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Challenging the admissibility of self-incriminating materials provided by listed companies to the Stock Exchange and the SFC

March 2017

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Background

From time to time licensed firms are required by the Securities and Futures Commission (the "**SFC**") to provide information in the exercise of its supervisory powers over intermediaries. Sometimes, firms may be presented with a dilemma: they feel compelled to comply but at the same time worry that prejudicial statements made in such answers will be used as evidence against them should criminal proceedings be subsequently instituted (whether against the firm itself or its senior management).

If the SFC were to invoke its formal investigative powers conferred by the Securities and Futures Ordinance ("**SFO**"), the licensed firms may rely on the statutory protection under section 187 of the SFO, which provides for the exclusion of self-incriminating answers from the evidence in criminal proceedings against the person giving those answers. This statutory protection, however, does not extend to answers given in the course of routine supervision by the SFC in a more "casual" manner, usually through the Licensing Department or the Intermediaries Supervision Department. In this connection, the recent case of *SFC v Chan Shui Sheung Ivy* [2016] 3 HKC 185 (Magistracy Appeal 630/2014) may shed light on the possible arguments against the admissibility of statements provided by licensed firms or persons to authority such as the Stock Exchange of Hong Kong Limited ("**SEHK**") and the SFC.

The *Ivy Chan* Case

The facts of the *Ivy Chan* case which are relevant to our present purposes, can be briefly stated as below.

The Respondent, Ivy Chan, was an executive director of PME Group Ltd ("**PME**"), a company listed on the Main Board of the SEHK. The Respondent was charged with providing false or misleading information to the SFC by way of three public announcements of PME, knowing that the announcements were false in a material particular or being reckless as to

whether they were or not. At trial, the SFC sought to adduce four letters issued by PME ("**PME's Letters**") in response to four inquiry letters from the SEHK as evidence regarding the Respondent's state of mind. The Respondent objected on the basis that the statements made in the letters could not be established to have been made voluntarily because they had been made to a person in authority under a threat of disciplinary proceedings and in violation of the privilege against self-incrimination. The Magistrate ruled that PME's Letters were inadmissible for the following reasons:

(1) all the inquiry letters from the SEHK required the answers to be truthful and threatened criminal proceedings if they were false and contained a reminder about the undertaking to the SEHK. The last two letters contained explicit reminders about threat of disciplinary proceedings. Hence, all answers were made with the knowledge that any failure to comply might subject the person or the company to disciplinary proceedings;

(2) any possible sanction, even a censure, could affect the reputation of the Respondent or the company and this damage could be irreparable and thus the threat of disciplinary proceedings could amount to a real threat in the mind of the letter recipient (i.e. the Respondent);

(3) the SEHK was a "person in authority" in the Respondent's mind since it was the one who could institute disciplinary proceedings against her;

(4) therefore, the prosecution failed to prove that admission made in PME's Letters were admissible or voluntarily made.

SFC's Appeal

The SFC appealed to the Court of First Instance by way of case stated, challenging, *inter alia*, the Magistrate's ruling on the admissibility of PME's Letters.

As to whether SEHK was a person in authority, the SFC relied on certain Canadian and Australian cases and argued that the Respondent had not perceived the SEHK to somehow have power to influence the course of criminal prosecution against her. It is further submitted that:

(1) in the context of the present case, the SEHK inquiry letters were investigating possible breaches of the Listing Rules and cannot be said that the SEHK was acting on behalf of the SFC or had any control over the criminal proceedings commenced by the SFC. Further, the SEHK was not investigating possible breaches of the SFO and this must have been clear to the Respondent;

(2) objectively it could not be said that the coercive power of the state [i.e. the authority] had been engaged, nor was there any evidence that the Respondent perceived the SEHK inquiry letter as such;

(3) any threat of disciplinary proceedings was in relation to the SEHK's own disciplinary proceedings, leading only to possible reputational consequences, and thus could not have been made by the SEHK as a person in authority for the purposes of the exclusionary rule.

However, in Zervos J's view, the approach taken by the SFC focused on the issue too narrowly. Based on the materials before the Magistrate, it was clear that the SEHK and the SFC work closely together in relation to their regulatory responsibilities, and that information and materials that are obtained by the SEHK in its inquiries or investigation may be passed on to the SFC for their investigation and action. It was also apparent from the first enquiry letter from the SEHK that a comprehensive set of questions were being asked that were directed not only to a breach of Listing Rules but also possible criminal prosecution.

Zervos J, in upholding the Magistrate's ruling, affirmed that it was for the SFC to prove beyond reasonable doubt that the PME's Letters were made voluntarily in the sense that they were not obtained by fear of prejudice or hope of advantage exercised or held out by a person in authority, and that it was not for the Respondent to establish that no such fear or hope existed. It was open to the Magistrate to find that the SFC had not discharged this burden. The SEHK was clearly a body which had authority or control over the Respondent and as a director of PME she was obliged to cooperate in an investigation conducted by the SEHK, failing which disciplinary proceedings could be instituted against her. Accordingly, each of the findings of the Magistrate was open for her to make and they were not perverse.

Comments on the Appeal Judgment

The appeal judgment in this case is valuable in the sense that it makes clear that the general principles governing the admissibility of confessions are equally applicable in the context of an SEHK inquiry (see paragraphs 82-83 of the judgment). While this case is not direct authority concerning the admissibility of answers obtained by the SFC during day-to-day supervision, it is expected that the exclusionary rule of involuntary statements made to the SFC shall equally apply to licensed firms in criminal proceedings. Further, the Court's ruling makes it clear that potential disciplinary proceedings by the authority may, without more, constitute a real threat to the recipient with respect to the voluntariness of answers given to the authority.

However, as helpful as it might seem, the *Ivy Chan* case does not provide licensed firms with a concrete solution. First, whether the SFC is a person in authority remains fact-sensitive depending on the particular circumstances of each case, thereby creating uncertainties as to the eventual outcome. Second, if the SFC carefully avoids stating any kind of threat in its request for information (contrary to the SEHK enquiry letters in *Ivy Chan* case), then it becomes doubtful whether compliance with the request is the result of fear of prejudice excited by the SFC. Third, it is possible that *Ivy Chan* case is confined to its specific factual circumstances in that the SEHK, in issuing the enquiry letters, was in fact exercising its investigation powers directing not only to a breach of Listing Rules but also possible criminal prosecution, and any failure to comply with the SEHK enquiry letters might subject the person or the company to disciplinary proceedings.

To sum up, while the admissibility of answers provided to the SFC may be subject to challenges, caution must still be taken by licensed firms in providing answers to the SFC, especially when the SFC has not made it clear which statutory powers it relies on in making the enquiries and the potential consequences of failing to provide an answer to the enquiries, as any answer given under these circumstances may well be regarded as voluntary statements. In light of the risk of producing self-incriminating materials and the uncertainty in this area of law in the absence of a decision on point from a higher court, licensed firms are suggested to seek proper legal advice whenever they receive any forms of enquiry from the SFC.

End.

Our financial services regulatory and litigation team provides practical legal and regulatory advice to Securities and Futures Commission ("SFC") licence applicants, SFC licensed firms, banks and listed companies (as well as their directors and management staff).

We have solid experience in advising clients on SFC licensing obligations/exemptions, seeking various types of SFC/HKMA licences and registrations (e.g. securities, futures, FX, advisory, ATS, corporate finance and fund management licences), advising clients on daily legal and compliance obligations, and dealing with legal/regulatory issues which may arise from clients' businesses from time to time.

On the litigation aspect, we handle enquiries and investigations by securities regulators and government authorities. Examples are investigations and court proceedings brought by the SFC, the Hong Kong Monetary Authority, the Hong Kong Stock Exchange, the Police and the Independent Commission Against Corruption. We also handle other commercial litigations such as shareholders' disputes, employment disputes, contractual disputes and "mis-selling" claims.

We have solid experience in defending listed companies' directors (on insider dealing and other market misconduct offences), securities brokerage firms, warrant market makers, securities analysts, investment banks and retail banks.

The team is led by Mr. Philson HO (Partner), a lawyer and certified public accountant who has more than 20 years of experience in legal, compliance, finance, audit and listed companies' regulations. A former litigation partner of a major international law firm in Hong Kong, Mr. HO used to work in the SFC mainly responsible for licensing and compliance of Hong Kong financial services intermediaries.