hong Kong Society of Accountants, associate member of the Institute of Chartered Accountants in England and Wales, fellow of the Taxation Institute of Hong Kong) practising professionally under the name of S.L. Lam & Company.

Thereafter the constitution of the Tribunal**{** XE "***constitution of the Tribunal***" \b **}** remained unchanged.

d. ***Legal representation{*** XE "***Legal representation***" \b ***}***

By formal letters dated 19th November 1998, the Tribunal appointed Mr. Peter Davies{ XE "Peter Davies" \b } to be its counsel together with Mrs. Winnie HO NG Wing-yee{ XE "Winnie HO NG Wing-yee" \b } who would assist him. Both counsel are from the Department of Justice.

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 legal representation.

Mr. Joseph LAU was represented in the inquiry by Mr. John Griffiths{ XE "John Griffiths" \b } SC, CMG, QC and Mr. Daniel Marash{ XE "Daniel Marash" \b } SC leading Mr. Kenneth CHOW{ XE "Kenneth CHOW" \b } and Mr. Boey CHUNG{ XE "Boey CHUNG" \b }. The instructing solicitors for Mr. Joseph LAU were Messrs. Richards Butler{ XE "Richards Butler" \b }

Mr. Johnson LAM was represented by Mr. Warren CHAN{ XE "Warren CHAN" \b } SC leading Mr. Christopher CHOI{ XE "Christopher CHOI" \b }. The instructing solicitors for Mr. Johnson LAM were Messrs. Fung & Lui{ XE "Fung & Lui" \b }.

One of the witnesses who gave evidence before the Tribunal chose to be legally represented. She was Miss Cleresa WONG Pie-yue{ XE "Cleresa WONG Pie-yue" \b }, a practising solicitor, who was represented by Mr. Peter Graham{ XE "Peter Graham" \b } instructed by Messrs. Wilkinson & Grist{ XE "Wilkinson & Grist" \b }, Solicitors.

e. ***The sending out of 'Salmon' letters{*** XE "***Salmon' letters***" \b ***}***

Pursuant to paragraph 17 of the Schedule to the Ordinance, it was the task of the Tribunal to determine whose conduct would be the subject of the inquiry or whether any person would be in any way implicated or concerned in the subject matter of the inquiry.

Based on information available at that time, the Tribunal identified only those two persons mentioned in the notice of 26th September 1998 signed by the Financial Secretary{ XE "Financial Secretary" \b }. Thereafter, in keeping with the practice adopted by previous Tribunals,

letters were served on those two persons. Those letters were of the kind commonly described as ‘Salmon’ letters{ XE "***Salmon’ letters***" \b } after Lord Justice Salmon{ XE "Lord Justice Salmon" \b } who in 1996, in the United Kingdom, sat as Chairman of the Royal Commission on Tribunals of Inquiry{ XE "Royal Commission on Tribunals of Inquiry" \b }. The purpose of the ‘Salmon’ letters was to give both persons advance notice that their conduct would be the subject matter of the inquiry. The letters had annexed to them an outline of the allegations made against them, such allegations being contained in a detailed case synopsis. The letters stressed, however, that the case synopsis was no more than a ‘guide’; the Tribunal would be free to investigate whatever matters it considered relevant in light of evidence led during the inquiry.

It should further be mentioned that the ‘Salmon’ letters{ XE "***Salmon’ letters***" \b } informed both implicated persons{ XE "implicated persons" \b } that the witness statements and documentary evidence from which the case synopsis had been drawn were available to them.

The ‘Salmon’ letters{ XE "***Salmon’ letters***" \b } were sent to both implicated persons on 11th November 1998. Both letters were, in substance, the same. A copy of the letter sent to Mr. Joseph LAU (which does not include the case synopsis) is attached to this report as Annexure M.

f. ***The Preliminary Hearing{*** XE "***Preliminary Hearing***" \b ***}***

A preliminary hearing was held on 24th November 1998 in the courtroom of the Tribunal in the Lippo Centre, Queensway.

The Tribunal said that ideally it would wish to begin the substantive hearing in early January 1999. However, the legal representatives of both Mr. Joseph LAU and Mr. Johnson LAM indicated that their clients were having difficulty obtaining the counsel of their choice in the limited time span available. For this reason the Tribunal extended the date of the commencement of the inquiry to Monday, 18th January 1999.

At the Preliminary Hearing{ XE "***Preliminary Hearing***" \b } an opening statement was made on behalf of the Tribunal by the Chairman. It is pertinent to record that, among other things, the following were stated :

(i) That the Tribunal carried out its work in an inquisitorial fashion rather than adversarial. It possesssed a broad discretion to receive and consider relevant material, whether by way of oral evidence, written statements, documents or otherwise. The Tribunal was not bound by the conventional rules of evidence that applied in adversarial proceedings.

In this regard it must, however, be emphasised that, while the Tribunal guarded its inquisitorial powers and the robust benefits of both speed and flexibility thus endowed, it was throughout the inquiry always conscious of the overriding need to ensure fairness. The guiding *dicta* came from the report of an earlier Tribunal[1] in which the following was said :

> "The need to be fair overrides everything. Thus, in inquisitorial proceedings the tendency to be flexible in matters of procedure and evidence-gathering stops when it ceases to be fair."

(ii) It was further stated that the role of counsel to the Tribunal was to present the evidence objectively regardless of which way it fell. Counsel, however, was not constrained to remain neutral throughout the inquiry. Where appropriate, he was entitled to employ his skills of advocacy to test and probe evidence. It was said that counsel to the inquiry would, of necessity, be involved in a large amount of administrative work, 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 counsel may from time to time have to meet with the Tribunal members in chambers. However, it was anticipated that once the inquiry commenced, such

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[1] See : Report of the Insider Dealing Tribunal in re : Hong Kong Parkview{ XE "Hong Kong Parkview" \b } Group Ltd., page 13.

meetings would be kept to the minimum necessary to ensure the orderly progress of the inquiry.

It is important to record, however, that, notwithstanding what had been said at the preliminary hearing, once the inquiry commenced there was in fact no need for any private meeting between counsel and the members of the Tribunal to discuss matters of law or substantive evidence (as opposed to administrative matters intended to secure the possible gathering of such evidence). When necessary, such matters were dealt with in open court. When, because of the dictates of time, administrative matters were dealt with by means of private communication, the details of such communication were subsequently announced in open court.

In this regard it is pertinent to note that on 27th January 1999, during the course of the inquiry, the Court of Appeal handed down judgment in respect of an earlier inquiry by the Insider Dealing Tribunal[1]. In that judgment, Mr. Justice Mortimer{ XE "Justice Mortimer" \b } made the following observations concerning the relationship between the Insider Dealing Tribunal and its counsel :

> "Mr. McCoy{ XE "McCoy" \b } agreed that it was permissible for counsel and the Tribunal to meet in private as often as necessary for the purposes outlined by the judge until the start of the inquiry. Thereafter, he submitted that there must be no private contract or meetings. For my part, I do not think that there can be an absolute rule of this nature. Obviously, the Tribunal should never meet with counsel privately and involve them in the judicial function or the decision-making process.

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[1] See : Dato Tan Leong and Tan Fo King v. the Insider Dealing Tribunal, Civil Appeal 162 of 1998.

> But there may be exceptional circumstances in which it is convenient for the Tribunal to meet counsel to discuss administrative matters or even a new line of inquiry after the hearings having begun. Such meetings should be kept to a minimum and the other parties should be told when the meetings are taking place and the nature of the discussion."

Prior to the handing down of that judgment, in accordance with the rules of general fairness, the Tribunal had, in fact, been following the spirit of the Mr. Justice Mortimer**{** XE "Justice Mortimer" \b **}**'s words. Upon receipt of the judgment, the Tribunal did its best to adhere to both their spirit and their letter.

(iii) At the preliminary hearing it was further stated that, in light of the fact that the cost of inquiries could for all parties be most substantial, the Tribunal encouraged those involved to use their best endeavours to achieve a balance between, on the one hand, not rushing the process of the inquiry and, on the other hand, not losing sight of the issues involved. To this end, it was stated that the Tribunal would encourage, for example, the drawing up of statements of agreed facts.

To this end, early in the process of the inquiry, the legal representatives were able to agree a considerable number of facts. Detailed statements of agreed facts were drawn up in respect of both Mr. Joseph LAU and Mr. Johnson LAM. These undoubtedly reduced the length of the inquiry and were of considerable assistance to the Tribunal in its deliberations.

g. ***Witnesses called{*** XE "***Witnesses called***" \b ***} during the inquiry***

A total of 25 witnesses were called to give evidence during the course of the inquiry. These included 5 expert witnesses. Those witnesses not called as experts were :

1. Winnie TANG Yuet-ngor;
2. LEE Hon-chiu;
3. Raymond CHAN Tat-kwan;
4. Felix CHAO;
5. Thomas LUI Kwong-hoi
6. WONG Kwong-ho;
7. Carmen WONG;
8. Henry LAM Wai-hon;
9. Phillis LOH Lai-ping;
10. Rosaline WONG Wing-yue;
11. Pauline WONG YU Wah-ling;
12. Patrick LEUNG Tai-loi;
13. Ellis CHONG Cheung-chu;
14. Mr. Thomas LAU Luen-hung;
15. Michael CHAN Yan-ming;
16. Cleresa WONG Pei-yue;
17. Joseph MAO Kam-shing;
18. Trevor CHEUNG Kwok-yuen;
19. Mr. Johnson LAM;
20. Mr. Joseph LAU.

As for the 5 expert witness**{** XE "expert witness" \b **}**, for ease of reference, a brief summary of their qualifications and experience is set out below rather than in the body of the report. The expert witnesses were :

1. Mr. Alex PANG**{** XE "Alex PANG" \b **}** (a director in the SFC**{** XE "SFC" \b **}**) who first joined Government in the field of securities and commodities in 1983. He has been with the SFC since its establishment in 1989 as head of the Surveillance Department of the Enforcement Division. He holds a diploma in advanced securities markets analysis.

2. Mr. Clive Rigby**{** XE "Clive Rigby" \b **}** (managing director of Lippo Securities Ltd.) who has over 30 years experience as a broker in the commodities futures trading industry and over 20 years experience as a broker in the securities industry.

He has been actively engaged in the Hong Kong financial market since the late 1970s.

3. Mr. Toby Heale{ XE "Toby Heale" \b } (managing director of Investor Information Ltd.) who also has over 30 years experience as a broker. He became a member of the London Stock Exchange in 1964 and has for many years been engaged in the Hong Kong financial market. Among other things, his present employment involves the provision of data analysis to stockbrokers.

4. Professor K.C. CHAN{ XE "K.C. CHAN" \b } (Head of the Finance Department at the University of Science and Technology and Associate Dean of its School of Business and Management) who received his Ph.D. in finance from the University of Chicago in 1985 and taught in the USA before returning to Hong Kong in 1993. He has been published in leading academic journals on various issues related to financial markets.

5. Mr. Richard Arthur Witts{ XE "Richard Arthur Witts" \b } (managing director of United Mok Ying Kie Ltd.) who is by profession a chartered accountant and was for 9 years secretary and general manager of the Hong Kong Stock Exchange{ XE "Hong Kong Stock Exchange" \b } before entering the Hong Kong stockbroking profession. He has served on the Council of the Hong Kong Stock Exchange.

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

The inquiry commenced, as scheduled, on Monday, 18th January; the evidence was completed and all submissions made by Friday, 12th March 1999. During this time the Tribunal sat on 28 days. Although, as a matter of practice, the Tribunal only sat in the mornings to enable the Tribunal members to attend to their working obligations in the afternoons, when it was necessary to accommodate witnesses or speed up the progress of the inquiry the Tribunal sat full days.

CHAPTER TWO

THE LAW

This chapter is divided into three parts. In Part One a number of general legal principles are canvassed, these being principles which the Tribunal found to be of importance in the course of its deliberations. In Part Two the relevant provisions of the Ordinance are studied while in Part Three, because of its importance to this inquiry, the meaning of 'relevant information{ XE "relevant information" \b }' (as defined in section 8 of the Ordinance{ XE "Ordinance:section 8" \b }) is considered.

Paragraph 13 of the Schedule to the Ordinance states that :

> "Every question before the Tribunal shall be determined by the opinion of the majority of the members except a question of law which shall be determined by the chairman."

Accordingly, whenever in this report a decision on a matter of law is referred to in terms indicating that it is a decision of the Tribunal it must be understood that it has been a decision made on the direction of the Chairman. Paragraph 13 is unambiguous concerning all other questions which, of course, include all questions of fact.

PART ONE : GENERAL LEGAL PRINCIPLES

a. *The standard of proof{* XE "*standard of proof*" \b *}*

At the preliminary hearing on 24th November 1998, during the course of the Chairman's opening statement, the following was said concerning the standard of proof which would be used in the inquiry :

> "The standard of proof applicable in these proceedings is a civil standard. But that is not to say that it is a standard of a mere balance of probabilities. Allegations of insider trading are akin to allegations of professional misconduct involving deceit or moral turpitude and, as such, demand a higher standard than that, though the standard will not be so high as beyond a reasonable doubt, which is the standard applied in criminal matters. Unless submitted otherwise by counsel and/or

> solicitors appearing before this Tribunal and accepted by it, the Tribunal shall adopt the standard of proof to a high degree of probability."

At the commencement of the inquiry, Mr. Griffiths indicated that he would in his final submissions be arguing that the Tribunal should adopt the standard applied in criminal cases; that is, the standard of beyond a reasonable doubt. Detailed submissions were, in fact, made and were adopted by counsel for Mr. Johnson LAM. In the result, therefore, both implicated persons submitted that the burden of proof provisionally stated by the Tribunal during the preliminary hearing was too low and should be the criminal standard.

The Ordinance was enacted in 1990. The first inquiry conducted under this new legislation concerned Success Holdings{ XE "Success Holdings" \b } Limited and took place in 1994. At the commencement of the substantive hearing in that inquiry, Stock J{ XE "Stock J" \b }. (Chairman of the Tribunal) heard detailed argument on the standard of proof and gave a considered ruling ('the Success Holdings ruling') in which he stated that the burden of proof placed upon counsel to the Tribunal in that inquiry was a civil standard but was higher than a mere balance of probabilities. It was his ruling that proof must be to a high degree or probability. To this Tribunal's understanding, the same standard of proof has been adopted by all subsequent Tribunals.

In reviewing the origins of the new legislation, Stock J{ XE "Stock J" \b }. noted that, although other jurisdictions had made insider dealing a criminal offence (often visited with condign punishment such as lengthy terms of imprisonment), it had *not* been made a criminal offence in Hong Kong. The Hong Kong Legislature, while stopping short of criminalisation, had nevertheless sought to ensure that insider dealers were stripped of their gains and made liable to significant penalties. As to the nature of the proceedings dictated by the Ordinance, Stock J. had no hesitation in deciding that they were not criminal. On page 7 of his ruling, he wrote :

> "There is no criminal offence alleged. There is no indictment. There is no prosecutor. The rules of evidence which pertain to criminal proceedings do not apply. That is not to say that the consequences which flow from an adverse finding are not in the nature of a penalty.

> But that fact of itself does not so colour the proceedings as to turn them into criminal proceedings properly so called. It is true that all conduct classified by law as criminal carries as a consequence liability to a penalty. But the converse is not necessarily true – in other words, liability to a penalty does not necessarily mean that the conduct giving rise to the penalty is criminal. The essence of the matter is that these are not proceedings which in themselves might or could result in the conviction for a criminal offence of any person whose conduct is the subject of examination."

In his submissions, Mr. Griffiths did not take issue with this finding as to the fundamental nature of the proceedings. As the Tribunal understood his argument, it was, however, that insider dealing is regarded essentially as fraudulent conduct and that an adverse finding against an implicated party has consequences far graver than a simple monetary penalty. They include possible disqualification from directorships and severe damage to reputation. Accordingly, in cases of such gravity for those against whom adverse findings are made, the civil standard should, in principle, approximate to the criminal and, to avoid the difficulties of leaving the burden 'somewhere undefined between the criminal and civil standards', the burden should, in practice, be the criminal standard.

In support of his submissions, among other authorities, Mr. Griffiths referred to the *dicta* of Kempster J.A**{** XE "Kempster J.A" \b **}**. in **Attorney General v. TSUI Kwok-leng{** XE "**Attorney General v. TSUI Kwok-leng**" \b **}** [1991] HKLR 40 at page 45 :

> "Generally in civil proceedings, which, in our opinion, must include those conducted within the parameters of the Police (Discipline) Regulations, it remains good law that the civil standard of proof obtains albeit when considering, for example, an allegation of fraud, a higher degree of probability will be required than when considering an allegation of negligence. The degree of probability, falling short of satisfaction beyond all reasonable doubt, must be commensurate with the occasion even when the liberty of the subject is at risk. In cases of great gravity and in the realm of vendor and purchaser of land the civil standard may well approximate to the criminal."

As to the difficulties to be encountered by thus leaving the burden somewhere undefined between the criminal and the civil or only approximating to one, Mr. Griffiths urged the Tribunal (which consists of two members who are not necessarily legally trained) to adopt the ‘common sense’ approach of the English Court of Appeal in **In re a Solicitor{** XE "**In re a Solicitor**" \b **}** [1992] 2 WLR 552 in which Lord Lane C.J**{** XE "Lord Lane C.J" \b **}**. said (at page 562) :

> “It seems to us, if we may respectfully say so, that it is not altogether helpful if the burden of proof is left somewhere undefined between the criminal and the civil standards. We conclude that at least in cases such 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. This would seem to accord with decisions in several of the Provinces of Canada.”

It should be noted that when reference was made to ‘cases such as the present’ the Court of Appeal was then considering the conduct of a solicitor accused of swearing an affidavit in order to obtain a divorce knowing that it contained material falsehoods which at the divorce hearing itself were verified by that solicitor or at least not corrected. The conduct in question, therefore, was tantamount to the criminal offence of perjury or attempting to pervert the course of public justice. When referring to decisions in several of the Provisions of Canada, the Court of Appeal referred specifically to **In re Shumiatcher and Law Society of Saskatchewan{** XE "**In re Shumiatcher and Law Society of Saskatchewan**" \b **}** (1966) 60 D.L.R. (2d) 318, where the following passage appears, at p. 328 :

> “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. In the assessment of the evidence, the solicitor’s explanation should be accepted if there is reasonable probability of it being true.” [The Tribunal’s italics]

In this passage, it is stated that evidence establishing culpability beyond a reasonable doubt is required when, in civil disciplinary proceedings, a criminal act is alleged (or an act at least tantamount to a criminal act). This therefore begs the questions : can it be said that the conduct of implicated persons which is reviewed by an Insider Dealing Tribunal pursuant to the provisions of the Hong Kong Ordinance is conduct which is criminal or is at least tantamount to being criminal?

In this Tribunal's judgment, whatever may be the case in other jurisdictions, the fact remains that in Hong Kong insider dealing is not a crime. Can it then be said to be conduct which is tantamount to being criminal because it is essentially fraudulent conduct? That of itself leads to a study of the nature of insider dealing.

It is by no means agreed by academics or professionals in the financial field *why* such conduct should be regulated. In her publication, *Insider Dealing* (2nd edition, published by Longman, United Kingdom) Brenda Hanningan**{** XE "Brenda Hanningan" \b **}** has written at page 6 :

> "An initial difficulty in terms of justifying regulation is that it is not easy to identify an individual victim of the insider; indeed, it is frequently asserted that this is a victimless crime. This may not be the case if the insider dealing has occurred in a face to face transaction where it may be possible to establish some misrepresentation, some deliberate inducement to the other party (hereafter referred to as an outsider) to deal on the part of the insider. However, most insider dealing takes place on impersonal, anonymous stock exchanges where it is impossible to establish any relationship between the insider and the outsider other than the coincidental one of having both been in the market at the same time…
>
> However, even though it is not possible to show a direct causal link between the activities of the insider, the decision of the outsider to deal, and the loss incurred, it might still be possible to regard the outsider as a victim in the sense that he is a victim of an informational advantage possessed by other people in the market, of which he is ignorant, and which he could not have obtained. This, it is argued, is contrary to the idea of market egalitarianism which requires that all investors trading

> on impersonal exchanges should have relatively equal access to material information. The regulatory aim should therefore be ensure, as far as practically possible, that the market operates freely on the basis of equality between buyer and seller."

Other authors (as Stock J{ XE "Stock J" \b }. pointed out in the Success Holdings{ XE "Success Holdings" \b } ruling) have emphasised the abuse of confidential information and the abuse of trust which so often – but not invariably – accompanies insider dealing. Perhaps in such instances there may be some broad comparison with fraudulent conduct. But insider dealing, as a wrong under our legislation, is not restricted to fiduciaries.

In their publication, *Insider Crime – the New Law{* XE "*Insider Crime – the New Law*" \b *}* (Jordan Publishing, Bristol) the authors, Rider and Ashe{ XE "Rider and Ashe" \b }, attempt to sum up the motive for regulating insider dealing by saying :

> "… the main (if not only) convincing justification for controlling insider dealings is that it has a perceived, adverse impact on confidence. It does not matter, according to this view, whether insider dealing has a detrimental effect on the operation of the markets or the fortunes of issuers because, if enough opinion-forming individuals consider that it is wrong … insider dealing will alienate investors and potential investors, with adverse consequences for society as a whole. Most people would agree that stock markets, whether of the traditional or electronic variety, are efficient in allocating capital. For such markets to operate effectively and without inhibition, they require confidence and respect from their own societies and, increasingly, from the international community."

In short, there appear to be a variety of reasons why many jurisdictions, especially those with large and sophisticated financial markets, deem it necessary to regulate insider dealing and those reasons are not necessarily consistent with fraudulent conduct on the part of those who are culpable. Indeed, speaking generally, the determining motives appear more to be a desire to maintain confidence in the market place by not allowing those in possession of inside information to 'steal a march' on those who are not so advantaged.

As a civil wrong in Hong Kong, insider dealing would appear to be *sui generis*{ XE "*sui generis*" \b }. While, therefore, it may be conduct which is subject to penalty and while it may be conduct which attracts public reproach, the Tribunal does not accept that it is necessarily tantamount to fraudulent conduct. In this regard, the Tribunal agrees with the conclusions of Stock J{ XE "Stock J" \b }. in the Success Holdings{ XE "Success Holdings" \b } ruling (at page 20) :

> "These proceedings are not criminal proceedings. They are, or are in the nature of, civil proceedings. The allegation of insider dealing in this case is not an allegation of a crime, nor is it tantamount to such an allegation."

Stock J{ XE "Stock J" \b }. ruled that the standard of proof to be applied was therefore the civil standard which, because of the serious issues and equally serious consequences, was to be higher than a mere balance of probabilities though not as high as the criminal standard. As already mentioned, in respect of the questions posed by the terms of reference then before his Tribunal, Stock J. ruled that the standard of proof required to be met by counsel to that inquiry would be proof to a high degree of probability.

Again, as already mentioned, in essence, the Success Holdings{ XE "Success Holdings" \b } ruling has been followed by all subsequent Tribunals. In the Hong Kong Parkview{ XE "Hong Kong Parkview" \b } Group inquiry (conducted in 1996/1997) Burrell J{ XE "Burrell J" \b }. ruled that the standard of proof to a high degree of probability should remain the same throughout an inquiry even though allegations against one implicated person may be more serious than against another or the consequences more draconian in respect of one person than another. On page 19 of the report, the reasoning was expressed in the following terms :

> "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."

It is accepted, of course, that this Tribunal is not bound by decisions on the appropriate standard of proof made by earlier Tribunals. However, consistency of approach in matters of this nature is desirable. As Stock J{ XE "Stock J" \b }. remarked in the Success Holdings{ XE "Success Holdings" \b } report (at page 5) :

> "It is said that this ruling is of potential significance because this is the first inquiry under the Ordinance and that it should be taken as read that once the appropriate approach is set, it is an approach which will hold good for all future inquiries. That will be of assistance not only to those against whom allegations are made, but also to the regulatory authorities and their investigators."

Following on this, Burrell J{ XE "Burrell J" \b }. commented in the Chevalier International{ XE "Chevalier International" \b } inquiry report (at page 24) :

> "In addition it is desirable, although not essential, that there is consistency between one inquiry and another. In all previous inquiries [under the Ordinance] 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."

Although a tribunal of inquiry constituted under the Ordinance may not be a court, it nevertheless performs a judicial function. Therefore, in approaching the question of consistency, assistance may be gathered from the principles applicable to decisions of co-ordinate courts. In this regard, *Halsbury's Laws of England*{ XE "*Halsbury's Laws of England*" \b }, 4th Edition, Volume 26 at paragraph 580 reads :

> "There is no statute or common law rule by which one court is bound to abide by the decision of another court of co-ordinate jurisdiction. Where, however, a judge of first instance after consideration has come to a definite decision on a matter arising out of a complicated and

> difficult enactment, the opinion has been expressed that a second judge of first instance of co-ordinate jurisdiction should follow that decision, and the modern practice is that a judge of first instance will as a matter of judicial comity usually follow the decision of another judge of first instance unless he is convinced that that judgment was wrong."

This Tribunal is not convinced that the standard of proof to a high degree of probability adopted by the earlier Tribunals was wrong. Indeed, it is satisfied that it is the appropriate standard, both in general principle and having regard to the factual situation that surrounds the allegations made in this particular inquiry. Accordingly, for this inquiry, the Tribunal adopted that standard and conducted its deliberations on the basis that it remained the same standard throughout.

Finally, for the sake of completeness, it should be recorded that the Tribunal was always aware in the course of its deliberations that no onus (or burden) of proof lay upon either Mr. Joseph LAU or Mr. Johnson LAM and if it may have done so in terms of sections 10(3) and 10(4) of the Ordinance{ XE "Ordinance:section 10(3)" \b }, such onus would be discharged on a balance of probabilities only.

b. ***Consideration of factual evidence***

The considerable benefit of an Insider Dealing Tribunal consisting of three members, two of whom are drawn from Hong Kong's business and professional community is that those two members bring to the Tribunal a wealth of relevant experience and expertise. As Burrell J{ XE "Burrell J" \b }. commented in an earlier report[1]:

> "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."

Indeed the two members of this Tribunal who are drawn from the community are both accountants with first hand experience of Hong Kong's

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[1] See Hong Kong Parkview{ XE "Hong Kong Parkview" \b } Group Ltd. report, page 21.

financial markets; both manage their own professional organizations. In such circumstances, the Tribunal has warned itself not to use such professional knowledge and experience in place of evidence called. In this regard the applicable principles are set out clearly in **Wetherall v. Harrison{** XE "**Wetherall v. Harrison**" \b **}** [1976] QB 773 which involved a consideration of how far members of a bench of justices may make use of their own specialist knowledge in a trial matter before them, one of the members being a medical doctor. Lord Widgery C.J**{** XE "Lord Widgery C.J" \b **}**. said (at page 778) :

> "So I start with the proposition that it is not improper for a justice who has special knowledge of the circumstances forming the background to a particular case to draw on that special knowledge in interpretation of the evidence which he has heard. I stress that last sentence, because it would be quite wrong if the magistrate went on, as it were, to give evidence to himself in contradiction of that which has been heard in court. He is not there to give evidence to himself, still more is he not there to give evidence to other justices; but that he can employ his basic knowledge in considering, weighing up and assessing the evidence given before the court is I think beyond doubt."

c. ***The drawing of inferences***

The Tribunal has warned itself that it may not base its findings on conjecture or speculation, no matter how 'educated' or 'informed' that conjecture or speculation may be. An inference may, of course, be drawn from the evidence provided that the evidence consists of primary facts which have been admitted or proved to a high degree of probability and the inference is a compelling one and is the only reasonable inference which can be drawn from those primary facts.

d. ***Good character***

In past inquiries, where applicable, the Insider Dealing Tribunal has, during the course of its deliberations, taken into account the good character of those implicated persons who were the subject of those deliberations. This Tribunal has done so too.

Neither Mr. Joseph LAU nor Mr. Johnson LAM have criminal convictions recorded against their names; there has been no evidence of them being condemned by any professional or disciplinary body. Indeed the Tribunal noted that Mr. Joseph LAU had in the past refrained from dealing in the securities of Chinese Estates at such times as the Stock Exchange Rules prohibited such dealing. There were suggestions made during the inquiry that historically Mr. Joseph LAU may not have been a favourite of shareholders or potential investors because he was seen in some eyes, prior to 1994, to be parsimonious in the award of dividends and it appears that his rights issues were not popular with a section of investors. However, the fact that Mr. Joseph LAU, because of his management decisions, may not at times have been a favourite of shareholders or potential investors is irrelevant to the question of good character. Accordingly, in respect of *both* men, the Tribunal has directed itself that their good character was relevant in two ways. First, it bolstered their credit in deciding what weight to attach to the evidence they gave before the Tribunal and, second, it established that, because both had remained of good character throughout their lengthy and successful careers, they were the less likely as a result to commit the civil wrong of insider dealing.

e. ***Demeanour***

During the course of final submissions counsel to the Tribunal spoke of the importance of demeanour in assessing the credibility of a witness. While, of course, the ability to watch and listen to a witness giving his or her evidence is of considerable assistance in deciding what weight to give to that witness's evidence, it must be remembered that demeanour is an imprecise concept and invariably subjective. The difficulties are increased when a member of the Tribunal is forced to hear testimony through an interpreter. In **R v. NG Wing-ming{** XE "**R v. NG Wing-ming**" \b **}** [1995] 1 HKCLR 64 Litton J.A**{** XE "Litton J.A" \b **}**. (as he then was) described the difficulties of relying too heavily on demeanour in the following terms :

> "Demeanour is a notoriously uncertain guide to the truth for obvious reasons. A witness comes into court as a total stranger to the judge who can hardly be expected to read from his or her facial expressions or "body language" indications as to truthfulness or otherwise. The inherent probabilities in most cases would be the first point of reference

> for the trial judge in seeking to ascertain the truth. Demeanour could only be a point of last resort."

In assessing the credibility of various witnesses, the Tribunal cautioned itself in accordance with that *dicta*.

PART TWO : A CONSIDERATION OF THE ORDINANCE

For the purposes of this inquiry, section 9(1)(a) of the Ordinance**{** XE "Ordinance:section 9" \b **}** defines the civil wrong of insider dealing in the following terms :

> (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;

In terms of the Ordinance, therefore, for insider dealing to be proved to the requisite standard, counsel to the Tribunal must prove a number of different matters. They are :

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

It has never been disputed that Chinese Estates was at the material time a listed corporation; that is, a corporation which has its shares and other issued securities listed on the Hong Kong Stock Exchange**{** XE "Hong Kong Stock Exchange" \b **}**.

b. The person dealing in the securities must be 'connected' to the corporation

It has never been disputed that Mr. Joseph LAU was at the material

time ‘connected to’ Chinese Estates in terms of section 4(1)(a) and (b) of the Ordinance in that he was a director and substantial shareholder in the company.

Similarly, it has never been disputed that Mr. Johnson LAM was at the material time also ‘connected to’ Chinese Estates in terms of section 4(1)(c)(i) of the Ordinance by reason of the fact that, as the broker acting on behalf of Chinese Estates in the disposal of Entertainment Building, he occupied a position which would reasonably be expected to give him access to relevant information.

c. The ‘connected’ person must ‘deal in’ the securities (or their derivatives) or else counsel and procure another person to deal in them.

Section 6 of the Ordinance**{** XE "Ordinance:section 6" \b **}** defines dealing in securities or their derivatives as follows :

> 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.

It has never been disputed by either Mr. Joseph LAU or Mr. Johnson LAM that, in terms of section 6 of the Ordinance, they dealt in the securities (that is, the shares and/or covered warrants) of Chinese Estates at a time when they were ‘connected’ to the company.

d. At the time of ‘dealing’ the ‘connected’ person must be in possession of information which he knows to be ‘relevant information’

It was in respect of this essential element of insider dealing that both Mr. Joseph LAU and Mr. Johnson LAM made their denials. It was the case of both persons that whatever information they possessed at the time of their dealings, it was not ‘relevant information’ and even if, objectively, the

Tribunal found it to be relevant, neither knew it to be so.

The meaning of 'relevant information' assumed such importance during the inquiry and is a matter of such complexity that it has been made the subject of Part Three of this chapter.

PART THREE : RELEVANT INFORMATION

If, at the time of dealing, the connected person must be in possession of information which he knows to be relevant information, what then is relevant information? Section 8 of the Ordinance**{** XE "Ordinance:section 8" \b **}** defines it in the following terms :

> 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.

'Relevant information' must, therefore, possess 3 elements, each of which must be proved by counsel to the Tribunal. Those elements may be described in the following manner :

(i) The information must not be generally known to the market; that is, to those individuals and institutions accustomed or likely to deal in the securities of the company;

(ii) It must be specific information;

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

a. Not generally known to those persons who are accustomed or would be likely to deal in the securities of the company …

By its very nature, inside information is information which is known only to a few and is not generally known to the market, the market being defined as those persons who are accustomed or would be likely to deal in the securities of the company. But who makes up that class of persons who are accustomed or would be likely to deal in the listed securities of a particular company?

Brenda Hanningan**{** XE "Brenda Hanningan" \b **}**, in her work, *Insider Dealing* (to which reference has already been made), described the drafting of this description of the market as constituting 'a curious provision' which may in practice be difficult to apply :

> "It has been suggested that this element of the definition works to the advantage of the market professionals who are permitted by it to deal on the information once they as a group know of it, even if the general investing public do not. It is not clear that this is the only interpretation of the provision, however, for the 'would be likely to deal' element arguably extends the provision to require disclosure to the wider investing public. In practice, given the evidential difficulties of identifying this particular group, the courts will probably apply an objective standard in determining whether the information was generally known."

In this inquiry, however, the definition has caused no difficulty to the Tribunal. Those experts who testified and who have worked in the Hong Kong market have agreed that, at the material time, Chinese Estates would most accurately be described as a 'second liner'. It was a company in which there were broadly 3 categories of investors : the financial institutions and investment funds; high net-worth individuals and, finally, the smaller investor who made up what one witness called the 'retail market'; namely, the investor on the street, often a speculator, the sort of investor who looked to the newspapers for tips and did not have access to the electronic, data-laden inner sanctums of the market professionals. In such circumstances, the Tribunal is satisfied that at the material time those persons accustomed to dealing in the securities of Chinese Estates or likely to deal in those securities constituted the wider investing public.

It has been submitted by counsel to the Tribunal that rumours of the sale leaked into the market on 21st November 1996, the day before the published announcement, and that such rumours had a material effect that day in raising the share price of Chinese Estates. Whether there were rumours in the market on that day and, if so, what effect they had, is a matter which will be considered later in this report. At this juncture, however, it need only be said that the Tribunal has not taken any leakage of rumours to be the equivalent of the wider investing public generally having knowledge of the sale. There may be circumstances in which news of an event is so well circulated by informal means that, despite no official announcement, such news becomes an 'open secret'. But there has been no suggestion that a situation of that kind prevailed in respect of Chinese Estates on 21st November 1999.

In fairness to both implicated persons, their legal representatives have always accepted that, until the press announcement on 22nd November 1996, the news of the sale of Entertainment Building had not been known to the investing public. In this regard, for example, most of the witnesses who had been part of the negotiating teams for the sale and purchase of the building testified that they understood such negotiations to be confidential.

b. Specific information{ XE "*Specific information*" \b *}* …

Specific information is information which possesses sufficient particularity to be capable of being identified, defined and unequivocally expressed[1]. In this primary sense it is to be contrasted with mere rumour, with vague hopes and worries or with unsubstantiated conjecture. Of course, in the ebb and flow of business affairs, what begins, for example, as a vague hope or worry may over time acquire sufficient substance and particularity to be properly defined as specific information. If and when such a transformation takes place is a question of fact.

Several texts have distinguished 'specific' information from

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

'precise' information. In this regard, in considering section 56(1)(b) of the Criminal Justice Act{ XE "Criminal Justice Act" \b }, 1993 which defined 'inside information' as being *inter alia* 'specific or precise', one text[1] has commented :

> "The second characteristic of inside information is that it must either be 'specific' or 'precise'. Information is precise when it is exact. The reason for putting in the word 'specific' was because, if left on its own, the word 'precise' might have the effect that, for example, information that there will be a huge dividend increase would not amount to inside information without also details of the quantum of the increase. The word 'specific' is intended to ensure that information about a huge dividend cut can be inside information, whilst mere rumour and untargeted information cannot … information may still be specific even though, as information, it has a vague quality. Thus, information that a company is having a financial crisis has been held to be specific. Also, information as to the possibility of a takeover may be regarded as specific information and will certainly rank as precise, given that it is more than mere rumour."

Our Ordinance uses only the description 'specific' and not 'specific or precise'. But in the view of the Tribunal that does not mean that the description 'specific' in our Ordinance must also include 'precise'. The distinction between those words remains valid. If not, much of the purpose of the legislation would be undermined. As was said by an earlier Tribunal[2] : "Information is not rendered general, as opposed to specific, merely because the information is broad and allows room, even substantial room, for particulars". In addition, as Brenda Hannigan has commented in her publication already referred to in this report[3] :

> "… the whole point of insider dealing frequently is to deal while the transaction is only contemplated, for once it has actually occurred the

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1 See 'Insider Crime' by Bider and Ashe, page 32 (1993, Jordan Publishing Ltd.).

2 See : The Public International Investments report (chaired by Stock J{ XE "Stock J" \b }.) Page 236.

> market is likely to be aware of it and will move to reflect that fact in the price, thereby preventing any profiting by insiders."

Contemplated transactions, by reason of the fact that they have not yet been 'signed and sealed', are invariably imprecise as to all details. Nevertheless, if the most probable consequence is that they will be concluded and that news of the finalised transaction will be likely to affect share prices, as Brenda Hannigan has pointed out, that is the time for the insider dealer to 'steal a march' on the wider investing public.

Earlier Tribunals conducting inquiries under the Ordinance have, of course, recognised the dangers of interpreting the description 'specific' too broadly. In the ordinary course of business, directors and others connected with public companies should be encouraged to invest in the listed securities of their companies. They should not be barred from the market for fear that anything of significance happening or contemplated within their companies will be deemed to be specific and price sensitive information.

As a result, earlier Tribunals have cited with approval the distinction drawn in some texts between, on the one hand, day to day activities which may, by normal analysis and deduction, be an indicator of the health of a company and, on the other hand, important, singular events (or contemplated events) which are likely to change a company's course. An analysis of an almost identical provision in the Companies Act of 1980{ XE "Companies Act of 1980" \b } reads[1] :

> "The definition of inside information contained in s73(2) is deliberately drafted so that the bulk of information which investment advisors, managers, senior employees etc. inevitably know, but which is not generally available, does not fall within the definition of inside information; thus, the reference in s73(2) to 'specific matters' concerning the company as contrasted with information which is merely of a general nature. In this way it is hoped that directors and employees will not be discouraged from holding shares in their

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[3] See page 39 *supra.*

[1] See the Company Lawyer, 1981, Vol 2, page 13 , at p. 14.

companies for fear of inadvertently committing a criminal offence."

In his closing submissions, Mr. Griffiths emphasised this distinction, citing the 1979 House of Commons speech by Mr. Parkinson, Minister of Trade{ XE "Parkinson Minister of Trade" \b }, made when considering the insider dealing provisions of the Companies Act of 1980[1]. The Minister emphasised that he was anxious not to discourage directors and employees from holding shares in the companies for which they worked. He continued :

> "I do not believe that the general body of information which a businessman has about his business for long periods in the year falls into the bracket of "unpublished price sensitive information". Of course he knows more about his business than people outside do, but the kind of knowledge we are after is knowledge of dramatic events, major happenings, and things which will transform the company's prospects. When someone has information about such matters, he should not be dealing. But I do not believe that the day-to-day running of major enterprises is full of day-to-day dramas."

Of course, what may or may not amount to specific information will depend always on the factual circumstances. In the inquiry before this Tribunal, those circumstances related to the sale of Entertainment Building. They did not however relate to knowledge of the agreement signed late on the afternoon of 21st November 1996. Why? Because knowledge of that agreement would not have provided an insider with the opportunity to exploit his information. The agreement was signed after the Exchange closed on 21st November and the formal announcement was made the following morning before the Stock Exchange opened. Accordingly, as far as allegations of insider dealing are concerned, the circumstances have related only to the negotiations leading up to the signed sale of shares contract.

It is perhaps a truism in the commercial world generally, but certainly in respect of the sale and purchases of properties, that nothing is certain until the signatures are placed on the contract. Promising

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[1] See House of Commons, Standing Committee A, at page 593, on 6th December 1979.

negotiations may fail at any time. This was emphasised to the Tribunal by a number of witnesses. To this end, it was submitted by Mr. Griffiths that, in respect of contractual transactions, knowledge of negotiations cannot amount to 'specific information' until such negotiations have reached the stage when it is almost certain that an actual agreement will be reached. For example, said Mr. Griffiths, if an agreement was reached in principle and the negotiators then adjourned to let the lawyers prepare the documentation, at that stage - but not before - those with knowledge of events would be in possession of specific information.

In this regard, both Mr. Griffiths and Mr. CHAN made reference to an earlier report of the Insider Dealing Tribunal[1] which concerned a contemplated placement of shares and in which the Tribunal (chaired by Burrell J**{** XE "Burrell J" \b **}**.), directed itself that :

> "Knowledge of a contemplated placement is capable of being specific information, even if the details are not known, provided that the offeror has reason to believe that the offer will be accepted."

This Tribunal, however, does not understand that test to equate to one of 'near certainty' or even, a 'very high degree of probability'. This is clear from the report itself for, having set out the terms of the test, Burrell J**{** XE "Burrell J" \b **}**. then continued by saying (at page 39) :

> "This does not go as far as Mr. TONG urged in his alternative submission, namely that there should be a very high degree of probability of acceptance. Nor does it accord with Mr. Marash who submitted that mere knowledge of a contemplated placement would suffice."

In this Tribunal's view, the definition of 'probable' as it appears in the *Shorter Oxford English Dictionary* (Volume II); namely, 'that may reasonably be expected to happen or to prove true' accords with the intent laid down by the earlier Tribunal and with a purposive

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[1] See the Hong Kong Parkview**{** XE "Hong Kong Parkview" \b **}** Group report, pages 36-39 (inclusive).

interpretation of our legislation. Accordingly, in the opinion of this Tribunal, knowledge of a contemplated commercial agreement is capable of amounting to specific information, even if all the terms have not yet been agreed, provided the probable consequence is that the agreement will be successfully concluded and the implicated person knows this to be so. Whether such knowledge, in each individual case, amounts to specific information is a matter of fact to be decided having regard to all relevant circumstances.

Does this test of 'probable consequence' unduly hamper a director or employee in being able to buy and sell securities in his company? This Tribunal does not believe so. It must be remembered that for 'specific information' to amount to 'relevant information' it must also be information which is price sensitive; that is, information which, when known to the investing public, will be likely materially to affect the price of the company's shares. If a director or employee has knowledge of a contemplated transaction which he knows will be likely materially to affect his company's share price and if, despite the inherent uncertainty of commercial negotiations, because of the substance and particularity of his knowledge, he reasonably expects the contract to be successfully concluded then he should at that time step back and stop dealing. The Tribunal does not consider this to be an undue handicap. As Mr. Parkinson said in his speech to the House of Commons s*upra*, even in major companies such 'dramas' do not arise day to day.

c. Information which would be likely materially to affect the share price …

Even though information about a company may be specific, it does not constitute 'relevant information' unless it is information which would, if it were generally known to the wider investing public, be likely materially to affect the price of the company's listed securities. As Stock J**{** XE "Stock J" \b **}**. said[1]:

"The test is hypothetical in that on the date that the insider acts on

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[1] See the Public International Investments report, page 239 and 240.

> inside information, he acts when the investing public, not in possession of the inside information, either does not act, or acts in response to other information or advice. The exercise in determining how the general investor would have behaved on that day, had he been in possession of that information, has necessarily to be an assessment. It is true that an examination of how those investors react once the information is stripped of its confidentiality and becomes public knowledge, will often provide the answer, although care must be taken to ascertain whether the investors' response is indeed attributable to the information released, or whether it is wholly or in part attributable to other events, or considerations."

In their text, *Insider Dealing* (The Round Hall Press, Dublin), the authors, Ashe and Murphy**{** XE "Ashe and Murphy" \b **}**, expand on this by saying :

> "In many cases the actual market impact of the information becoming generally available will be determinative of the impact on price. However, the test of price sensitivity has to be applied at the time the deal by the insider or tippee took place and conditions in the market may not be the same at the time of the release of the information. So it cannot always be assumed that the impact of the news on the market will be finally determinative of the issue."

The hypothetical nature of the test has been a matter of central focus in the present inquiry for two reasons.

First, it was broadly accepted that there was, in fact, no actual market impact of a significant nature after the sale of Entertainment Building was made public. It has already been noted in Chapter One that on the day of the announcement (22nd November 1996) Chinese Estates shares rose briefly from $9.05 to $9.30 but then fluctuated for the rest of the day in the range of $9.05 to $9.20. The price of the 2 covered warrant issues which Mr. Joseph LAU was actively purchasing at the time (#360 and #901) actually fell by more than 10% each.

Second, the evidence made it clear that Chinese Estates was not at that time perceived by the market to be operating in uneventful

circumstances so that news of the sale of Entertainment Building was the *only* matter of consequence related to it. Indeed, the opposite may be said to be true. Significant sections of the popular press were describing Chinese Estates as a 'laggard{ XE "laggard" \b }' and tipping its share price to rise; both its shares and covered warrants were being tipped as good buys. The stock market as a whole was bullish which added to the general buoyancy. Mr. Joseph LAU was himself, at about that time, a consistently major purchaser of both shares and covered warrants in his company while the 'Evergo spin-off{ XE "*Evergo spin-off*" \b }' created considerable market interest including media comment.

The test, of course, is not simply whether the news, along with other matters already known, would have been likely to affect the price of the company's securities; the test is whether it would have been likely to have *materially* affected the price. In a 1986 report (made under earlier legislation) Clough J{ XE "Clough J" \b }., in considering the same test; that is, whether information, if generally known, would be likely to bring about a material change in share price, considered the practical meaning of the word 'material' by saying :

> "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."

In assessing whether information would be likely, in all the circumstances, to bring about a material change in price, the Tribunal must judge whether it would influence ordinary reasonable investors (who are accustomed or likely to deal in those securities) to buy or sell. It is the likely impact on *those* investors that must be considered not the impact on insiders such as those dealing or those who are directors or employees who may well have a different view from those in the broader market.

The test of materiality was set out in a Malaysian case which has been cited with approval in several earlier reports of the Insider

Dealing Tribunal[1]. In **Public Prosecutor v. Alan NG Poh Meng{** XE "**Public Prosecutor v. Alan NG Poh Meng**" \b **}** [1990] 1 MLJ the matter was explained in the following terms :

> "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. The further element of the statutory test concerns materiality … 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 impact of the information on the ordinary reasonable investor, and thus on price, which has to be judged in an insider dealing case."
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> (per Foenander SDJ, at page X)

Information, in order to amount to 'relevant information', must be of the kind likely to have a material impact on the price of a company's listed securities. In this regard the Tribunal has acknowledged the principle that no doubt all information that is sufficiently price sensitive will be important information concerning a company's affairs but the converse is not necessarily true; namely, that all important information must be price sensitive. Important information or information of great interest concerning a company may excite comment but may nevertheless be information of the kind that would not be likely to have a material impact on the price of that company's securities.

In this regard too, the Tribunal has acknowledged that information concerning a company's affairs which, although important, is of a

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[1] See, for example, the Public International Investments report, page 241, and the Hong Kong Parkview**{** XE "Hong Kong Parkview" \b **}** report, page 41.

‘neutral’ or ‘mixed’ nature may influence some investors to buy and some investors to sell but will not thereby be likely to affect the price either up or down to a material degree; that is, to a degree that causes more than a mere fluctuation or slight change.

CHAPTER THREE

SPECIFIC INFORMATION

(a consideration of the evidence)

In the previous chapter, the Tribunal considered the definition of 'specific information' in so far as it is integral to the wider definition of possessing 'relevant information'. In this chapter it now considers the factual evidence relevant to the allegations that, at the time they dealt in the securities of Chinese Estates, the two implicated persons were in possession of specific information.

Mr. Johnson LAM

Mr. Johnson LAM said that he first contacted Chinese Estates in respect of Entertainment Building in late October 1996. Prior to that he had had no business dealings with the company or with the LAU brothers. Nor was there a personal relationship with either of the brothers which gave him any privileged admittance into their confidence.

He said that he had heard no rumours circulating among his colleagues that Entertainment Building was up for sale nor had he singled out Chinese Estates for close study. Why then did he contact the company? He did so, he said, because at that time there were a number of companies with Mainland funding that he knew were looking to purchase entire buildings in Hong Kong's central business district or sufficiently large sections of such buildings to give them the naming rights. As a broker, he said, it was his job to constantly check what may or may not be for sale and so he canvassed a number of companies. Chinese Estates was one of those companies.

On the occasion of that first contact, he said that he spoke to Mr. Thomas LAU and in conversation, among other matters, asked whether Chinese Estates would be interested in selling Entertainment Building. Mr. Thomas LAU replied that if the price was right his company would consider the matter. In his interview with the SFC**{** XE "SFC" \b **}** (dated 29th April 1997) Mr. Johnson LAM said that, during this first conversation with Mr. Thomas LAU, he recalled a price of around $3,800 million being mentioned.

Although he had not been given a firm mandate from Chinese Estates, some indication of willingness at least had been given and Mr. Johnson LAM testified that he then set about trying to find a buyer. Initially, he said, he did not consider Hysan to be a potential purchaser and looked instead for a company with Mainland funds or a commercial enterprise known for its interest in property speculation. However, he was not successful. During this time, he remembered making 'one or two' calls to Mr. Thomas LAU to see if the price could be lowered but he was told on each occasion that such matters would only be discussed when (and if) there was a 'solid buyer' in existence.

It was an admitted fact in the inquiry that Mr. Johnson LAM only contacted Hysan concerning Entertainment Building on 18th November 1996, some three weeks after his first discussion with Mr. Thomas LAU. He explained this delay by saying that, frankly, he had had a number of dealings with Hysan in the past – none of them successful – and considered Hysan to be a conservative organization concerned mainly with doing business in its geographical area of influence; namely, Causeway Bay. He was aware that the company had some property interests in Mid-Levels, he said, but was aware of no such interests in Central.

That Hysan was considered by the business community to be a conservative company was confirmed by Mr. H.C. LEE himself in the course of his testimony.

What then occurred on 18th November when Hysan was first contacted?

That first contact was directly between Mr. Johnson LAM and Mr. H.C. LEE. Mr. Johnson LAM recalled a personal meeting; Mr. H.C. LEE spoke of a call, indicating a telephone call, but was never pressed on the matter and nothing really turns on it. In his interview with the SFC**{** XE "SFC" \b **}** (dated 17th May 1997) Mr. H.C. LEE described that first contact in the following terms :

> "We did not have any contact before 18th November 1996. On that day, LAM Yee-ming called me and said there was an offer in relation to Entertainment Building. He asked me if I was interested and the price

> was ranging from $3.5 billion dollars to $3.6 billion dollars. I told him I was interested but I required some more information related to Entertainment Building, such as floor plan, tenancy information and the rate of return."

Counsel to the Tribunal asked Mr. H.C. LEE why, with just one call, he should have expressed 'interest' in the purchase of Entertainment Building, the suggestion being that this amounted to an indication of intent to enter into serious negotiations. Mr. H.C. LEE did not accept that he had made any such obvious indication. In this regard the transcript reads :

> "Q: This was just one phone call. Why did you say on the basis of this one phone call that your were interested?
> A: Yes, I am interested but I need information before I can consider it.
> Q: Before this phone call, had you considered buying Entertainment Building? Had you had your eyes on it? Was that the situation?
> A: No."

Mr. Johnson LAM conceded that Mr. H.C. LEE had expressed interest but said that he believed it to be more an outward sign of politeness rather than anything to raise expectations. Such polite expressions of interest had been made on previous occasions with no fruitful outcome. He described Mr. H.C. LEE as being a gentleman who would never object to approaches being made to him, who would always express interest but would also ask to see further documents and be given time to study matters.

In regard to this first meeting, the Tribunal is satisfied that it amounted to nothing more than an initial introduction; that Mr. H.C. LEE did not have sufficient information available to him to be able indicate a serious interest to buy and Mr. Johnson LAM was well aware of that fact.

Mr. Johnson LAM recalled that during their meeting he gave Mr. H.C. LEE a brochure of Entertainment Building and was asked to send over details of the tenancy schedule. This was faxed to the offices of Hysan at about 5:30 that same evening. There was no further contact that day.

What then occurred on the following day; that is, 19th November 1996?

In this regard, the evidence of Mrs. Pauline WONG{ XE "Pauline WONG" \b } YU Wah-ling ('Mrs. Pauline WONG') is of central importance for she was at the time the property director at Hysan answerable to Mr. H.C. LEE. Mrs. Pauline WONG testified that on the evening of 18th November she was informed by Mr. H.C. LEE that Entertainment Building may be for sale and that a tenancy schedule was being sent over. She said that it did not strike her that evening that Mr. H.C. LEE was showing any real interest in the possible purchase; that interest, to the best of her memory, came only the next day when more relevant data was available.

Mrs. Pauline WONG said that she was given the tenancy schedule the next morning; that is, on the morning of 19th November 1996, and at around 9 a.m. she and Michael CHAN Yan-ming ('Mr. Michael CHAN{ XE "Michael CHAN" \b }'), the financial director, held a meeting with Mr. H.C. LEE. The meeting was relatively short. During that meeting Mr. Michael CHAN was asked to consider such matters as rental returns and the like; essentially, therefore, the financial aspects. It was Mrs. Pauline WONG who was instructed to contact Mr. Johnson LAM and to commence discussions about price. The job of communicating with Mr. Johnson LAM lay, therefore, with Mrs. Pauline WONG and no other senior member of Hysan's staff.

The time when Mrs. Pauline WONG *first* contacted Mr. Johnson LAM on 19th November became a matter of considerable importance in the inquiry. It was an admitted fact that at or about 2:30 p.m. on that day Mr. Johnson LAM had made the order with his broker for one million shares in Chinese Estates. Accordingly, if he had begun discussions with Mrs. Pauline WONG *before* that time, there would be evidence to show that, at the time of his share dealing, he knew that Hysan, one of Hong Kong's largest and most reputable publicly-listed property companies, had begun serious negotiations to acquire Entertainment Building. If, however, he had not begun discussions with Mrs. Pauline WONG until *after* 2:30 in the afternoon, the evidence would then indicate that, at the time of his share dealing, all he knew of Hysan's intentions concerning the acquisition was a polite show of interest by Mr. H.C. LEE and a request to study a tenancy schedule.

Mrs. Pauline WONG testified that, as soon as she left the meeting, she asked her secretary to contact Mr. Johnson LAM. This would have been before 10 a.m. However, although she remembered speaking to Mr. Johnson LAM at some time that day, she could not remember when exactly that had been, whether in the morning or the afternoon, and she had no independent note either in her desk diary or among her other papers which indicated the time.

In fact, Mrs. Pauline WONG was called to give evidence on two occasions (on day 6 and day 10 of the inquiry) and on both occasions she confirmed that she was unable to remember when it was on 19th November that she first spoke to Mr. Johnson LAM. On the first occasion that she testified, during her cross-examination by Mr. Warren CHAN{ XE "Warren CHAN" \b }, the following exchange took place :

> "Q: You said that you cannot remember exactly. Am I right that you cannot rule out the reasonable possibility that you might have first spoken to him on the 19th only after 2:30 p.m. on that day – in all fairness?
>
> A: I cannot rule out that completely, but I do remember I asked my secretary to call Johnson LAM immediately when I came out of Mr. LEE's office.
>
> Q: But you cannot now remember whether you were able to get hold of Mr. LAM?
>
> A: I am sure I spoke to him on that day anyway."

Four days later, having checked her records, Mrs. Pauline WONG was unable to be more certain.

Mrs. Pauline WONG did have a note among her papers of Mr. Johnson LAM's mobile telephone number but, from an interpretation of the context of the note, she said that in all probability it had only been noted down by her on 20th and *not* on 19th November 1996.

But if Mrs. Pauline WONG (through no fault of her own) was unable to come forward with evidence that indicated *when* she had first spoken to Mr. Johnson LAM on 19th November, Mr. Johnson LAM himself was able to place evidence before the Tribunal which supported his memory

of events; namely, that he had not spoken to Mrs. Pauline WONG until late in the afternoon of 19th November, some two hours after he had made his purchase of shares in Chinese Estates.

Mr. Johnson LAM's business obligations meant that he had to spend a good portion of his working day away from his office. In order to communicate with clients, friends and his own staff he therefore carried a mobile telephone. When he was working in his office, he said that he forwarded all incoming calls on his mobile telephone to his office number and made all outgoing calls on that same office number. It was, therefore, easy to see from the activity record of his mobile telephone when he was in the office for any extended period and when he was elsewhere. He said that the activity record of his mobile telephone for 19th November 1996 revealed that from about 10 in the morning until after 4 in the afternoon some 46 calls were either made or received. This was an average of just over 7 calls an hour. On this basis, he said, the activity record showed that he was out of his office until about 4:30 that afternoon when he returned to his office and forwarded all calls to his office line. But during that extended period of time there is no record of a call made to either Hysan or to Chinese Estates.

The activity record, of course, does not reveal the identity of incoming calls. It was, therefore, conceded by Mr. Warren CHAN{ XE "Warren CHAN" \b }, counsel for Mr. Johnson LAM, that one or more of the approximately 16 incoming calls shown on the record from between 10:00 a.m. and 4:30 p.m. may have been from Hysan. But if that was the case, argued counsel, and if negotiations had been commenced in the morning or very early afternoon, surely there would be some evidence of Mr. Johnson LAM using his mobile telephone to contact Chinese Estates to advise Mr. Thomas LAU of this new turn of events and to relay Hysan's opening offer or some record at least of a call back to Hysan. Mr. CHAN argued that it would be inconceivable for a broker of Mr. Johnson LAM's experience and skill simply to sit on the matter for several hours. But there was no evidence of any calls to Chinese Estates or Hysan. Mr. CHAN submitted that this supported Mr. Johnson LAM's testimony that he only spoke to Mrs. Pauline WONG for the first time late on the afternoon of 19th November 1996 after he had returned to his office and had not spoken to her earlier that day, certainly not at any time prior to purchasing his shares in Chinese Estates.

When Mr. Johnson LAM gave evidence, he said that he did not speak to Mrs. Pauline WONG in respect of the sale of Entertainment Building until at least 4:30 in the afternoon by which time he was back in his office and using his office line. The Tribunal accepts that, in this regard, he was not in any way contradicted by the activity report of his mobile telephone; indeed that record lent support to his testimony.

But if Mr. Johnson LAM had not dealt in the shares of Chinese Estates for an extended period of time, why would he chose that very afternoon to make such a substantial purchase? If it was a co-incidence then, at first blush, it was a striking one.

When interviewed by the SFC**{** XE "SFC" \b **}** in April 1997, he explained his reason for making the purchase in the following terms :

> "I realised this stock was already on a bull run at that time. Therefore, I just wanted to gamble on this stock and tried to trade it."

He expanded upon this in his testimony, saying that he had gone to a favourite hotel bar for lunch that day. There were newspapers available and he recalled an article on Chinese Estates which spoke of the benefits of the 'Evergo spin-off**{** XE "*Evergo spin-off*" \b **}**'; he further recalled some mention, he said, of the fact that the net asset value per share was still low. That was his motivation for making the purchase. It was a speculative buy based solely on the recent performance of Chinese Estates shares and the optimistic view expressed by the media. The order, he said, was not in any way motivated by the thought that Hysan would buy Entertainment Building. At that moment in time, he said, he had no grounds for believing that Hysan would even necessarily come back to him for more information let alone enter into serious negotiations.

In this regard, the Tribunal accepts that there are a number of matters which supported Mr. Johnson LAM's evidence.

First, it must be remembered that he was at that time a regular 'player' in the market. He maintained a margin account in order to speculate in shares, he kept a television monitor in his office so that he could

constantly keep track of share movements. On a day to day basis he was buying and selling, and did so seemingly in a wide range of securities.

Second, through his business connections and his skill as a property broker, he had made very substantial earnings by way of commissions. Indeed, it was never disputed that earlier in 1996 he had brokered the sale of a large commercial property for a price of several billion dollars. He possessed the necessary affluence, therefore, to buy large blocks of shares.

Third, as a speculator in the stock market, it was not surprising that he checked the business and financial sections of the local press on a daily basis for opinions and tips and there is unchallenged evidence that at about that time there were a number of articles recommending the investing public to purchase the listed securities of Chinese Estates. On 19th November alone there were 3 such articles in the Chinese press.

As an example, *Wen Wei Po*, in an article headed – 'Can Take a Chance on Chinese Estates' – said the following :

> "Other than that, Chinese Estates, which was recommended last week, continues to perform well. It would not be a big surprise if in the short-term it regains the HK$10 level."

In addition, *Sing Pao*, in an article headed – 'Chinese Estates Rising Trend Could Repeat History' – said the following :

> "Evergo China (#631) will be listed on Wednesday, Chinese Estates (#127) is paving the way, reaching a high of HK$7.95 yesterday and closing at HK$7.80, a rise of 20 cents. In the short-term, Chinese Estates is even more attractive as a speculative buy, as it is still a big laggard. Even though it has risen a few tens of cents recently, it still lags behind the market by a thousand to two thousand points. Chinese Estates would be fair value at around HK$9 now. However, Chinese Estates has always been like this, either so bullish it scares you, or so volatile when it is active, or rising to the point which you can't believe. Three years ago, Chinese Estates rose spectacularly by three-fold in a period of no more than three months. This time history could repeat itself. Keep a close watch on this."

In summary, there is evidence that in the days leading up to 19th November 1996 - and in particular on that day itself - the media was actively tipping Chinese Estates as a speculative purchase, a purchase which promised at least short term profits.

In respect of Mr. Johnson LAM's testimony, it should finally be mentioned that the Tribunal found him to be a credible witness. The long lapse of time since the events in question may have caused him to forget or confuse certain matters but the Tribunal was satisfied that he did his best honestly to recall events and to explain his beliefs and motivations at the relevant times.

In the circumstances, in the opinion of the Tribunal, it has *not* been proved to a high degree of probability that when Mr. Johnson LAM purchased his shares in Chinese Estates at about 2:30 in the afternoon of 19th November 1996, he had already been contacted by Mrs. Pauline WONG and therefore already knew that Hysan was prepared to enter into serious negotiations to acquire Entertainment Building.

What then has been proved? The evidence has revealed that, at the time of his dealing, Mr. Johnson LAM knew only that Chinese Estates *may* be prepared to sell Entertainment Building if the price was right and that Hysan had expressed some 'polite interest' in the possibility of acquiring the building subject to receipt of the necessary data to enable it to consider the matter. In the opinion of the Tribunal, that did not even amount to knowledge of a contemplated agreement; neither Chinese Estates nor Hysan had yet committed themselves sufficiently for even that preliminary stage to be reached. It certainly did not amount, therefore, to knowledge of negotiations which had reached such an advanced stage that, despite their inherent uncertainty, the probable consequence was that a sale agreement would be successfully concluded.

In the circumstances, in the unanimous opinion of the Tribunal, it has not been shown that, at the time of his dealing, Mr. Johnson LAM was in possession of specific information concerning Chinese Estates. He cannot, therefore, be identified as an insider dealer.

Mr. Joseph LAU

During the inquiry it was essentially the uncontested evidence that by November 1996 Mr. Thomas LAU had for some time been responsible for the day to day management of Chinese Estates while Mr. Joseph LAU, the Chairman, took a less active daily role, reserving for himself the responsibility of overseeing strategic matters and making the final decision in regard to such matters. For example, in his testimony, Mr. Joseph LAU spoke of taking a very active role in managing the 'Evergo spin-off{ XE "*Evergo spin-off*" \b }'. This was in his opinion, a matter of strategic importance to Chinese Estates.

Although by November 1996 Mr. Joseph LAU was playing a less active role in company affairs, he still came to work every day. He and his younger brother had offices on the same floor within a few paces of each other and there was evidence that they spent time in conference with each other on a daily basis. It is therefore apparent that Mr. Joseph LAU kept himself abreast of company affairs and was consulted on matters of importance.

Concerning Johnson LAM's approach in or about the end of October 1996 to ask if Entertainment Building may be for sale, Thomas LAU testified that he informed his elder brother of this approach a few days later. There was at that time a brief discussion about the matter. Neither were serious about selling, said Thomas LAU; in short, that was not their firm intention, but both were open-minded on the matter.

In a statement dated 27th February 1999, Joseph LAU recalled that conversation in the following terms :

> "I recall that sometime around end of October to beginning of November 1996 Thomas LAU informed me that he had received an enquiry from yet another estate agent in respect of Entertainment Building. He told me this in passing. I regarded this at the time to be no more than a general enquiry such as we had received in the past, and I thought no more of it. I did not know who the agent was at that time. Regarding Johnson LAM, I did not know him at all prior to the sale of

> Entertainment Building. Thereafter, until 20th November 1996, no one made any mention to me of any possible sale of Entertainment Building."

In light of subsequent events, it is not surprising that Mr. Joseph LAU was only next informed of the possible sale of Entertainment Building on 20th November 1996.

As stated earlier, Mr. Johnson LAM had no success in finding a buyer in the first three weeks of November and only made his approach to Mr. H.C. LEE of Hysan on the afternoon of the 18th November 1996. The events of the afternoon of 18th constituted nothing more than an introduction of the property to Hysan. What has been described as an expression of 'polite interest' by Mr. H.C. LEE would have given Mr. Johnson LAM no cause to report back to Chinese Estates.

As for the following day; that is, 19th November, as indicated earlier, the weight of evidence has showed that Mr. Johnson LAM was only advised by Mrs. Pauline WONG of Hysan's desire to enter into negotiations late in the afternoon of that day, sometime around 4:30 p.m.

In his evidence, Mr. Thomas LAU recalled a telephone conversation with Mr. Johnson LAM that same afternoon but could not remember exactly when. During that conversation, said Mr. Thomas LAU, he gained the impression that Mr. Johnson LAM was 'testing' the lower reaches of the price at which Chinese Estates would be prepared to sell Entertainment Building. A figure of some $3,500 million was mooted. He made it clear, however, that the price must be at least $3,600 million or more. It was the thrust of Mr. Thomas LAU's evidence that, from what was said during the conversation, he believed Mr. Johnson LAM may have a potential buyer. He said that he asked about the identity of such a buyer but was given no name. That conversation, he said, was of such a tentative, exploratory nature that he did not find it necessary to pass on details to his elder brother.

Was Mr. Joseph LAU at this time in direct communication with Mr. Johnson LAM or anybody else, other than his younger brother, who had knowledge of the negotiations for the sale of Entertainment Building? There was no evidence to suggest that he was, indeed during the negotiating

stage all the evidence indicates that Mr. Joseph LAU spoke only to his younger brother and was kept advised of developments by him alone.

What then of 20th November 1996? That day was, in fact, the first day of trading of Evergo. To mark the occasion, there was a ceremony at the Stock Exchange in the morning which was attended by Mr. Thomas LAU. Mr. Joseph LAU chose not to attend. Mr. Thomas LAU testified that he could not possibly have had a conversation with Mr. Johnson LAM concerning the sale of Entertainment Building that morning because of his presence at the ceremony. He said it was only after he returned from the ceremony that, to the best of his memory, he spoke to Mr. Johnson LAM. This, he said, would have been at about noon or in the early afternoon.

It was during this conversation, said Mr. Thomas LAU, that he learnt for the first time that the intended purchaser was Hysan. Armed with the knowledge that the price being offered by Hysan met the minimum contemplated; namely, $3,600 million, and that, in his opinion, Hysan, a conservative company, would not have made such an offer lightly, he now knew that the matter should be taken seriously. Mr. Johnson LAM, suggested that the terms of a possible sale could better be negotiated at the offices of their lawyers, Messrs. Sit, Fung, Kwong & Shum{ XE "Sit Fung Kwong & Shum" \b }. This was agreeable to him, said Mr. Thomas LAU, and it was therefore at around 2:30 that afternoon that he instructed certain of his staff to make up the negotiating team.

Mr. Thomas LAU said that he attempted to contact his older brother to advise him of developments but was unable to do so. It was only later, he said, sometime between 4 and 5 that afternoon, that he was able to speak to his brother and give to him the identity of the intended purchaser. Mr. Joseph LAU could not remember exactly when that day he was first told that Hysan was negotiating to purchase Entertainment Building but believed it to be sometime during the afternoon or early evening.

According to the brothers, during that conversation between them, Mr. Joseph LAU said that the ‘bottom line’ price at which a sale could be agreed was $3,600 million that being what he considered to be about the market value of the building. Mr. Joseph LAU, however, did not express any desire to become directly involved in the negotiations, leaving that to his

brother who, in his turn, delegated the responsibility to his negotiating team acting in concert with the company solicitors and Mr. Johnson LAM.

Mr. Joseph LAU testified that even at this stage, knowing that Hysan was the intended buyer and that the negotiating teams were meeting at the offices of the solicitors in an attempt to settle the terms of sale, he still did not believe that an agreement was likely. He gave a number of reasons for this. First, he said, in his experience many property negotiations which appeared promising came to nothing. Second, even though he knew Hysan to be a reputable company, he considered it to be inherently conservative with no history of purchasing commercial buildings outside of Causeway Bay or indeed from outside of what he described as 'the Lee family'.

However, with respect to Mr. Joseph LAU, the Tribunal was unanimously of the opinion that, in his evidence, he strove excessively to distance himself from an intimate knowledge of events that day and strove equally to emphasis the uncertainties at the expense of the very tangible positive factors that were evident in the negotiations.

For example, in the conversation between the two brothers, Mr. Thomas LAU testified that he told his elder brother that Hysan was negotiating to purchase at a figure of $3,600 million or above, this equalling (or being better than) the stipulated minimum. In this regard, the transcript of Mr. Thomas LAU's testimony reads as follows :

> "I was doing things until 4 to 5 o'clock, it was the time that I was about to leave, anyway, and I discussed that with Joseph LAU, and then I told him that there were people talking about buying the building at around $3.6 billion or above, and also that the buyer is Hysan, so I just told him things, these things."

However, when asked about the same matter, Mr. Joseph LAU had a different recollection. In this regard, the transcript reads :

> "Chairman: … in the afternoon of 20th November 1996 – you say that your brother, Thomas, approached you in the late afternoon about Entertainment Building and he told you that the buyer, or rather the interested party, was Hysan.

A: He said that the broker told him.

Chairman: Is it correct that he also told you that the price that was being actively considered was around $3.6 billion?

A: Are you talking about considered by the counterparty or just ourselves?

Chairman: Well, that the price that was being actively considered in negotiations was around $3.6 billion?

A: He did not tell me that what price was being asked or that, so he only asked me what was the bottom price, and normally we would just talk about at what sort of price he can sell and at what sort of price he could not sell. But other things – he would not tell me what was being asked or said.

Chairman: So to the best of your memory, you do not recall him saying anything about people negotiating with Johnson LAM about buying the building at around $3.6 billion or above?

A: As I remember, he did not. Our usual relationship is just that he inquired a bottom price from me and then he would go, and he would not tell me or report to me that that price can be done or that sort of thing."

The Tribunal rejected Mr. Joseph LAU's evidence in this regard. In the opinion of the Tribunal, Mr. Thomas LAU's evidence that he kept his elder brother informed of such important matters as the price being offered by the intended purchaser was entirely credible.

As a result of the conversation in the late afternoon of 20th November, the Tribunal is satisfied to a high degree of probability that Mr. Joseph LAU knew that the intended buyer was a public company of substantial reputation and resources; that it was seemingly prepared to meet their minimum asking price and was exhibiting sufficiently serious intentions to purchase that it was sending its negotiating team to the offices of the solicitors representing Chinese Estates. All of that constituted positive news of considerable particularity.

What then was taking place between the negotiating teams themselves at about that time?

At about 3 p.m. – an hour or so before the LAU brothers had spoken to each other – Mr. Michael CHAN, Hysan's finance director, had drawn a cheque for $50 million, that being the deposit, a figure seemingly at least provisionally agreed at that time and one which was in fact paid over that evening.

At about 5 p.m. – at about the time the LAU brothers were talking or shortly thereafter – Miss Cleresa WONG Pie-yue{ XE "Cleresa WONG Pie-yue" \b }, Hysan's solicitor, was receiving instructions from Mrs. Pauline WONG which included the instructions that the intended purchase price was $3,600 million.

At about the same time, the solicitors for Chinese Estates were preparing a draft agreement which set the purchase price at the same figure of $3,600 million and the initial deposit at $50 million. It is pertinent to note that, when Messrs. Sit, Fung, Kwong & Shum{ XE "Sit Fung Kwong & Shum" \b } faxed that agreement to Hysan's solicitors, Messrs. Wilkinson & Grist{ XE "Wilkinson & Grist" \b }, shortly after 7 p.m. that evening, in a covering letter they said :

> "We are instructed that it is imperative for the proposed Provisional Agreement to be signed tonight otherwise the deal may not be able to proceed further."

It is not disputed that at around 9 p.m. that same night the negotiating teams met at the offices of Messrs. Sit, Fung, Kwong & Shum where negotiations continued. After completing certain social functions, Mr. Thomas LAU joined his colleagues at those offices at around 10 p.m.

Nor is it disputed that sometime after midnight a provisional agreement of sale and purchase was signed for the transfer of Entertainment Building. The agreed price was $3,600 million. That agreement was signed on behalf of Chinese Estates by Mr. Thomas LAU and on behalf of Hysan by Mrs. Pauline WONG.

In her testimony, Mrs. Pauline WONG recalled that at about midnight there was some mention of changing the structure of the agreement

to one consisting of a sale of shares. Among other things, this would reduce stamp duty payments and allow for certain tax benefits by way of losses carried forward. She said, however, that as the parties wanted a binding agreement that night (which would be consistent with the demand for speed set out in the letter of Messrs. Sit, Fung, Kwong & Shum) it was agreed that the existing provisional agreement of sale and purchase would be signed as a binding agreement. She said that, to the best of her memory, it was anticipated that a sale of shares agreement would supersede it but that was not definite. It appears that the Hysan team at least believed that a binding agreement had been signed that night as the next morning; that is, the morning of 21st November 1996, a letter was sent by fax and mail to the directors which commenced :

> "The Company has always been looking for opportunity to diversify outside Causeway Bay area and an opportunity was brought to us two days ago for the acquisition of Entertainment Building located in core Central. After careful evaluation and negotiation, a Provisional Sale and Purchase Agreement has been reached with Chinese Estates Holding Ltd. for the acquisition of the building. Gross floor area of the building is about 211,129 sq. ft. The consideration is HK$3.6 billion which is equivalent to about HK$17,000/sq. ft. Completion of the acquisition is scheduled on or before 20 May 1997."

It is apparent too from his evidence that Mr. Thomas LAU, although not a lawyer, considered the provisional agreement which he signed at about 2 a.m. to be a document of significance even though, in his judgment, if 'both parties' agreed to alterations then that agreement would be rendered void. As he said in the course of his testimony :

> "According to my commercial judgment, whether the sale of the company can be completed or not, we think – I think that the sale of the building would still be able to proceed because I think that is a mutually interested deal. But then if you are talking about the legal matter, since I am not a lawyer, I cannot tell. In my experience, if we have this agreement and if both parties agreed to have any alterations in that agreement, so the former agreement should be voided and should not be effective. It is because if the former agreement would still be effective, then there is no need further to talk about another agreement."

After the provisional agreement had been signed, Mr. Thomas LAU testified that he telephoned his elder brother to report to him. This was around 2 a.m. and Mr. Joseph LAU was finishing a card game with friends. According to Mr. Thomas LAU, he told his brother that agreement had been reached on the sale of the building at $3,600 million but that Hysan now wished to purchase 'the company structure' and, as a result, he would ask $3,680 million as consideration for the sale of shares when the parties continued their negotiations the following day.

When he testified, Mr. Joseph LAU recalled that conversation with his younger brother in the following terms :

"Chairman: Did your brother, to the best of your memory, mention to you that an agreement of some sort had in fact already been signed?

A: He did not mention that any agreement was signed, and he was just saying that the price was negotiated at $3.6 billion, but now that it was going to negotiate with selling of the company at $3.68 billion – no, my brother's asking price is $3.68 billion, for the sale of the company, and he only said that he would discuss it tomorrow.

Chairman: When that conversation was over, did you have the view that a deal had been struck or that a deal was likely?

A: I did not think of that, because I was still playing cards. I played till quite late. After that I just went home, had a shower and went to bed to sleep."

The Tribunal was unable to accept that Mr. Joseph LAU at that time - because it was late and he was playing cards - did not put his mind to the matter of whether a deal had, in fact, been struck or was likely to be successfully concluded. He was Chairman of Chinese Estates, he was responsible for the final approval of strategic decisions. Entertainment Building was a major asset of Chinese Estates, a building of architectural distinction in a prime location. It defies the reality of the situation to think that he would not have been concerned to know the 'state of play' at that time. The Tribunal was satisfied on the evidence that, even if he was not told that a provisional agreement had, in fact, been signed, Mr. Joseph LAU

would have been aware of the following matters :

First, that Hysan, despite being perceived by him as a conservative company without a history of buying commercial buildings in Central, had agreed a price for the building itself and, after negotiations lasting into the early hours of the morning, was patently a serious bidder.

Second, that the price already agreed for the building was, in his own mind, an acceptable market price.

Third, that as the reason for the continued negotiations related to a desire to purchase the shares of the proprietary company rather than the building itself, there could not have been any major stumbling blocks encountered so far over such fundamental matters as the method of payment of the purchase price or the completion date.

Fourth, with his experience in the property field, he would have known that a switch from a purchase of the building itself to a purchase of shares was not that unusual and while obviously it created new uncertainties it was not of itself indication of a major setback; the price difference moving from $3,600 million to an 'asking price' of $3,680 million with Hysan, however, to obtain tangible benefits in the process.

In the circumstances, the Tribunal had no difficulty in finding that, by the conclusion of the 2 a.m. telephone conversation with his brother, Mr. Joseph LAU was then in possession of specific information concerning the sale of Entertainment Building to Hysan. By that time at least, despite the inherent uncertainties of all commercial negotiations, because of the substance and particularity of what he had been told concerning the negotiations, he must have known that the probable consequence was that an agreement would be successfully concluded.

In the circumstances the Tribunal was satisfied that it had been proved that Mr. Joseph LAU traded in the listed securities of Chinese Estates on only one day when he was in possession of specific information concerning the sale of Entertainment Building, the information not yet being in the public domain. That day was 21st November 1996 during which he purchased 61,120,000 #560 covered warrants and 126,160,000 #901 covered

warrants at a total cost of some $65,000,000 but did not purchase any shares in Chinese Estates.

Of course, information which is specific does not, constitute ‘relevant information’ unless it is also information which would, if it were known to the investing public, be likely materially to affect the price of a company’s listed securities; in this case the listed securities of Chinese Estates. Whether the specific information possessed by Mr. Joseph LAU in the early hours of the morning of 21st November 1996 was information likely materially to affect the price of the listed securities of Chinese Estates will be considered in the following chapter.

CHAPTER FOUR

THE MATERIALITY TEST{ XE "MATERIALITY TEST" \b }

The exercise in determining whether, if specific information about a company was known to investors generally, it would be likely materially to affect the price of that company's securities, cannot be anything other than an assessment. As Stock J{ XE "Stock J" \b }. said[1], the test is hypothetical in that on the date that the insider acts an inside information, he acts when the investing public, not in possession of that inside information, either does not act or acts in response to other information or advice.

A. Proof of the actual impact of the news on the market …

However, despite the essentially hypothetical nature of assessing whether specific information, if it was generally known to the market, would be likely materially to affect the price of a company's securities, it is accepted that the answer may well lie in discovering how the market did in fact react when the news became public. In this regard, it bears repeating the words of Ashe and Murphy in their text, *Insider Dealing*[2] :

> "In many cases the actual market impact of the information becoming generally available will be determinative of the impact on price."

This, of course, begs the question of when the information of the sale of Entertainment Building did, in fact, become generally available.

In this regard, it is agreed that the formal announcement of the sale of Entertainment Building was published in the press on the morning of 22nd November 1996. By the opening of the Stock Exchange that morning, therefore, and during the early hours of trading, investors would have had the opportunity to read the announcement and press comments about it or to be informed of the news by friends and work colleagues. It is therefore clear that news of the sale of Entertainment Building was generally known to investors on the morning of 22nd November 1996.

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1 See Chapter Two of this report, page 65.

2 Page 65 *supra*.

How then did the price of Chinese Estates' listed securities move on that day? Did the formal announcement create a significant impact?

The 5-minute graph{ XE "graph:5-minute" \b } (Annexure L) shows that the share price opened that morning at $9.20, 15 cents up from the previous day's closing price. It rose a further 10 cents within the first hour of trading but then slipped back to $9.05. Thereafter it spent the rest of the day fluctuating between $9.05 and $9.20, closing at $9.05. At the end of that day, therefore, according to that graph, there had been no increase in the share price. The trading statistics detailed in Annexure C are slightly different, showing a price high for the day of 9.35, a low of $9.00 and a closing price of $9.10. These statistics, therefore, reveal an insignificant price rise of 0.55% from the previous day's closing price. The number of shares traded that day dropped to just under 24,000,000 from more than 36,000,00 the previous day.

On the following day of trading - 25th November - the share price reached a high of $9.20 but then slipped back to under $9.00, closing the day at $8.80. The number of shares traded fell to below 8,000,000.

As for the 2 covered warrant issues due to expire in January 1997, #560 fell 13.64% on 22nd November and a further 9.21% on 25th November. The number of warrants traded on those 2 days were well down on the volumes attained on 21st November. Issue #901 fell 10.26% on 22nd November and a further 10.00% on 25th November. The number of warrants traded on those 2 days also fell.

Taken on their own, these statistics do not demonstrate that the formal announcement of the sale of Entertainment Building had a material impact on the price of Chinese Estates' securities either on the day of the announcement or on the following trading day. The share price may have risen in the first hour of trading on 22nd November but thereafter it fell back and (at best) ended the day just 0.55% up on the previous day's trading. Taken at its highest, therefore, and assuming no other factors affecting the market, the statistics reveal that the impact of the formal announcement caused a small, initial increase which endured for only part of the morning. By the end of that day there was no material change. Indeed, if anything, the more volatile warrants showed a material change for the worse.

However, as indicated in Chapter One, counsel to the Tribunal submitted that the true impact of the news had already been absorbed by the market on the day *before* the formal announcement; that is, on 21st November. This was due to the fact, he said, that rumours of the sale had leaked into the market and had been acted upon by investors. In this regard, to quote Mr. Rigby{ XE "Rigby" \b }:

> "There is an old adage in the stock market "Buy on the rumour. Sell on the news". This concept is grounded in generations of experience and common sense. Essentially what it means is that if one waits final confirmation of an event one will be too late to profit from it. It is a widely understood concept and experience backs up the belief that corporate developments such as spinoffs, asset sales and takeovers very often leak into the market well before any public announcement is made."

The 21st November 1996 - the day before the formal announcement of the sale - was a significant day for Chinese Estates. Its share price had been rising steadily since 12th of that month, jumping 3.77% in value on 20th November, the first day of public trading of its spin-off, Evergo China. But then on 21st November itself the share price rose 9.70% on a turnover of 36,186,000 shares which eclipsed the previous day's turnover of 19,849,000 shares. The trading statistics (Annexure C) show that the percentage increase in the value of Chinese Estates shares on 21st November was by far the largest single-day increase between 1st April of that year and the end of January of the following year. The 2 covered warrants (#560 and 901) rose that day by 41.94% and 44.44%. These figures patently reveal a material increase in the price of the securities of Chinese Estates on 21st November.

But has it been shown to a high degree of probability that, first, rumours of the sale of Entertainment Building did come into the market on 21st November and, second, that it must have been buying motivated by these rumours which was responsible for the increase in the price of Chinese Estates' listed securities that day?

Proof of a rumour, of course, is never easy. However, in his statement of 5th August 1998 Mr. Alex PANG{ XE "Alex PANG" \b }, the

expert witness from the SFC{ XE "SFC" \b }, referred to 3 newspaper articles, all dated 22nd November, which, he said, spoke of rumours concerning the sale of Entertainment Building circulating in the market the previous day. In this regard an article in the *Standard*, which quoted a named dealer, read in part as follows :

> "A late rebound on the Hong Kong stock market yesterday following a major property purchase, failed to counter earlier profit-taking with shares ending 0.51 per cent down.
>
> Dealing Manager at Sassoon Securities Simon Tam said news of Hysan Development's purchase of Entertainment Buildings from Chinese Estates for $17,000 per square foot – considered a good price – helped the market pick up late in the day.
>
> Hysan's share price rose 40 cents to $28.90 and Chinese Estates were up 80 cents at $9.05."

There appear to have been 2 articles in the *South China Morning Post*. The one article began :

> "Hysan Development Co. yesterday shed its image as a conservative property player and stunned the market with the $3.64 billion purchase of the entire Entertainment Building in Central from Chinese Estates Holdings."

And then continued :

> "News of the transaction, which leaked out yesterday afternoon, boosted Hysan's shares 40 cents to $28.90 while Chinese Estates closed up 80 cents at $9.05."

The second article in that newspaper seemingly authored by a different journalist (or at least under a different by-line) said :

> "Property companies Chinese Estates and Hysan Development were actively traded amid talk that they were to sign a deal to transfer ownership of the Entertainment Building to Hysan."

It was submitted by Mr. Griffiths that, as to whether in fact there were rumours in the market on 21st November, the articles were hearsay and should therefore be ignored. The Tribunal accepts that in civil or criminal proceedings in our courts of law the articles could not be used to prove the fact that rumours were circulating on that day. In that regard they are clearly hearsay. However, section 17 of the Ordinance{ XE "Ordinance:section 17" \b } gives to the Tribunal a number of powers to enable it expeditiously to conduct inquiries and they include the power to -

> "Receive and consider any material whether by way of oral evidence, written statements, documents or otherwise, notwithstanding that such material would not be admissible in evidence in civil or criminal proceedings in a court of law;"

The Tribunal was of the opinion, therefore, that it was not obliged to disregard the contents of these newspaper articles and was entitled to give weight to them, the amount of weight, of course, being tempered by the inherently second-hand nature of the contents that could not be tested in evidence and, in any event, the lack of detail concerning the nature, extent and duration of the reported rumours. The Tribunal also bore in mind that it was not made aware of any Chinese language newspaper that reported such rumours although those newspapers constitute the greatest number of daily publications in the local media which report and comment on the Hong Kong financial markets.

Other than the articles in the *Standard* and the *South China Morning Post*, there was no other evidence to indicate the existence of rumours in the market on 21st November. There was, for example, no first hand evidence from any dealer or broker to the effect that he or she had heard the rumours that day or placed orders on behalf of clients who said they had heard such rumours. None of the expert witnesses who were involved hour by hour in the market at that time – Mr. PANG (as a monitor), Mr. Rigby{ XE "Rigby" \b }, Mr. Heale or Mr. Witts – was able to testify to such rumours.

As to when the rumours were first known to be circulating, whether early in the morning or later, there was again no hard evidence. Mr. Alex PANG{ XE "Alex PANG" \b } accepted, however, that it was highly unlikely

that they would have started circulating with any degree of generality before the afternoon of 21st November. He was, understandably, unable to say the extent to which the rumours had circulated, whether they had reached the ears of just a few or many and, if so, which of those few or many had purchased on the strength of those rumours that afternoon.

In all the circumstances, with no positive evidence (including, for example, testimony of investors who bought on the rumours), even though the Tribunal was of the unanimous opinion that some rumours may well have been circulating on the afternoon of 21st November, it could not be satisfied to a high degree of probability that such rumours were sufficiently widespread among those accustomed or likely to deal in the securities of Chinese Estates that afternoon that they caused buying of a level which materially affected the price of the company's listed securities.

The Tribunal's caution in respect of the evidence of rumours was heightened by the fact that an analysis of the day's trading revealed that the price of Chinese Estates shares rose more in the morning, when it was accepted that rumours would *not* yet have reached the market, than it did in the afternoon when it was submitted that such rumours *were* then circulating. An analysis of the 5-minute trading graph for the day (Annexure K) shows that the share price rose 5.45% in the morning but only 3.42% in the afternoon. As Mr. Griffiths pointed out in his final submissions, there has been no evidence to suggest that whatever combination of factors moved the share price so significantly in the morning fell away entirely in the afternoon; that same combination, to some degree, must still have been present.

That there were other factors influencing the price of Chinese Estates securities at that time has never been disputed; only the degree of that influence has been in contention. What then were those other factors? The Tribunal, on the evidence, found that there were 4 such factors; namely, the bull run on property stocks, the purchase of securities by Mr. Joseph LAU, hedging activities by the issuers of covered warrants and the Evergo spin-off{ XE "*Evergo spin-off*" \b }.

1. The bull run{ XE "bull run" \b } on property stocks

The last 5 months of 1996 saw a substantial rise in the Hang Seng

Index{ XE "Hang Seng Index" \b } from 10,681 at the end of July to 13,451 at the end of that year. Many property development and property investment companies shared in that advance. Mr. Richard Witts, one of the expert witnesses who testified before the Tribunal, presented a number of graphs showing the individual performance of 7 property companies in November 1996. They included Chinese Estates. All enjoyed substantial increases in their share prices in that month. The following figures are extracted from Mr. Witts' report :

	Closing Price on 29/10/96	Closing Price on 22/11/96	%
Hong Kong Lands	$2.23	$2.86	28.25%
Amoy Properties	9.25	11.10	20.00%
Great Eagle	24.10	31.00	28.63%
Henderson Investment	8.35	9.40	12.57%
Hysan Development	24.00	28.15	17.29%
Wharf (Holdings)	30.30	37.70	24.42%
Chinese Estates	7.25	9.10	25.52%

Mr. Witts commented in his report that there were no obvious negative factors influencing property companies in the autumn of 1996. Interest rates were at 'comparatively subdued' levels and property prices advancing. Mr. Witts accepted that not all property securities would advance uniformly in a bull run. Some would initially lag behind but would then be seen as opportunistic buys by investors. He described the process in the following terms.

> "It is normal for surges in the Index to be lead by the shares of Hong Kong's major banks and property developers. The less glamorous property investors will, initially at least, be left behind. In the absence of particular negatives, these shares will then be the beneficiary of what is termed rotational buying. By this I mean that investors will buy stocks that are perceived as laggards and which have not participated in the surge."

There was evidence that in November 1996, prior to the formal announcement of the sale of Entertainment Building, certain sections of the media saw Chinese Estates as a laggard and recommended its securities (both its shares and its warrants) as a speculative purchase. For example, on 14th November 1996 an article appeared in *Sing Pao* under the headline :

'Chinese Estates strived to recover lost ground after lagging behind' –

> "Chinese Estate (127) has lagged behind the market. In the beginning of this year, the share price of Chinese Estates was $7.1 when Hang Seng Index{ XE "Hang Seng Index" \b } was 11,000. Yesterday, Hang Seng Index rose to nearly 13,000, an increase of 2,000 points, but the share price of Chinese Estates was still $7.20. Shares that lag behind will soon recover. If Chinese Estates strives to move up, there is always possibility that it will reach $8."

On the same day, the *Apple Daily* wrote under the headline : 'Lagged behind and, underpriced, Chinese Estates is rising ' –

> "The net asset value per Chinese Estates share in the end of 1995 was $11.2. At that time, the value of wholly owned properties in Hong Kong was nearly $20,000,000,000. Considering factors such as the placement this April and the rise of at least 13% in property price, the net asset value per share is worth around $12.20 at the moment by estimation. The share price is at around 25% discount of the true value. Amongst the large property shares, it is rare to have similar big discounts.
>
> Shareholders do know the past image of Chinese Estates but this will fade with time. The stock market is not a place to argue with bank notes, like Lai Sun Development (488), compare to Chinese Estates, its image was not that good either but since the end of last year, its share price has increased by 1.4 times. *Chinese Estates can be speculated as a laggard and it is a bargain to speculate its assets. Stock players who are willing to take a bigger risk may speculate on Chinese Estates Warrants 560 and 901."* [the Tribunal's italics]

On 15th November, the *Sing Tao Daily* commented under the headline : 'Chinese Estates warrants are worth noticing' –

> "It is obvious that share price of Chinese Estates has lagged very much behind the market. Since the Group is not a property development share, it has not been noticed by the market. However, there has been a trend recently to speculate rental related shares… Judging from the

> chart, as long as there is a slight halt, the shares will have momentum for another breakthrough beyond the present upward fluctuation sector, catching up the gap that it has lagged behind previously. It may reach $8.5 or $9 as a target."

In the circumstances, Mr. Witts was of the opinion, shared by other experts and by the Tribunal too, that one of the causes for the general rise in price of Chinese Estates' shares and covered warrants in November (up to and including 21st of that month) lay in the fact that it was benefitting from a general advance in property securities and was in addition being seen by a number of newspapers as a good speculative buy, a laggard that was going to catch up.

2. The purchase of securities by Mr. Joseph LAU{ XE "*Joseph LAU:*purchase of securities" \b *}*

As stated in Chapter One, it was never disputed during the inquiry that from 1994 through until early 1998 Mr. Joseph LAU was a consistent purchaser of the listed securities of Chinese Estates rather than a seller.

To provide added assistance in this regard, the Statement of Admitted Facts filed at the beginning of the inquiry is attached to this report marked Annexure N. Paragraphs 17 to 20 of those Admitted Facts give details of Mr. Joseph LAU's acquisitions over an extended period of time as does Annexure B which sets out his daily trading between 29th October and 21st November 1996 (inclusive).

In Annexure B, the total purchases made each day by Mr. Joseph LAU are reflected as a percentage of that day's market turnover. These percentages illustrate the high level of his participation in the period of 24 days preceding formal announcement of the sale of Entertainment Building. For example, in this time he purchased 35,796,000 shares which the Tribunal calculated to be approximately 40% of that month's turnover.

On 21st November Mr. Joseph LAU did not purchase any shares in Chinese Estates but he did make substantial purchases of covered warrants purchasing 61,120,000 of stock #560 (being 30.02% of the day's turnover) and 126,160,000 of stock #901 (being 20.88% of the day's turnover).

Commenting on this substantial and regular acquisition of both shares and covered warrants, Mr. Clive Rigby{ XE "Clive Rigby" \b } commented in his report :

> "I believe that the trading record shows that Joseph LAU's buying was of such a size that its effect would inevitably push prices higher. I would be surprised if he did not realize that this would force the hedgers to, in turn, buy more."

On all the evidence, the Tribunal was satisfied that between 29th October and 21st November 1996 (inclusive) the heavy buying by Mr. Joseph LAU would have played a role in both maintaining and also to a degree in increasing the price of Chinese Estates securities, more especially when that buying is considered in light of the activity surrounding the covered warrants. Mr. Rigby{ XE "Rigby" \b } himself recognised the covered warrant factor when, in his comment set out above, he made reference to 'hedgers', these being the issuers of the covered warrants.

In this regard, specifically, the Tribunal noted that on 20th November Mr. Joseph LAU purchased 9,356,000 Chinese Estates shares which comprised 47.14% of that day's total turnover and which must have brought a reaction from the issuers of covered warrants who would have sought to hedge their positions. This in turn, in light of the general media recommendations, may have triggered increased buying by retail investors.

3. Hedging activities{ XE "Hedging activities" \b }

In his report, Mr. Toby Heale{ XE "Toby Heale" \b }, another expert witness who testified before the Tribunal, concentrated on the hedging activities brought about by the existence of covered warrants. The Tribunal is indebted to him for the lucid explanation given on the essential nature of covered warrants. Mr. Heale explained that they are 'leveraged instruments' which, while always moving in close relationship with the ordinary share price, nevertheless provide the investor with the potential for far greater returns :

> "This gearing is central to what the issuers of warrants try to provide

> and it is what the buyers of warrants want exposure to. The result is that the performance of a share is largely transferred from that share to the covered warrants on it. The result is that the share ceases to perform as well as it used to, or could be expected to, because there is another vehicle in existence (the warrant) that gives better performance to the investor. This is why companies and their directors are often hostile to warrants being issued on their shares. The warrants detract from the share's ability to perform. The lesser performance of the share makes raising new capital more difficult, and it makes rewarding executives with share options less meaningful. Warrants detract from the investment attraction of the company and reduce wealth accumulation by shareholders.
>
> It is generally known and accepted that houses like Merrill Lynch and Credit Lyonnais etc. write warrants because they make money out of them. They make money out of them by managing their risk. Although these warrants are called 'Covered', the cover is not necessarily what a layman would understand or expect. The issuer does not usually own all the shares of the company which they would need to issue in exchange if all the warrants were to be presented for conversion into the shares of the underlying company. But they do own a substantial but varying percentage so as to limit their risk."

How then do the issuers of the covered warrants manage their risk? In this regard, Mr. Heale spoke of the use of complex computer programmes which make use of mathematically proven formulae to 'analyse or reduce or manage' risk. A central method by which this is done is by buying or selling the underlying share; by a requirement to buy when the underlying share is rallying and by a requirement to sell when the underlying share is falling in price. Mr. Heale explained it in the following terms :

> "The issuers without exception in my experience manage this risk on a computer programme, one example of which is called the Delta Hedge. This programme makes calculations based on a number of variables and assumptions entered into it by the risk manager. These variables and assumptions would typically include interest rates and predictions of interest rate moves, the level of the index, the remaining life of the warrant and so on. It also watches the underlying share price. If the

> share price rises, the writer's risk of having to provide shares in exchange for their warrants rises, particularly when the warrant is approaching its expiry date, and the Delta Hedge, or similar programme, will require buying of the underlying shares by the warrant issuers to reduce their risk. If the share price falls, the Delta Hedge will recommend selling the underlying share. It can be seen that each time when the share price rises, for any reason, the warrant issuers will need to buy shares. *In other words a share price rally will feed on itself by creating a further need for the warrant issuers to buy more shares each time the price rise"*. *[the Tribunal's italics]*

When he testified before the Tribunal, Mr. Joseph LAU accepted that, while he may initially have had a benign view of the covered warrant issues, by November 1996 he was of the opinion that their existence was adversely affecting the performance of Chinese Estates' shares in that the net asset value (the NAV) of the shares was not being adequately reflected in their price. He said that he took advice on the issue and, in order to remove the impediment, was told that he needed to purchase significant amounts not only of shares in his own company but also of the covered warrants themselves. As warrants 560 and 901 were both due to expire first (on 31st January 1997), he said that he concentrated on those 2 issues. Annexure B to this report shows that he began to purchase those warrant issues on 6th November 1996 and by the close of trading on 21st November had acquired 39.17% of the total issue of warrant 560 and 37.67% of warrant 901, all of which, of course, were later converted for shares in Chinese Estates[1].

Mr. Heale was of the opinion that Mr. Joseph LAU's concerns about the deleterious effect of the covered warrants on the performance of his company's shares were justified. He was further of the opinion that his heavy buying in order to remove or substantially reduce that deleterious affect was justified.

In respect of the price rise in the securities of Chinese Estates in November, up to and including 21st of that month, Mr. Heale attributed one of the fundamental causes to a shift in the 'supply and demand' position of

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[1] For details of the conversion dates and the number of warrants converted on each occasion, see the Admitted Facts (Annexure N) at paragraph 19.

Chinese Estates shares.

In this regard, he referred to the Evergo spin-off{ XE "*Evergo spin-off*" \b } in which Chinese Estates accomplished the separate listing of its Mainland property interests on the Hong Kong Stock Exchange{ XE "Hong Kong Stock Exchange" \b } by vesting them in a new, publicly-listed company, Evergo China Holdings Limited. Investors who held shares in Chinese Estates the day before the Register of Members{ XE "Register of Members" \b } was closed were entitled to a special interim dividend *in specie* of 623 Evergo China shares for every 4,000 shares of Chinese Estates held by them. So that the necessary records could be tabulated, the Register of members remained closed for 3 trading days from 13th to 15th November (inclusive).

Mr. Heale testified that the risk managers of the covered warrants would have known that warrant holders would be likely to covert their warrants in order to obtain Chinese Estates shares which, in turn, would entitle them to the special interim dividend of Evergo China shares. His research, he said, showed that there were, in fact, conversions which, while not large, when taken in conjunction with evidence of the continued purchase of shares and warrants, would have placed the risk managers on notice that the balance of supply and demand was changing. The issuers of covered warrants, he said, were among the larger buyers of Chinese Estates shares in the month of November 1996 up to the announcement of the sale of Entertainment Building (Mr. Joseph LAU was the largest individual buyer) because, in great measure, their risk management programmes would have directed them to purchase. The limited 'free float' of Chinese Estates shares at that time would also have had an impact, he said. Mr. Heale summarised the position in his report by saying :

> "The situation therefore was that a share [Chinese Estates], trading at a discount of about 35% to its NAV, which had been a laggard in the market in share price performance terms and which also had an abundant supply of warrants available, suddenly went into a position of net demand. That demand was inserted into the market position as a result of the distribution *in specie* of the Evergo China shares, and the buying by Joseph LAU and by the warrant issuers. The resulting price rise is no more than one should expect from such a substantial shift in the underlying supply and demand, particularly in view of the other

> causes to which I refer above. The performance of the share price under those circumstances is not surprising. In terms the warrant issuers use, the share had been gapped (as, in all probability, so had the warrant issuers). The supply of shares at a given level had been exhausted and the share price rose quickly to the next higher price level where there was supply."

It should be noted that other expert witnesses agreed with Mr. Heale's basic submission that when a share is rising, the risk managers of covered warrants related to that share will inevitably purchase that share. Mr. Rigby{ XE "Rigby" \b }, in his report, said :

> "Another factor in the buying pressure is, of course, the hedging activity of the warrant issuers. Delta hedging is a reactive strategy not a proactive one. By this I mean that hedgers have to buy more as prices go up. They do not buy in a flat or declining market. This can snowball in a thin market."

It is pertinent to note that, in Mr. Rigby{ XE "Rigby" \b }'s opinion, Chinese Estates was not a share which, comparatively, enjoyed a large trading volume. Except in exceptional circumstances, it was therefore a 'thin' share and substantial buying by Mr. Joseph LAU and the covered warrant issuers would, therefore, have had a noticeable effect.

Professor K.C. CHAN{ XE "K.C. CHAN" \b }, also an expert witness, said that he had reviewed Mr. Heale's analysis and agreed with it. It is of interest that when he examined the daily trading of covered warrant issuers in November 1996, he found that the buying activites were 'more concentrated' on 14th – 15th and then again (significantly) on 21st – 22nd of the month. The early buying concentration, he said, could be explained by a reaction to the conversion of warrants to enable warrant holders to participate in the benefits of the Evergo spin-off{ XE "*Evergo spin-off*" \b }. The buying activity on the 21st – 22nd, he believed, could well reflect the 'delta hedging{ XE "delta hedging" \b } needs' of warrant issuers, especially on 21st November.

In light of the concurrence of expert evidence, the Tribunal was satisfied that the hedging activities of the issuers of covered warrants would

also have been a factor causing the rise in the price of the listed securities of Chinese Estates in November 1996, including 20th and 21st of that month.

4. The Evergo spin-off{ XE "*Evergo spin-off*" \b *}*

From a historical perspective, it may be said that the Evergo spin-off**{** XE "*Evergo spin-off*" \b **}** was not a success. However, in the Tribunal's opinion, what cannot be ignored is that when public dealing in the shares of Evergo China commenced on 20th November 1996 it caused a flurry of activity. Evergo China shares ended the day up 11.8% on their placement price. Even on their second day of trading – 21st November – they continued to rise and be actively traded. The *South China Morning Post*, in an article published on 22nd of the month, reported the previous day's trading in the following terms :

> "Evergo China saw plenty of action during its second day of trading yesterday, closing 3.72 per cent higher at $1.67 amid the highest volume in the market. Shares in the China property developer rose to as high as $1.78 in early trading as more than 173 million shares changed hands. The company had earlier placed 160 million shares to institutional investors at $1.44 a shore. Brokers said the shares had benefitted from the general interest in stocks with exposure to China, and the renewed fervour shown by investors for property issues. Evergo, which was spun off from Chinese Estates, has interests in 23 projects in China."

But what of the shares of Chinese Estates itself? These rose 3.77% on the first day of trading in Evergo China shares and 9.70% on the second day. Was there, however, evidence of any causal link?

In this regard, Professor CHAN conducted a statistical analysis to see if in the 15 trading days that followed the listing of Evergo China any correlation could be found between the price movement of its shares and those of its 'parent' company which retained a 63.8% interest in Evergo China**{** XE "Evergo China" \b **}**. Professor CHAN concluded that the volatility of Chinese Estates securities during the first few days of public trading in Evergo China was not so much related to whatever news was affecting other property stocks but rather was caused by the same trading behaviour that was affecting the share price of Evergo China.

As to the suggestion that the price rise was caused by rumours of the sale of Entertainment Building, Professor CHAN commented :

> "The evidence that the Evergo China's listing was a significant factor causing the price movements in the days around the sale of the Entertainment Building, suggests that we need to be cautious in interpreting whether CEHL's [Chinese Estates'] price movements were related to the sale of the Entertainment Building. In my view the significance of the Evergo China factor in explaining CEHL's price movements makes it difficult to accept the suggestion by Mr. PANG …"

On the basis that Chinese Estates had retained a 63.8% interest in Evergo China, Mr. Heale was of the opinion that an increase in the price of shares in Evergo China had to benefit the parent company. The following is an extract from the transcript of his evidence :

> "Q: What about the perception of CEHL [Chinese Estates] when Evergo has turned out to be a very successful listing?
>
> A: It has to improve. It has to improve because there is more value in CEHL as a result of the successful debut of Evergo China and the higher price attached to those shares.
>
> Q: Is this something that might attract some professional and retail investors, in your view?
>
> A: I do not think it would detract – whether it attracted them or not, I do not know. I cannot think for a second it would detract, so, yes, an increase in value and a good start to Evergo China would bring people closer to buying, or bring them in to buy."

Mr. Witts was even firmer in the view that the considerable interest on 20th and 21st November in the newly listed shares of Evergo China would have enhanced the value of Chinese Estates securities in the mind of the market.

The media widely reported the heavy trading on the first day of listing. The *Tin Tin Daily* reported :

> "… Evergo China is worth speculating on even more. Due to the high

> turnover, one can sell it as soon as one buys it. It is sure to attract large, medium and small investors into the fray."

At least one newspaper commented on the success of Evergo China having a beneficial effect on the share price of Chinese Estates. In this regard, the *Oriental Daily News*, on 21st November, published a headline which read :

> "Evergo China Performed Well on first day of listing. Chinese Estates Mother Prospering Because Of Her Son With Share Prices Reaching New High."

Mr. Rigby{ XE "Rigby" \b }, however, did not share the opinion of the other experts. While he accepted that the heavy trading in the shares of Evergo China on 20th and 21st November would have had a positive impact on Chinese Estates' price, in his opinion, the effect would have been minor and could not account for the 9.77% increase in the share price on 21st of that month.

By November, he said, the news of the spin-off was stale news and had been discounted. In addition, after the 'opening hype', trading volume and prices declined continually through until the summer of the following year, eventually (in June 1997) dropping below 95 cents. This, said Mr. Rigby{ XE "Rigby" \b }, was to be contrasted with the performance of the 'Red Chip{ XE "Red Chip" \b }' Index which roughly doubled in the same period.

The Tribunal accepts that by the opening day of the listing of Evergo China certain sections of the market would no doubt already have discounted the news of that spin-off in assessing whether to buy the securities of Chinese Estates. It also accepts that after the first few days of trading, the shares of Evergo China set into a steady decline: further indication of the market's general long term view of those shares.

However, the focus of the Tribunal in this inquiry has been brought to bear essentially on just 2 days; namely, 21st November (the day before the formal announcement of the sale of Entertainment Building) and 22nd November (the day of the announcement). When focusing on those 2 days,

the Tribunal has been unable to ignore the fact that Evergo China had just been listed amid considerable media fanfare and in its first 2 days of trading – 20th and 21st November – had risen some 15% above its placement price. In addition, share turnover had been some of the heaviest in the market.

Nor has the Tribunal been able to ignore the fact that, with a 63.8% interest in Evergo China, investors may well have acted on the basis that Chinese Estates was a good buy too; even if only on a short term speculative basis. The press after all was tipping Chinese Estates at about this time as a good speculative purchase in respect of both its shares and the existing covered warrants. Professor CHAN's correlation analysis was also persuasive in demonstrating the likelihood of a direct causal link between the volatility of the listed securities of both companies at this critical time.

CONCLUSION

Naturally, in assessing the impact on Chinese Estates' securities of the various factors to which reference has been made, none of the expert witnesses was able to isolate and then quantify in mathematical terms the impact of each individual factor. At best what could be commented upon by the experts was whether, in their opinions, when taken together with all other known factors, one particular factor would or would not have had a material influence.

In conclusion, therefore, it was the unanimous opinion of the Tribunal that it was *not* demonstrated to a high degree of probability that when news of the sale of Entertainment Building became generally known it did have a material impact on the price of Chinese Estates' listed securities. In broad terms, by way of a summary, 3 factors influenced the Tribunal in reaching this decision.

First, aside from the sale of Entertainment Building, there were at the time a number of other dynamic factors affecting both the market generally and Chinese Estates in particular which the Tribunal is satisfied must, to varying degrees, have had an impact on the price of the listed securities of the company.

Second, while the Tribunal accepts that there may well have been rumours of the sale of Entertainment Building in some sections of the market during the afternoon of 21st November, it could not be satisfied on the paucity of evidence that such rumours had circulated to a degree that caused a level of buying sufficient to boost materially the price of Chinese Estates listed securities.

Third, when the formal announcement of the sale was made the following day; that is, on the morning of 22nd November, there was no evidence of a materially favourable impact on the price of Chinese Estates securities. Nothing beyond a short-lived fluctuation was shown; indeed the covered warrants fell back on 22nd November while on the following trading day (25th November) both the shares and the covered warrants were down.

B. Whether the news was nevertheless likely to have a material impact …

In their text, *Insider Dealing*[1], the authors, Ashe and Murphy{ XE "Ashe and Murphy" \b }, make it clear that the materiality test cannot always be determined simply by having regard to evidence of the actual impact on the market of the information when it became generally known. In this regard it bears repeating their words :

> "… the test price sensitivity has to be applied at the time the deal by the insider or tippee took pace and conditions in the market may not be the same at the time of the release of the information. *So it cannot always be assumed that the impact of the news on the market will be finally determinative of the issue."* [the Tribunal's italics]

In the final analysis, the materiality test must always amount to an assessment. It is self-evident that in the period between an insider acting and the inside information becoming generally known there may be intervening events which affect the fortunes of the general market; there may be intervening events which affect the fortunes of the individual company within that market. On a rising market there may, for example, be profit taking which cannot always be anticipated. Invariably, stock markets are

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[1] See Chapter Two page 44.

fluid, complex institutions and as such may act in a fashion contrary to even the most educated estimates. As Mr. Clive Rigby**{** XE "Clive Rigby" \b **}** commented in his report :

> "Stock market traders' decision making is based on varying mixes of rumours, tips, supposition, belief and expectation as well as analysis. They may at times act irrationally but they are invariably motivated by the desire to make profits."

As stated in Chapter Three, the Tribunal found that Mr. Joseph LAU only came into possession of specific information concerning the sale of Entertainment Building in the early hours of 21st November 1996. He therefore traded in the listed securities of Chinese Estates for just one day – 21st November – before news of the sale was placed in the public domain. In the circumstances, in respect of that single day's trading, in the absence of evidence of actual impact, the Tribunal has asked itself this question: has it been shown to a high degree of probability that the information of the sale, if it had been generally known that day, would have been *likely* materially to affect the price of Chinese Estates' listed securities and did Mr. Joseph LAU know that it was information that was *likely* to have such an affect? In this regard, the Tribunal considered a number of matters which had been raised during the inquiry.

1. Media interest

During the course of his testimony, Mr. Joseph LAU attempted to convey the impression that, at the time negotiations were being concluded, he did not consider the sale of Entertainment Building, at what he believed to be a fair market price, to be a matter of any great moment. For example, at one time he said that it was 'only the sale of a property' at its net asset value. At another time the transcript reveals the following exchange :

> "Q: … you say that essentially this was just another piece of business and it never entered your mind that it was something important or special that should prevent you from continuing to buy shares or warrants?
>
> A: Of course, in my mind, I would not think that was important, therefore I was still buying shares and warrants; otherwise, I would

stop.

Q: This was your view all along?

A: That was what I thought."

Mr. Joseph LAU may personally have chosen to adopt a sanguine attitude towards the sale. But, as chairman of a public company that concentrated heavily on property investment, and with an on-going obligation to ensure the interests of all shareholders, the Tribunal was satisfied that he must – and did – appreciate the importance of the disposal both to Chinese Estates itself and to the market generally. The size and architectural distinction of the building, its prime location in Central, the fact that it was being sold as an entire unit and the price to be obtained made this manifestly a disposal of considerable interest to the market generally and to likely investors too. Mr. Joseph LAU must have known that it would attract considerable interest which, of course, it did.

On 23rd November, numerous articles appeared in the Chinese language press, many showing photograph of Entertainment Building.

On that same day an article appeared in the *South China Morning Post* under the headline : 'Plaza deal spurs land revaluation'. The article began :

> "Hysan Development's purchase of the Entertainment Plaza in Central has analysts across Hong Kong revaluing property stocks.
>
> The "above-market" price paid by Hysan had set a new benchmark by which other property holdings must be valued, they said.
>
> Trevor CHEUNG**{** XE "Trevor CHEUNG" \b **}** at Credit Lyonnais Securities**{** XE "Credit Lyonnais Securities" \b **}** said : "The fact that a whole building changed hands between two listed companies means this transaction will have to be a benchmark. Because of the deal we are revising upward our NAVs (net asset values)."

The article continued :

> "… many analysts will be working this weekend to update their NAV

> estimates. A member of Lehman Brothers' property team said : "We are in the process of seeing what amount we will increase NAVs. It is reasonable to assume that net asset values [for property investment firms] are being raised across the board."."

Another article in the same newspaper (seemingly written by another journalist, Ms. Peggy Sito{ XE "Peggy Sito" \b }) commented :

> "Analysts said the $3.64 billion purchase, which would be completed in May next year, reflected the full market value of the property in the short term.
>
> They said Chinese Estates and other property investment companies with good commercial portfolios such as Hongkong Land{ XE "Hongkong Land" \b } and Great Eagle Holdings{ XE "Great Eagle Holdings" \b } would benefit more than Hysan from this aggressive purchase.
>
> The net asset value of Hongkong Land{ XE "Hongkong Land" \b }, which has a dominant holding in Central commercial properties, has been revised up by analysts by 20 per cent to 35 per cent after the deal."

An analysis circulated to clients by Credit Lyonnais Securities{ XE "Credit Lyonnais Securities" \b } on 22nd November, the day of the formal announcement, commented that the sale was another piece of positive news which was 'building to drive the Hong Kong market well beyond fair value'. In respect of Chinese Estates itself the article commented :

> "The most obvious beneficiary is Hongkong Land{ XE "Hongkong Land" \b } as it is the most pure play on Grade A office. Its NAV will increase by more than 20% to US$3.96/share. It is top pick in the sector along with Swire and on a trading basis Chinese Estates. *This is an excellent deal for Chinese Estates who will have more than HK$2.7bn profit from the transaction and NAV moves up to HK$12.5/share."* [the Tribunal's italics]

There was, therefore, wide media coverage of the sale. If any of the parties to the sale came in for negative comment, it was not Chinese

Estates but was Hysan which was criticised in some quarters for paying too high a price. In an article dated 26th November in the *South China Morning Post* a Mr. Andrew Taylor**{** XE "Andrew Taylor" \b **}** at Asia Equity was quoted as saying that Hysan had paid a 'ludicrous price' and would suffer dearly for its purchase. Other commentators, however, were of the opinion that Hysan had secured a 'gem' and would benefit in the long run from its 'aggressive' buy. Concerning Chinese Estates, the evidence before the Tribunal was to the effect that the general media reaction was that it had secured – to quote the Credit Lyonnais analysis – an 'excellent deal'.

In light of the evidence that a substantial portion of those accustomed or likely to invest in Chinese Estates were small retail investors, many looking for short term speculative profits, and also that at about that time the company was being punted in some sections of the media as a laggard likely to climb in price[1], it is the opinion of the Tribunal that the positive media coverage of the sale must have had the potential at least to provide an additional incentive to investors - especially speculators looking for short term gains - to purchase the company's listed securities.

*2. The NAV factor**{*** XE "*NAV factor*" \b ***}***

With the exception of Mr. Alex PANG**{** XE "Alex PANG" \b **}**, the expert witnesses who gave testimony on the subject agreed that property investment companies are commonly valued in the stock market on a basis relative to their net asset value. The Tribunal had no reason to disagree with this concensus.

To understand the fundamental concept, Mr. Heale referred the Tribunal to an English publication, the *Investors Chronicle**{*** XE "*Investors Chronicle*" \b ***}***, that explained in simple terms the invariable manner in which property shares are valued :

> "Property companies come in four main varieties : investment companies, development companies, trading companies and dealing companies. And many quoted companies are hybrids. The last three types of share are more complicated to value, but shares in property

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[1] See pages 73-75 *supra*.

> investment companies are valued almost entirely by looking at their asset backing. Most of them invest in good quality office blocks, shops, factories and warehouses – all of which are usually readily saleable to the big investment institutions. So it is possible to put a fairly realistic price on the buildings a property investment company owns – though the actual sums involved are tricky. And most property companies publish up-to-date valuations of their properties regularly.
>
> To get the company's asset value per share you take the value of its buildings and land and knock off everything it owes. Divide the end figure by the number of shares in issue and you have your net asset value per share. The share price itself will normally be slightly below this asset value … Typically, a share price will stand at a discount of around 10 to 30 per cent of its assets."

In its 1995 annual report, Chinese Estates reported that Chesterton Petty**{** XE "Chesterton Petty" \b **}** Limited had carried out a valuation as a result of which, as at 31st December 1995, investment properties held by it had been assessed to have a valuation of $19,220,913 million. There was no further reported valuation of its investment properties before the announcement of the sale of Entertainment Building on 22nd November 1996, almost 11 months later. In such circumstances, as Mr. Heale said, it would be necessary from time to time, in between formally reported valuations, for market analysts to 'update' their estimate of a company's current net asset value. In respect of the sale of Entertainment Building, Mr. Heale accepted that this would explain the newspaper reports[1] which commented after the sale of Entertainment Building that many market analysts would be updating their NAV estimates of property investment companies.

Mr. Heale pointed out that of course a revision of NAV estimates by market analysts did not mean that the Entertainment Building had necessarily been sold above market price, it meant only that the analysts were out of date and were bringing themselves up to date. However, while the Tribunal accepted that correctness of that assertion, it could not ignore the evidence that, because of the media reports, the ordinary, reasonable investor would probably have been led to believe that a benchmark price had

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[1] Quoted on pages 87-88 *supra*.

been attained by Chinese Estates which warranted an upward revision of its net asset value per share. Indeed, in this regard the analysis of Credit Lyonnais Securities{ XE "Credit Lyonnais Securities" \b } (quoted on page 131 *supra*) bears repeating :

> "The most obvious beneficiary is Hongkong Land{ XE "Hongkong Land" \b } as it is the most pure play on Grade A office. Its NAV will increase by more than 20% to US$3.96/share. It is top pick in the sector along with Swire and on a trading basis Chinese Estates. *This is an excellent deal for Chinese Estates who will have more than HK$2.7bn profit from the transaction and NAV moves up to HK$12.5/share.*" [the Tribunal's italics]

From the contents of its 1995 annual report (published in early 1996), the net asset value per share of Chinese shares could be calculated at $11.20. On the basis of the Credit Lyonnais analysis, however, that NAV per share had now been revised upwards by $1.30, an increase of more than 11%. Other market analysts, of course, may not have been so generous in their revision.

The Tribunal accepted that, with the general increase in property prices in 1996, investors would have appreciated that there must contemporaneously have been a general upward revision in the net asset value of most real estate portfolios held by property investment companies. But there has been no evidence to suggest that such investors were, in general, any more up to date than the market analysts whose advice they read. Accordingly, if the analysts felt it necessary to make sharp upward revisions of their NAV estimates, there is every reason to think that a material number of ordinary, reasonable investors would follow the published wisdom and do so too, providing a further reason to purchase Chinese Estates securities.

In talking of ordinary, reasonable investors, the Tribunal was further of the opinion that investment funds too, in light of the upward revision of NAV estimates, may well have considered it prudent to boost their holdings of property investment stocks, including shares in Chinese Estates.

3. Realisation of capital gains

In his statement dated 15th May 1998 (paragraph 51), Mr. Alex PANG{ XE "Alex PANG" \b } of the SFC{ XE "SFC" \b } said the following :

> "The above information (i.e. contemplated sale of a major asset which would realise huge profits), if known to the market at that time, would have a positive effect on the price of CEHL's securities. The reason for this is that :-
>
> (a) In May 1986 when Evergo Industrial Enterprise Ltd. (its chairman, Joseph LAU) made an offer to shareholders of Chinese Estates Ltd., the then capital value of the old Entertainment Building was stated as $300 million. In 1991 the estimated reconstruction cost of the Entertainment Building was $363.3 million. Therefore, the total cost (including acquisition cost and reconstruction cost) of Entertainment Building should not be more than 663.3 million. In June 1993 Chesterton Petty{ XE "Chesterton Petty" \b } valued it at $2.4 billion.
>
> (b) Assuming CEHL was serious in its indication through Thomas LAU to sell Entertainment Building{ XE "Entertainment Building:tenancy" \b }, and if a sale could be arranged at the prevailing market price, it would realize enormous profits for CEHL.
>
> (c) Normally, when a listed company makes huge profits, this would have a positive effect on the price of the company's securities. To a lesser extent, the anticipation of huge profits would also have a positive effect on the price of the company's securities."

This statement was the subject of robust criticism by the other experts who testified before the Tribunal. They argued that in the circumstances under consideration 'historical cost' was essentially irrelevant. In particular, Professor CHAN wrote in his report :

> "For property investment companies like CEHL [Chinese Estates], their properties get appraised by the stock market constantly, taking into account the latest market information of commercial properties. The share prices of CEHL and other property investment companies reflect

> the latest transaction prices and the market's expectation about future supply and demand conditions. The share prices of property investment companies change whenever the market updates the valuation of their assets upon receiving new information about the commercial properties market. This process takes place continuously as new information about latest transaction prices reach the stock market. For these reasons, the historical cost of acquisition and rebuilding of Entertainment Building is a irrelevant piece of information as far as the market is concerned. Even the independent valuation published in the CEHL's Annual Report is relevant only to give a base value which may be raised or lowered as the property market moves. The stock market does not wait for an official professional appraiser's report to update the company's share prices."

The Tribunal accepted the essential validity of this opinion. However, the Tribunal was also of the opinion that if a company was intending a change in business direction which required a financial 'war chest' and if that company was able to realise substantial capital gains by selling a property at a price which the market at the time saw as setting a new benchmark, then those accustomed or likely to invest in the company would well believe that such a substantial capital realisation would be to the company's very clear advantage.

In this regard, evidence was placed before the Tribunal which showed that Chinese Estates had earlier decided on a change of direction from property investment to property development. In the company's 1995 annual report the following was stated :

> "The Group plans to increase its property development activities, either by way of teaming up with other developers or on its own. The aim is to generate a stable recurring income for the Group from development projects. The Land Development Corporation has awarded a redevelopment project in Wanchai to a consortium in which the Group has a 40% interest and this project represents one step which has been achieved towards implementing this policy. The Group also intends to continue to dispose of its non-core properties when appropriate and to concentrate mainly on major investment and development properties."

As mentioned earlier in this report[1], a number of stock market analysts were aware of this change of business direction. For example, in a document dated 15th November 1996 Credit Lyonnais Securities{ XE "Credit Lyonnais Securities" \b } commented :

> "… the company has also begun to extend its tentacles into the realm of residential property development. The Company is making the transformation from a property investor to an amalgamated property company. With the outlook for office leasing remaining at best neutral to mildly positive, the company is capitalising on the buoyant sentiment in the sales market to lock in the capital gains on its properties. Not only will such disposals shore up profits in the financial year 1996 and financial year 1997, the enhanced financial position will enable the company to boost its development landbank."

In the opinion of the Tribunal, therefore, investors would have had grounds for believing that Chinese Estates, by selling Entertainment Building, had demonstrated its market skill in realising substantial capital gains on the sale that would help fund its property development landbank.

C. The determination of the Tribunal

The Tribunal had no hesitation in coming to the finding that, in the great majority of cases, with a sale of such influence and interest, an insider would be foolhardy to deal before news of the sale was in the public domain.

But the Tribunal, of course, was tasked with determining the particular not the general. In light of the various factors referred to in section B, the Tribunal found it a most difficult task to determine whether the information of the sale of Entertainment Building, if it had been generally known on 21st November 1996, would have been likely materially to affect the price of Chinese Estates listed securities and whether Mr. Joseph LAU knew that it was likely to have such an affect.

In the result, one of the Tribunal members was satisfied to a high degree of probability that, no matter how the market may have reacted, news

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[1] See Chapter One, page 3.

of the sale of Entertainment Building was nevertheless news that was likely materially to boost the price of Chinese Estates listed securities and that Mr. Joseph LAU, who well understood the nature of his own shares, did know that the news would be likely to have such an impact. However, the remaining two members were not so satisfied.

It has already been said that the size and architectural distinction of Entertainment Building, its prime location, the fact that it was being sold as an entire unit and that the price obtained was setting a new benchmark made it manifestly a sale which would attract interest in the market generally and also among investors and likely investors. The remaining two members had no difficulty in coming to that conclusion nor to the conclusion that it was, in that sense, a sale of consequence and that Mr. Joseph LAU must have known that to be the case.

But, in the opinion of the two members, while specific information of the sale would have been of interest to investors and viewed favourably by a significant number of them, and while these are factors which may indicate that the information was price sensitive, they could not be satisfied that, in the circumstances prevailing at the time, the information was of such a nature as to be likely *materially* to boost the price of Chinese Estates' listed securities. Nor could the two members be satisfied, in the circumstances prevailing at the time, that Mr. Joseph LAU must have known – and did know – that the information, if made public, would be likely to have that *material* impact.

There were a number of reasons why, on the evidence, the two members came to that finding. They were, in summary : the neutral affect of selling at market value, the lack of evidence of any actual impact on share prices and the investors' perception of Chinese Estates.

1. The neutral effect of selling at market value

It was the opinion of three of the experts who testified before the Tribunal (Mr. Heale, Mr. Witts and Professor CHAN) that the sale of a building such as Entertainment Building at a price that the market could readily assess to be essentially the prevailing market price, while it may excite interest, especially interest in the media, would nevertheless be

considered by the market to be essentially neutral information; in short, information that would not be capable of having a material affect on the share prices of either the vendor or the purchaser.

It was never disputed that in the second half of 1996 commercial property prices in Hong Kong were rising. But this rise, said the three experts, would have been computed into the share prices of property investment stocks on an on-going basis. Therefore, benchmark sales would excite interest not because they necessarily revealed that the vendor had sold well above prevailing market price and had thereby made an unexpected profit but because such sales acted as 'markers' confirming the level of the rising market which had already, to a large degree, been estimated and computed into the price of property investment stocks. The following exchange between the Chairman of the Tribunal and Professor CHAN illustrates the point.

> Chairman: … could there not be a situation, which I think has been mooted here from time to time, that simply a new level was reached; in other words, Hysan did not overpay and CEHL [Chinese Estates] did not give away a bargain. Both parties came on a rising apex and both of them met at the top of the triangle. In other words, your market is rising and you have hit the rising market, you have both hit a perfectly good, rational deal?
>
> A: It is entirely possible. In fact this is my argument.
>
> Chairman: So on that basis then, would that not be good news for both sides?
>
> A: It would be neutral news for both sides, because CEHL basically exchanged an asset for cash and Hysan bought a property at fair market price. So it is neutral news.

In the opinion of the two members, Professor CHAN contended with merit that, if a sufficiently large section of the market had considered Chinese Estates had sold well above prevailing market price, that should have been reflected in an increase in the price of Chinese Estates shares when news of the sale was made public. But there was no increase of any significance. Conversely, if the market believed that Hysan had paid far too much for the building, that should have been reflected in a corresponding

drop in the price of Hysan shares. However, on 22nd November 1996 – the day of the announcement – Hysan's share price closed at $28.15, down only 35 cents from the previous day, while by the close of the next trading day its price had increased to $29.30 and then settled into a range of between $29.50 and $30.00. Professor CHAN concluded from this that the market in general had not believed that Hysan had paid above prevailing market price. As he said in his report :

> "This should not be a surprising conclusion. Why should Hysan, a large listed property-investment company interested in buying the Entertainment Building for investment purposes, overpay for the Entertainment Building? We should not expect CEHL [Chinese Estates], that was in no financial difficulties, to sell Entertainment Building for less than the market price either. In a transaction such as the sale of the Entertainment Building from one sophisticated investor to another, I would expect the price to reflect or be very close to the prevailing market price."

Mr. Heale was of the same view. Despite the media hype and the talk of excellent deals, it was his submission that Chinese Estates had sold in a rising market at essentially the prevailing market price and had therefore done no more than exchange one form of asset (property) for another of equal value (cash) for which it would then have to find some profitable use. At that moment in time, therefore, there was simply no rational basis for a significant number of investors to purchase Chinese Estates securities. Later perhaps it would be time to buy if Chinese Estates showed that it had put the money to good use and had generated increased recurring profits that in turn would generate expectations of increased dividends.

Mr. Witts went even further, suggesting that the sale was not the undiluted good news for Chinese Estates that it may have been for other property investment companies with large holdings in Central such as Hongkong Land**{** XE "Hongkong Land" \b **}**. In his opinion, in respect of Chinese Estates, the majority of informed investors would have considered the news to be either neutral or mixed.

Mr. Witts accepted that there could be occasions when the sale of a significant asset by a property investment company would – on that fact

alone – have a favourable impact on the share price. As he expressed it :

> "This could be, for example, where a company is suffering tight liquidity problems and, as a consequence, a depressed share price. A major asset sale here would be perceived as 'saving' the company and an appreciation of the share price would almost certainly follow as a direct consequence."

He pointed out, however, that Chinese Estates at that time was not suffering any form of liquidity problem. It had been reported in June 1996, he said, that Chinese Estates had a debt to equity ratio of 18.5% but a figure of less than 20% would be regarded by the market as being very low.

In his opinion – an opinion which the two members felt was rationally based – while Chinese Estates had secured a large war chest for future projects, it had at the same time 'cashed out' of Central and disposed of its only prime, rent-bearing asset in that area during a period of optimism and rising property prices. Accordingly, the news – while no doubt it was of importance and of interest to the market – was not all one-sided. The views of Mr. Witts, a gentleman of considerable experience in the Hong Kong market, were illustrated in a number of answers given during the course of his testimony to counsel for the Tribunal. For example, when asked to comment on the likely attitude of investors to the sale, he said :

> A: … of course they will focus on it; they are going to realise that he [Mr. Joseph LAU] will not get rent any more from that building; they are going to realise that he has cashed out of Central; and they will know that he has, yes, $3.6 billion in cash, but no idea what he is going to do with it unless it is to move into residential property development, for example, which has been a hint.
>
> Q: That is probably what a portion of the market perceived, you said earlier?
>
> A: Sure.
>
> Q: That was good news : they were liquid, they could move into redevelopment, residential?
>
> A: Yes, if you were positive on residential property development, that is true. If you were not, then you would be rather more

jaundiced in your attitude.

Shortly thereafter the following exchange took place :

Q: We have also heard many times that the sale was a benchmark?

A: I think any sale of a building in Central is going to be a benchmark because it is so comparatively rare.

Q: Yes, but the price –

A: Not the price, just the fact that it happens. Whether it was at a high price or at a low price, it is not often that we get buildings change hands in Central.

Q: But did not everybody re-rate their NAVs on the basis of it?

A: Indeed.

Q: And did not other property shares go up as a result of the –

A: Indeed they did, as I say in my own statement, but not Chinese Estates, who as I say cashed out.

Q: In view of all of that, how can you say that the news was neutral at best, probably bad?

A: Because we come back to the same point; he [Mr. Joseph LAU] has cashed out, he has taken his chips off the table, however you want to put it – he has sold his only asset in Central. Hindsight is a wonderful thing. We can now say that it was the correct thing to do, but I do not thing it was necessarily perceived as that at the time. Property prices were advancing strongly and he was no longer going to participate."

2. The lack of evidence of any actual impact on share prices

The materiality test is a hypothetical test. Nevertheless, having regard to the evidence of the three expert witnesses considered in the preceding section, and to the complexity of circumstances surrounding the sale of Entertainment Building, the two members were of the opinion that the lack of evidence of any *actual* impact on the price of Chinese Estates securities following the announcement of the sale had to raise a doubt in their minds. If, despite the considerable media interest that was manifested at the time, there was still no significant rise in the price of Chinese Estates shares; if indeed the covered warrant prices fell immediately and within a couple of trading days the share price dipped too, that had to constitute some

evidence that the news was never likely to be sufficiently price sensitive to bring about a material increase in the listed securities of Chinese Estates.

3. The investors' perception of Chinese Estates

During the course of the inquiry it became apparent that historically Chinese Estates, under the chairmanship of Mr. Joseph LAU, had not been popular with investors. Prior to 1994 the dividend policy of the company and its rights issues had been viewed unfavourably by large sections of the market. It is apparent that from 1994 onwards Chinese Estates had been more generous in its dividend policy but the two members of the Tribunal recognised that it takes time to change investor perceptions.

Mr. Joseph LAU accepted that the shares of Chinese Estates had not been as popular with the investing public as he would have wished. Certainly, he was of the opinion that the shares had traded at too great a discount to their net asset value, a fact which, he believed, did not reflect well on the management of the company and was not in the interests of shareholders. He therefore attempted to redress the position.

In the 1994 annual report, it was stated that some $814 million had been spent on the repurchase and cancellation of Chinese Estates shares and warrants in order to reduce the dilution factor and thereby increase the net asset value per share. Again, in the 1995 annual report, it was stated that some $48 million had been spent on the repurchase and cancellation of Chinese Estates shares for the same purpose. The results, however, were not encouraging. The shares continued to trade at a large discount. They continued to remain a laggard in the market.

In the course of his testimony, Mr. Joseph LAU said that he originally co-operated in ensuring the issue of covered warrants on Chinese Estates shares because he believed at that time that such issues would attract investor attention to his company. Regardless, Chinese Estates continued to be regarded by investors with a lack of enthusiasm other than as a laggard share which may, in a bull run, be speculated along with other laggards.

In such circumstances, the two members were unable to reject outright Mr. Joseph LAU's testimony that he did not believe that the sale of

Entertainment Building, at what he saw essentially as the prevailing market price, would be so well received by previously apathetic or cautious investors as to bring about a material increase in the price of his company's listed securities.

Why then did Mr. Joseph LAU make such substantial purchases of covered warrants (but not shares) on 21st November 1996? Was that on its own perhaps on indication that he was attempting to exploit his inside information? The Tribunal (that is, all three members) was not able to come to any such conclusion on that evidence alone. Mr. Joseph LAU testified that he did so because it was part of an on-going strategy to keep the share price of Chinese Estates stable and hopefully to bring about a situation in which the shares did not trade at such a large discount to their net asset value. He was concerned at what he now considered to be the malevolent effect of the covered warrants on his company's share price. He had been advised to make substantial purchases of both shares and covered warrants in order to lessen the unwelcome effect and that was the policy he was following. He had followed this general policy earlier in the year and from 29th October (when, under the Stock Exchange Rules, he was allowed to trade again upon the formal announcement of the Evergo spin-off{ XE "*Evergo spin-off*" \b }) he had continued to pursue that same strategy on a daily basis[1]. It was his evidence that he continued to trade on 21st November because he did not think at that time that his knowledge of the sale of Entertainment Building constituted information that would be likely to materially increase the price of his company's listed securities. If he had been of such a belief, he said, he would have ceased trading for that one day.

CONCLUSION

In light of the matters set out above, the two members could not be satisfied to a high degree of probability that the specific information of the sale of Entertainment Building possessed by Mr. Joseph LAU on 21st November 1996 was also information that, if generally known, would have been likely materially to affect the price of the listed securities of Chinese Estates. Nor could they be satisfied to the same high degree of probability the Mr. Joseph LAU knew that the information, if in the public domain, was

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[1] For a breakdown of Mr. Joseph LAU's purchases from 29th October to 21st November 1996. See Annexure B to this report.

likely to have such affect.

By a majority decision, therefore, the Tribunal**{** XE "Tribunal:conclusion" \b **}** found that Mr. Joseph LAU had not, in his dealings in the listed securities of Chinese Estates between 19th and 21st November 1996, been in breach of section 9(1)(a) of the Ordinance.

D. Reference to section 10(3) of the Ordinance{ XE "***Ordinance:***section 10(3)" \b ***}***

Section 10(3) of the Ordinance provides the following defence to a person who has been proved to have entered into a transaction which constituted insider dealing :

> (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.

During the course of the inquiry it was argued on Mr. Joseph LAU's behalf that, if the Tribunal was satisfied that he had entered into a transaction which was insider dealing, he was nevertheless entitled to be exonerated as an insider dealer by virtue of that section.

In the end result it was not necessary for the Tribunal to write out its findings in respect of this defence. However, for the sake of completeness (and in fairness to Mr. Joseph LAU) it should be mentioned that if it had been necessary for the Tribunal to write out its findings in detail, the Tribunal would have found – again by a majority decision - that Mr. Joseph LAU had established that he entered into the transactions otherwise than with a view to making a profit by the use of relevant information.

It must be emphasised, however, that while the Tribunal had little difficulty in disposing of the allegations made against Mr. Johnson LAM, it faced a far more onerous and less clear-cut task in respect of Mr. Joseph LAU. The majority decisions reflect this fact.

In the unanimous opinion of the Tribunal, this inquiry (in so far as it has related to the dealings of Mr. Joseph LAU) has again highlighted the need for a higher level of awareness by the Chairman and Directors of companies as to when it is safe to deal in their own company's securities. As it was said in an earlier inquiry[1], it is imprudent, without the benefit of professional advice, to conduct such dealings in the shadow of major transactions that will almost certainly attract considerable market and media interest. It leaves the individual open to the risk, as in the present matter, of being seen or perceived as an insider dealer.

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[1] See page 86 of the Chevalier (OA) International report.

CHAPTER FIVE

CONCLUSIONS

In answer to paragraph (a) of the Financial Secretary{ XE "Financial Secretary" \b }'s Notice under section 16(2) of the Ordinance dated 26th September 1998, the Tribunal{ XE "Tribunal:conclusion" \b } has made the following findings :

(1) That, by unanimous decision, the dealings in the listed securities of Chinese Estates by Mr. Johnson LAM Yee-ming during the period from 19th to 21st November 1996 (inclusive) did not constitute insider dealing;

(2) That, by a majority decision (pursuant to paragraph 13 of the Schedule to the Ordinance), the dealings in the listed securities of Chinese Estates by Mr. Joseph LAU Luen-hung during the period from 19th to 21st November 1996 (inclusive) did not constitute insider dealing.

As no insider dealing was identified, the Tribunal was not required to investigate and report on the matters set out in paragraphs (b) and (c) of the Financial Secretary{ XE "Financial Secretary" \b }'s Notice.

ACKNOWLEDGEMENTS

The Chairman personally would like to record his appreciation for the assistance given to him by the two members of the Tribunal{ XE "Tribunal:acknowledgements" \b }, Mr. Simon LAM Siu-lun{ XE "Simon LAM Siu-lun" \b }, and Mr. Eric NG Kwok-wai{ XE "Eric NG Kwok-wai" \b }. Their contribution during the court hearing and their methodical, patient and highly professional approach to their consideration of the evidence was to be admired. Tribunal members play a vital role in Insider Dealing inquires and Hong Kong is fortunate to be able to enlist the services of people of such high calibre.

The Tribunal was ably administered during the inquiry by its staff; namely, Mr. Eric NG Kwok-yung, Secretary to the Tribunal, Miss Wanda SIN Sui-ping, Secretary to the Chairman, Mr. Michael SO Wai-shan and Ms. HO Yuk-ying. For the first time, the Tribunal employed the transcription services of Messrs. Smith Bernal. It is indebted to all those who undertook the transcription duties with such reliability and speed.

The Tribunal also wishes to express its gratitude for the assistance given to it by all the counsel and solicitors involved in the inquiry. Without exception they carried out their respective duties with professionalism, vigour and courtesy. Their level of assistance, especially in the submission of detailed, written arguments, made the work of the Tribunal a good deal easier.

Finally, appreciating the technical complexity of this inquiry, the Tribunal wishes to extend its thanks to all the expert witnesses who prepared reports and who testified. The Tribunal appreciates that they have busy, professional careers. But without their experience and time-consuming research, the Tribunal would have been greatly hampered in its work.

The Honourable Mr. Justice Hartmann
Chairman

Mr. Simon LAM Siu-lun{ XE "Simon LAM Siu-lun" \b }
Member

Mr. Eric NG Kwok-wai{ XE "Eric NG Kwok-wai" \b }
Member

CHAPTER SIX

COSTS

In light of the Tribunal's findings that Mr. Johnson LAM's dealings did not fall foul of the Ordinance and that similarly, by a majority decision, the dealings of Mr. Joseph LAU did not constitute insider dealing, both parties made applications for payment of their legal costs{ XE "legal costs" \b }. Counsel to the Tribunal opposed both applications.

The law

During the hearing on costs, it was agreed by counsel that, in accordance with paragraph 13 of the Schedule to the Ordinance, matters of law concerning costs were to be determined by the Chairman. Thereafter, in accordance with the Chairman's directions on the law, all questions were to be determined by the opinion of the majority of the members. The Tribunal has proceeded on this basis.

Section 26A of the Ordinance{ XE "Ordinance:section 26A" \b } empowers the Tribunal to award to any person whose conduct has been the subject of an inquiry the costs reasonably incurred by that person. Costs so awarded constitute a charge on the general revenue. For present purposes, the relevant portions of section 26A read as follows :

> (1) Subject to subsection (5), at the conclusion of an inquiry or as soon as reasonably practicable thereafter, the Tribunal may award to –
>
> (a) any witness;
>
> (b) any person whose conduct is, in whole or in part, the subject of the inquiry,
>
> such sum as it thinks fit in respect of the costs reasonably incurred by him in relation to the inquiry.
>
> (2) …
>
> (3) …
>
> (4) Subject to any rules made by the Chief Justice{ XE "Chief Justice" \b } under section 36, Order 62 of the Rules of the Supreme Court shall apply to the award and taxation of any costs awarded by the Tribunal under this section.

Section 26A(1) therefore gives the Tribunal a discretion to award costs to an implicated party. However, the exercise of that discretion is subject to the provisions of subjection (5) which reads :

> (5) This section shall not apply to any person referred to in subsection (1) who is –
>
> (a) a person who has been identified as an insider dealer in a determination under section 16(3);
>
> (b) …
>
> (c) …
>
> (d) any other person who and in respect of whom it appears to the Tribunal has by his own acts or omissions caused or brought about (whether wholly or in part) the institution of the inquiry under section 16.

Any discretion to award costs is therefore removed from the Tribunal if, *inter alia*, the person applying for costs has been identified as an insider dealer or if it appears to the Tribunal that the person applying for costs has by his own acts or omissions caused or brought about – whether wholly or in part – the institution of the inquiry.

It is to be emphasised that, if it is found to be applicable, subsection (5) totally removes any discretion to award costs. Accordingly, in the opinion of the Tribunal, it is only if subsection (5) is found *not* to be applicable that it may then exercise its discretion in accordance with the rules and principles set out in Order 62 of the Rules of the Supreme Court**{** XE "Rules of the Supreme Court" \b **}**.

Section 26A was added to the Ordinance in 1995. There does not appear in any Tribunal reports published since that time to be an occasion when it was necessary to consider those principles in detail. This Tribunal therefore has not been able to seek assistance from any rulings of earlier Tribunals. Nor has it been referred to any provision in other Hong Kong legislation worded similarly to subsection (5).

In Chapter Two of this Report, reference was made to the various motives behind the regulation of insider dealing in those jurisdictions where

it has been made the subject of criminal or civil sanctions[1]. The unique nature of the Hong Kong legislation in respect of insider dealing was also the subject of analysis, the conclusion being reached that :

> "As a civil wrong in Hong Kong, insider dealing would appear to be *sui generis*{ XE "*sui generis*" \b }."

That being the case, it is the opinion of the Tribunal that subsection (5) is also to be read in essence as being *sui generis*{ XE "*sui generis*" \b }; that is, as a provision specifically drafted and passed into law by the Legislature in order to meet the special circumstances of insider dealing as a civil wrong in Hong Kong.

Subsection (5) therefore does not present the Tribunal with the exercise of any discretion but rather with the clearly defined task of deciding whether, in the factual circumstances of each individual case, there is reason to find that either of the implicated parties has by his own acts or omissions caused or brought about the institution of the inquiry.

The inquiry that is spoken of is not the SFC{ XE "SFC" \b }'s [the Commission's] investigation. It is the inquiry instituted by the Financial Secretary{ XE "Financial Secretary" \b } in terms of section 16 of the Ordinance. That section reads :

> (1) If it appears to the Financial Secretary{ XE "Financial Secretary" \b }, whether following representations by the Commission or otherwise, that insider dealing in relation to a listed corporation has taken place or may have taken place, he may in accordance with this section require the Tribunal to inquire into the matter.

The acts or omissions to be considered need not be the *sole* cause of the institution of the inquiry. Subsection 5(d) provides that it is sufficient if they materially contributed to its institution; that is what the Tribunal understands by the qualifying phrase : 'wholly or in part'.

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[1] See page 30 of this report.

It has long been accepted in our Common Law system that costs shall 'follow the event' unless statute otherwise dictates or, in the absence of such provision, unless there are good reasons for making a different order. See, for example, R v. Kwok Moon-yan{ XE "R v. Kwok Moon-yan" \b } and Lok Man-chiu{ XE "R v. Kwok Moon-yan and Lok Man-chiu" \b } [1989] 2 HKLR 396 per Silke V.P. (at page 400) –

> "… the normal practice is that an order should be made for the payment of costs out of public revenue unless there are positive reasons for making a different order."

The Tribunal finds nothing in subsection (5) to suggest that the normal practice should not be followed. Accordingly, for the Tribunal to find that subsection 5(d) is applicable to either of the implicated parties, it must be satisfied that there are positive reasons for so finding.

It may be argued, of course, that virtually all inquires will be caused to a material degree by the acts or omissions of the implicated parties, no matter how innocent. How then are such acts or omissions to be considered? Silke V.P., in R v. Kwok Moon-yan{ XE "R v. Kwok Moon-yan" \b } *supra*, held that costs may be refused where the conduct of the individual has brought suspicion on himself and/or has misled the investigating authorities into thinking that the case against him is stronger than it is. In this regard, the Vice President said :

> "We do not view this as meaning that there must be both a bringing of suspicion *and* a misleading before a successful [party] will deprived of his costs. If it is the view of the Court that a man has brought suspicion on himself, or having done that, he has also misled the prosecution, either by the very bringing of that suspicion, or some other matter, into thinking the case against him is stronger than it is then these, either separately or combined, are factors which lie for the consideration …"

The collegiate principles laid down in R v. Kwok Moon-yan{ XE "R v. Kwok Moon-yan" \b } (which have been applied in criminal matters since 1989 and continue to be applied) would appear to provide the jurisprudential genesis for the wording of subsection (5) of section 26A of the Ordinance.

The Tribunal is satisfied that those principles offer the most appropriate guidance to it in interpreting subsection (5) and it has reached its findings in accordance with those principles.

The Tribunal's findings in respect of Mr. Joseph LAU

At the conclusion of Chapter Four of this report[1], the Tribunal made the following comments :

> "In the unanimous opinion of the Tribunal, this inquiry (in so far as it has related to the dealings of Mr. Joseph LAU) has again highlighted the need for a higher level of awareness by the Chairman and Directors of companies as to when it is safe to deal in their own company's securities. As it was said in an earlier inquiry, it is imprudent, without the benefit of professional advice, to conduct such dealings in the shadow of major transactions that will almost certainly attract considerable market and media interest. It leaves the individual open to the risk, as in the present matter, of being seen or perceived as an insider dealer."

While this was primarily intended to sound a general note of caution to the public, the comments also specifically related to Mr. Joseph LAU and the manner of his conduct which, in the opinion of the Tribunal, left him open to the real risk of being seen or perceived to be an insider dealer.

Immediately before these comments were made, the Tribunal made the following statement :

> "It must be emphasised, however, that while the Tribunal had little difficulty in disposing of the allegations made against Mr. Johnson LAM, it faced a far more onerous and less clear-cut task in respect of Mr. Joseph LAU. The majority decisions reflect this fact."

As concerns Mr. Joseph LAU, this was stated not simply to reflect the complexity of the issues raised but also to indicate that we found it to be in many respects a borderline matter, one in which, by his own acts and

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[1] See pages 102.

omissions, Mr. Joseph LAU had brought suspicion upon himself.

Concerning the critical question of Mr. Joseph LAU's possession of relevant information, the Tribunal was satisfied that a time came when he was in possession of specific information concerning the sale of Entertainment Building before that information was in the public domain. As to whether that information, if it had been generally known, would have been likely materially to affect the price of Chinese Estates listed securities and whether Mr. Joseph LAU knew that it was likely to have such affect, the Tribunal confessed that it had been faced with a 'most difficult task'. This was because the issues were not clear cut; they were again borderline and, in the opinion of the Tribunal must have been perceived to be so by Mr. Joseph LAU at the relevant time. Yet despite this, and despite the fact that he was Chairman of the company and standing in a position of good faith to all its shareholders, he chose not to step back for a brief period of time and refrain from trading in his own company's securities, he chose instead to continue trading.

It is true that, when interviewed by the SFC**{** XE "SFC" \b **}**, he averred that, 'one or two days before, the signing of the agreement', he had consulted his solicitors to seek advice on the danger of insider dealing and was assured that there would be no problem as the sale of Entertainment Building fell within the ordinary course of business of Chinese Estates. That, on the face of it, would appear to show that he did act in the cautious and prudent manner to be expected ideally of the Chairman of a publicly listed company when faced with a possible conflict of interests. It transpired, however, that he did not consult his solicitors on the subject and did not receive any such legal advice. In such circumstances, such statement to the SFC can be of no assistance to him.

In determining whether, on all the evidence, the Tribunal could be satisfied that the specific information in Mr. Joseph LAU's possession constituted information that was likely materially to affect the price of Chinese Estates securities and whether he knew it was likely to have such affect, the Tribunal stated the following by way of preamble[1] :

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[1] See page 94 of this report.

> "The Tribunal had no hesitation in coming to the finding that, in the great majority of cases, with a sale of such influence and interest, an insider would be foolhardy to deal before news of the sale was in the public domain. But the Tribunal, of course, was tasked with determining the particular not the general."

In the final analysis, the Tribunal concluded that the dealings by Mr. Joseph LAU did not constitute insider dealing. But that is a different matter from finding that his conduct was nevertheless imprudent and at worst perhaps foolhardy; that it was conduct of the kind that - when scrutinised by the regulatory authorities - would give rise to reasonable suspicion.

Why did the Tribunal, even though it found him not to be an insider dealer, nevertheless come to these unanimous findings concerning Mr. Joseph LAU's conduct? In broad terms, they may be summarised as follows –

a. In 1996, although Chinese Estates had indicated a desire to increase its property development activities, it remained in substance a property investment company. Entertainment Building was one of its major property investments, a building of architectural distinction situated in a prime location. What was being sold by Chinese Estates was not a portion of that building but the entire building to a single purchaser, a relatively rare occurrence in Central. Mr. Joseph LAU must have known that the sale of one his company's prime assets would excite considerable media and market interest.

b. Would that interest, however, be essentially neutral in character or was there a risk that it would excite market interest of a more positive nature? Even though Mr. Joseph LAU may have been satisfied that the price obtained for Entertainment Building was the prevailing market price and there would be no cause, therefore, for analysts and other investors to think he had engineered a coup of some kind, nevertheless he must have appreciated that property prices had been rising during the year and that in all likelihood the sale would be seen as setting a benchmark price in a bouyant market. There was, therefore, the risk that in some quarters of the market the perception would arise that the sale had displayed shrewd

timing and that Chinese Estates had thereby secured maximum gains in order to boost the war chest needed to finance its heralded move into property development. In the opinion of the Tribunal, this must have made Mr. Joseph LAU realise that the inevitable media and market interest may well be expressed in terms complimentary to the management abilities of Chinese Estates.

c. In the opinion of the Tribunal, there were a number of events directly linked to the fortunes of Chinese Estates at that time which should also have called for a cautious approach by any insider possessing knowledge of the sale of Entertainment Building. First, on 20th November 1996 trading in the shares of Evergo China commenced. That first day's trading was positive. The Evergo spin-off{ XE "*Evergo spin-off*" \b } appeared to be a success. Mr. Joseph LAU appreciated that the positive market reaction would rub off on the parent company, Chinese Estates, helping to boost its shares too. Second, at that time portions of the press were punting Chinese Estates as a laggard that would soon catch up with other property stocks. In such circumstances, knowing that the shares of Chinese Estates may well flourish, even if only temporarily, he must surely have realised the real risk that the news of the sale of Entertainment Building, even though he himself did not consider it price sensitive, may well be seen by investigating authorities at a later time to be a probable cause of any share price rise; if not the primary cause, at least another positive factor thrown into the mix to attract investors' attention. Yet, despite this risk - knowing that Hong Kong monetary supervisors do monitor and possibly do investigate these matters - he avoided the path of caution.

In the opinion of the Tribunal, these factors, when taken together, provide positive reason to find that by his conduct Mr. Joseph LAU brought suspicion upon himself. It must be remembered that legislation prohibiting insider dealing has been in existence in Hong Kong since 1978. As Chairman of a publicly listed company and an active trader in shares himself Mr. Joseph LAU must have been aware of the sort of circumstances in which a perception of insider trading may well arise and when, therefore, despite his own conviction that it would not amount to insider dealing, it would nevertheless be prudent to refrain from trading. Why? Because that way he would avoid the

risk of being perceived as an insider dealer. In the unanimous opinion of the Tribunal, having regard to the matters detailed above, when he was in possession of specific information concerning the sale of Entertainment Building, prudence dictated that Mr. Joseph LAU refrain from trading, if only for a day or so until the news was made public or at the very least that he takes legal advice on the matter. He chose not to do so.

What then of Mr. Joseph LAU's defence under section 10(3) of the Ordinance{ XE "Ordinance:section 10(3)" \b }; namely, that he traded in the shares of Chinese Estates at the material time otherwise than with a view to the making of a profit or the avoiding of a loss by the use of any relevant information then in his possession? Although it has not been necessary for the Tribunal to deal with the defence in detail, it was stated that, if it had been necessary, the Tribunal would have found – again by a majority decision – that Mr. Joseph LAU had established that defence[1].

The defence centred on Mr. Joseph LAU's need at the relevant time to combat the tactical buying and selling of Chinese Estates shares by the issuers of various covered warrants. In this regard, the Tribunal referred to the testimony of one of the expert witnesses in the following terms[2] :

> "Mr. Heale was of the opinion that Mr. Joseph LAU's concerns about the deleterious effect of the covered warrants on the performance of his company's shares were justified. He was further of the opinion that his heavy buying in order to remove or substantially reduce that deleterious affect was justified."

In his statement to the SFC{ XE "SFC" \b } investigators prior to the commencement of the inquiry Mr. Joseph LAU did state that he traded in covered warrants and the 'underlying shares' to 'corner them back' and that his purpose had been to prevent the 'drastic fluctuations' in the share price of Chinese Estates caused by the hedging activities of the issuers of covered warrants. In that regard there can be no suggestion that he brought

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1 See page 102 of this report.

2 See page 78 of this report.

suspicion upon himself by omitting any mention of the matter until after the inquiry commenced.

However, although it is not a matter of great moment, it should be noted that no evidence was available to the investigators of any 'drastic fluctuations' in the share price in the sense of drastic movements up and down; the volatility described was rather one of the shares constantly performing below expectations.

In addition, when talking in general terms of why he purchased the shares of Chinese Estates over a prolonged period of time – without specifically excluding his trading on the days around 20th November – he said (as translated) :

> "Now, according to your records, I am holding around 67% (of the total shares). I bought the shares of Chinese Estates because of the very big discount existing between the share price of Chinese Estates and its net asset value. I felt that the shares would be a bargain. Therefore, whenever I had some money, I would buy Chinese Estates shares."

This, on a plain reading, may well have indicated to the investigators that an equally dominant long-term motive for buying Chinese Estates securities was because they represented a bargain; in short, that there was a co-existent profit motive that would negative a defence under section 10(3).

It is not the finding of the Tribunal that Mr. Joseph LAU's conduct was the sole cause of the institution of the inquiry. During the costs hearing his counsel justifiably (in the Tribunal's opinion) criticised certain aspects of the investigation. Nevertheless the Tribunal is satisfied that positive reasons exist to find that Mr. Joseph LAU{ XE "Joseph LAU:cost not awarded" \b } to a material degree, by his acts and/or omissions, brought suspicion upon himself and/or misled the investigating authorities to believe the case to reveal him to be an insider dealer was stronger than it proved in the final analysis.

In the circumstances, in terms of subsection (5) the Tribunal is deprived of any discretion to award him his costs or part thereof. There

will be no order for costs in his favour.

The Tribunal's findings in respect of Mr. Johnson LAM

The Tribunal is satisfied that subsection (5) of section 26A does not apply to Mr. Johnson LAM. There is no evidence that by his acts or omissions he brought any suspicion upon himself. When interviewed by the SFC**{** XE "SFC" \b **}**, he explained the circumstances surrounding his purchase of the Chinese Estates shares. Nothing in those circumstances (which the Tribunal found to be proven) can be the subject of criticism.

As such, Mr. Johnson LAM is entitled to his costs in terms of section 26(1) of the Ordinance. The Tribunal can find no reason, in the exercise of its discretion, why all his costs reasonably incurred in relation to the inquiry should not be awarded. The Tribunal's view of Mr. Johnson LAM and his conduct has already been set out in the body of the report.

Mr. Johnson LAM**{** XE "Johnson LAM:costs awarded" \b **}** is therefore awarded his costs (to include senior counsel assisted by a junior) to be taxed if not agreed.

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The Honourable Mr. Justice Hartmann June, 1999
Chairman

Mr. Simon LAM Siu-lun{ XE "Simon LAM Siu-lun" \b }
June, 1999
Member

Mr. Eric NG Kwok-wai{ XE "Eric NG Kwok-wai" \b }
June, 1999
Member