**From Protection of Minority Shareholders to Comment on Securities and Futures Composite Bill**
由保護小股民的觀點評論〈證券及期貨條例〉草案

The key to protection of minority shareholders lies on (1) the proof of intent can be replaced by circumstantial evidence or actions deemed knowingly and recklessly, (2) the burden of going forward with the evidence should be on defendant and (3) The HK SFC should be further empowered by law as the US SEC to compel evidence being provided. 保護小股民的關鍵在於(1) 事實舉證可以被接受並可取代意圖舉證，(2) 次級舉證責任在辯方，(3) 香港證監會應如同美國證監會被法律附以強制被告提出解釋或無罪證明的權力。

**The procedure is described as follows** 其執行過程如下

1) The HK SFC can order an administrative hearing to determine responsibility for the violation and to impose sanctions for all 6 forms of trading misconduct. At this stage, proof of intent is not necessarily required, actions deemed knowingly and recklessly and/or circumstantial evidence can allow the HK SFC to initiate an administrative hearing. 初級舉證責任在控方，對六項失當行爲以意圖舉證爲主，但事實舉證可以被接受。

2) The burden of going forward with the evidence should be allowed to shift to market players who need to provide explanation and evidence of innocence to the HK SFC. 香港證監會根據舉證可以對六種行爲失當者舉行聽證以決定責任誰屬，而次級舉證責任即刻轉至辯方。由辯方提出解釋或無罪證明。

3) The HK SFC needs to be further empowered by law (as the US SEC is protected by constitution) to compel evidence being provided. 美國證監會受美國憲法保障以強制被告提出解釋或無罪證明的權力，因此香港證監會應被法律附以同樣權力。

4) If the defendant has "willfully" violated the Securities Acts he can be criminally prosecuted. The SEC can bring the matter to the attention of the Justice Department who handles the criminal action. In both criminal and civil cases, prosecutors need to undertake the "burden of persuasion". In the criminal case, "burden of persuasion" on prosecutors produces evidence "beyond a reasonable doubt". In the civil case brought by the US SEC, "burden of persuasion" on prosecutors produces "preponderance of the evidence". 若香港證監會認定該失當行爲是有意的，則可提出民事訴訟。但刑事訴訟須由法院判定或提出。刑事控方“具說服力舉證”應超越“合理的懷疑”。民事控方“具說服力舉證”應稍微超越辯方“具說服力舉證”。

5) The Blue Bill should further incorporate clauses of no-way default rule (each party pays for their own expenses), class action suit (claimholders act together) and contingent payment (pay attorney only if cases are won) to fully protect minority shareholders in civil case. 美國證交法的成功，與民事法定權利息息相關，美國行之有年的民事法定權利例如----1）訴訟雙方各自付錢 2）債權人或股民集體訴訟 3）勝訴才付款給律師-----應加入藍案中。

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**The Securities and Futures Composite Bill Blues**

The Securities and Futures Composite Bill (hereafter the White Bill) has proposed six forms of trading misconduct including (1) insider dealing, (2) misleading stock and option trading, (3) manipulating stock and option prices, (4) manipulating the stock market, (5) disclosing confidential information on stocks and options and (6) false or misleading statements to induce stock and option trading.

The White Bill has faced fierce resistance mainly from security houses and merchant banks because it proposes shifting the burden of proof onto them when they are accused of false or misleading statements to induce stock and option trading. A consensus opinion from 10 security houses (G10) was submitted. As a result, the burden of proof has been shifted to the prosecution in the revised Blue Bill.

I have made several comments to the Blue Bill in my Chinese articles published in Hong Kong Economic Journal including; (1) the burden of going forward with the evidence should be on defendant at several stages in the process (2) consideration should be given to the definition of intent in the substantive elements of a violation. Since proof of intent is almost impossible, evidence such as actions deemed as knowingly and recklessly should be accepted as a substitute for intent.

The burden of proof issue prompted a comment from Mr. Gary Lynch who is currently advising G10 (Hong Kong Economic Journal, Feb 2). His major comments are (1) burden of proof should be on prosecution and (2) proof of intent also applies to most trading misconduct in the US while in practice the indirect circumstantial evidence can be accepted by court.

I would like to elaborate my view using cases and examples. Let's start from the China Mobile case. However, this case is only used as a live academic example for this article. We have observed significant short-selling of China Mobile by security houses from November 1st to 7th, 2000. The daily short sale volume constitutes 12-14% of daily trading volume and the one-week short sale volume constitutes around 70% of daily trading volume. As a consequence, on November 8, without any publicly available negative information about China Mobile, an analyst with CS First Boston suddenly revised his price target for China Mobile down to HK$49 from a lofty HK$76 just 2 weeks ago. On Nov. 21, CS First Boston further revised China Mobile target price to HK$39.

Misleading information was released by Union Bank of Switzerland Warburg (UBS) that they had interviewed Mr. Chen Jinqiao from the Ministry of Information Industry on November 24. Mr Chen confirmed that the caller pay system will be implemented in 2001. China Mobile shares plunged more than 20%, hitting a new low of HK$39.60 a week after, consistent with what CS First Boston has predicted. Most surprisingly, UBS later announced that Mr. Chen is not from the Ministry of Information Industry. UBS's denial clearly shows an evidence of sending misleading information to the market.

An important issue is what standards for proving intent would apply in cases brought by the US SEC. In this case the issue is the proof of intent that prosecutors have to prove the intent of manipulation by UBS. According to Professor Netter, former economist from the US SEC and Professor of Law and Finance, University of Georgia, in the US the proof of intent is an element of many securities laws violations (fraud) in the US, including most analogies to the 6 forms of misconduct contained in the Blue Bill in Hong Kong. Is the proof of intent absolutely required in all violations in the US practice? The answer from Professor Netter is No. Can it be proved by circumstantial evidence in some situations? The answer is yes.

This practical difficulty is acknowledged by the Chairman of the UK Financial Services Authority (UK FSA), Mr. Howard Davies, stated in March 1999 that the UK has already eliminated the notion of the proof of "intent" by prosecutors for most trading misconduct. The Monetary Authority of Singapore has also proposed to abandon the proof of intent from insider dealing in 2001.

I would like to present an example of reckless substituting for intent. Assume someone drives in the school zone at 90 miles an hour and he kills a pedestrian. Even though we know he is not intentional, his behavior in driving 90 miles an hour on school zone is deemed reckless. An example of circumstantial evidence is that no one sees the pedestrian being killed but a policeman a block away stops a car that was going 90. This coupled with the fact the policeman seeing no other cars in the area and the dead pedestrian might be enough evidence to convict the driver. In the case of China Mobile, according to Professor Netter, that the circumstantial evidence of the announcement that Mr. Qian is not from Ministry of Information Industry coupled with significant short selling and declining stock price may be sufficient to deem their action as knowingly and recklessly

The proof of intent is required for 5 of the 6 forms of misconduct under the Blue Bill. Since the HK SFC does not have the same teeth and grit as the US SEC in enforcement even under the same legal system, hence the HK SFC's enforcement ability may further reduced if the possibility of substituting circumstantial evidence is not included in the Bill.

The second issue is the "burden of going forward with the evidence". I accept Mr. Lynch's statement that the burden of proof lies with the prosecution; this is true of every case, whether civil or criminal. That may be the complete story in HK, but it is not the

complete story in the US. In the US, the prosecution must, of course, make a convincing case including the proof of intent that a violation has been committed as in the above case. However, UBS then has the "burden of going forth with the evidence". That is, UBS needs to provide evidence of innocence to the US SEC: it has the burden of effectively rebutting the prosecution's case. How is this burden being enforced in the US?

Professor Netter brings to my attention the following practice documented in "Securities Regulation" by James Cox *et al.* (1997, p924) that "...if the SEC staff's concerns are not satisfied by the information available to it through its informal investigation, it can seek the Commission's authority for a formal investigation, in which the staff is authorized to issue subpoenas and administer oaths...Once the formal order is granted, the staff has the power to issue subpoenas nationwide against any person or records significant to the investigation. If a person refuses to comply with the subpoena, the SEC staff must apply to the federal district court to enforce the subpoena. An SEC subpoena can be judicially enforced against recalcitrant parties without the staff's having to prove probable cause that the securities laws have been violated.....By and large, the Commission's power to investigate suspected cases of securities law violations is unrestricted. The courts have held with some consistency that so long as the staff is acting in good faith, its discretion to determine who will be required to testify before it or what documentary information will have to be produced will not be second-guessed...".

In the US, constitutional protections apply to US SEC investigations, any challenges to the US SEC's subpoenas are regularly rejected by courts. As a result, over 90% of SEC enforcement proceedings are settled, not litigated. It significantly improves the efficiency of the enforcement by the US SEC. It is the reason why we need to empower the HK SFC by making explicit the requirement of effective compliance of "burden of going forward with the evidence" by suspects in the Blue Bill.

In addition, in the US if the defendant has "willfully" violated the Securities Acts he can be criminally prosecuted. The SEC can bring the matter to the attention of the Justice Department who handles the criminal action. In both criminal and civil cases, prosecutors need to undertake the "burden of persuasion". In the criminal case, "burden of persuasion" on prosecutors produces evidence "beyond a reasonable doubt". In the civil case brought by the US SEC, "burden of persuasion" on prosecutors produces "preponderance of the evidence".

In layman's language the preponderance of the evidence means prosecutors need to undertake at least a little more than 50% of the burden, while "beyond a reasonable doubt" is a much stronger requirement than preponderance of the evidence. Professor Netter said without concrete statistics that we may think the prosecutors may need to undertake, say 90% of burden. According to Professor Netter, under the US practice, only a few cases of trading misconduct were brought to the court for criminal charges, while most of cases were settled by civil suits.

The success of the US SEC also lies on the complementary devices of civil suits. In the US securities law, several provisions create private rights of action for shareholders for damages against alleged violators. Professor Netter points out that even the threat of a private party civil suit and the accompanying discovery requirements are a compelling reason for parties to be careful about taking actions that might be considered violations of the securities laws. However, this provision cannot work well in Hong Kong since there is no no-way default rule (each party pays for their own legal expenses), no class action suit (stakeholders fight as a group) and lawyers do not accept contingent payment (pay only if the case is won) as in the US. Minority shareholders cannot file a civil action against market players as easily as in the US.

As a conclusion, I suggest the following:

1. The HK SFC can order an administrative hearing to determine responsibility for the violation and to impose sanctions for all 6 forms of trading misconduct. At this stage, proof of intent is not necessarily required, actions deemed knowingly and recklessly and/or circumstantial evidence can allow the HK SFC to initiate an administrative hearing.
2. The burden of going forward with the evidence should be allowed to shift to market players who need to provide explanation and evidence of innocence to the HK SFC. More importantly, the HK SFC needs to be empowered by law to compel evidence being provided (The US SEC is protected by the US Constitution to compel evidence being provided).
3. If the defendant has "willfully" violated the Securities Acts he can be criminally prosecuted. The SEC can bring the matter to the attention of the Justice Department who handles the criminal action. In both criminal and civil cases, prosecutors need to undertake the "burden of persuasion". In the criminal case, "burden of persuasion" on prosecutors produces evidence "beyond a reasonable doubt". In the civil case brought by the US SEC, "burden of persuasion" on prosecutors produces "preponderance of the evidence".
4. The Blue Bill should further incorporate clauses of no-way default rule, class action suit and contingent payment to fully protect minority shareholders in civil case.