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Insider Trading

How Can Hedge Fund Managers Understand and Navigate the Perils of Insider Trading Regulation and Enforcement in Hong Kong and the People's Republic of China

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An old Chinese curse states: "May you live in interesting times." This proverb is often coupled with a more severe curse: "May you come to the attention of those in authority." For institutional investors trading in markets in Hong Kong and Mainland China (People's Republic of China or PRC), these are indeed "interesting" regulatory times. More importantly, an evolving legal and regulatory landscape has significantly increased the likelihood that those traders who are not informed and careful in their research and trading on those markets shall eventually "come to the attention of those in authority." For a further discussion of regulatory requirements governing establishing a hedge fund manager presence in Asia, see "Primary Regulatory and Business Considerations When Opening a Hedge Fund Management Company Office in Asia (Part Four of Four)," The Hedge Fund Law Report, Vol. 5, No. 3 (Jan. 19, 2012).

The fact patterns that may lead to unwanted attention may be familiar to those who frequently trade in the equity markets in the Far East. Consider the following: two weeks before the end of the quarter, an analyst at a hedge fund calls the head of investor relations (IR) for a technology company that trades on the Shanghai Exchange to ask about a new product in development. As the conversation progresses, the head of IR states that the company's earnings have already exceeded the publicly released projections for quarter end by five percent. It is unlikely that an experienced IR professional for a U.S.-listed company would selectively disclose such information, which would very likely be material.

The fact that these disclosures may occur with some regularity, however, does not mean that they are legal in either Hong Kong or the PRC. Under the governing statutory authority in both jurisdictions, they are not. In Hong Kong, the Securities and Futures Commission (SFC) has begun to build a strong insider dealing enforcement record, having obtained at least five prison sentences for insider dealing since 2009.[1] In the PRC, contrary to the beliefs of many investment professionals, those who trade on selectively disclosed material information likewise put themselves at risk of prosecution. Indeed, Chinese courts have recently held tippees liable for trading on information obtained from insiders based on PRC insider trading law.

This article examines the provisions of Hong Kong and PRC insider trading law most important to U.S.-based hedge fund managers. For the sake of comparison, at the outset we also discuss the corresponding provisions of U.S. insider trading law. For a related discussion of U.S. insider trading law, see "Perils Across the Pond: Understanding the Differences Between U.S. and U.K. Insider Trading Regulation," The Hedge Fund Law Report, Vol. 5, No. 42 (Nov. 9, 2012). Importantly, in some instances, the insider trading laws in the PRC and Hong Kong may require hedge fund managers to proceed more cautiously than they would with regard to similarly-situated U.S. issuers. Given that corporate and IR executives in Hong Kong and the PRC may lack the training and vigilance of their U.S. counterparts, it is crucial that hedge fund managers understand the rules applicable to trading on selectively disclosed inside information in these jurisdictions. The risk of civil and criminal liability for foreign investors has increased as regulators push to clean up the *laissez-faire* attitude towards inside information that has historically prevailed in the Hong Kong and PRC markets.

Basic Overview of Insider Trading Liability in the U.S.

To understand how provisions of Hong Kong and PRC insider trading law can sometimes impose stricter standards than those in the U.S., it is necessary to review the key provisions of U.S. insider trading law. In the United States, insider trading is prosecuted through a series of anti-fraud laws, the most prominent of which is Section 10(b) of the Securities Exchange Act of 1934 (Exchange Act) and Rule 10b-5 thereunder. These laws broadly prohibit the use of "manipulative or deceptive devices" in connection with the purchase or sale of securities. U.S. courts have held that insider trading can be a form of fraud prohibited by Section 10(b) and Rule 10b-5 if the following basic elements exist:

- A person or entity *purchases or sells securities*;
- While in possession of *material, nonpublic information*;
- Where the trader or tipper has acted in *breach of a fiduciary or similar duty*; and
- The culpable parties acted with the appropriate level of *scienter* or "guilty knowledge."[2]

There are two basic types of insider trading cases. The first involves situations where the defendant receives material nonpublic information in the context of a fiduciary or other confidential relationship and then purchases or sells securities while in possession of that information. The second involves so-called "tipper/tippee" liability where an individual (i.e., a tipper) breaches a duty by providing material, nonpublic information to someone else who has traded (i.e., a tippee). In these situations, the U.S. securities laws impose liability on both the tipper and tippee. The vast majority of insider trading cases involving investment funds involve allegations of tippee liability.

A key distinguishing feature of U.S. insider trading law is the "duty" requirement, which is rooted in the premise that only fraudulent conduct may be prosecuted under Section 10(b) and Rule 10b-5. Under U.S. law, insider trading can only be actionable if the trader or tipper had a duty to either make some sort of disclosure or refrain from trading.[3] Regulators rely on two different theories to establish a duty. Under the "classical theory" of insider trading, a corporate insider violates a duty to current and future shareholders by trading, without disclosure, on the basis of material nonpublic information.[4] A corporate insider may be an officer, director or employee, or a so-called "temporary insider" such as a lawyer, consultant, or investment banker.[5] Under the "misappropriation theory" of insider trading, persons other than corporate insiders may be liable for insider trading if they receive material nonpublic information in confidence and breach their duty to the source of the information by trading.[6] For a tipper to breach a duty, the tipper typically has to be acting for a "personal benefit," which can be something tangible, like money, or intangible, like the desire to make a "gift" of the information to a personal friend, business associate, or family member.[7]

Basic Overview of Insider Trading Regulation and Enforcement in Hong Kong

In recent years, Hong Kong regulators have become increasingly active in enforcing their insider dealing laws. In stark contrast to years past, Hong Kong regulators are now perceived as some of the toughest and most vigilant enforcers in the global markets.

The Hong Kong Securities and Futures Ordinance (Ordinance) authorizes the SFC to investigate suspected insider dealing and refer cases to either: (1) the Financial Secretary to commence a civil proceeding before the Market Misconduct Tribunal (MMT); or (2) the Secretary of Justice to commence a criminal trial in the Court of First Instance of the High Court. The MMT has extensive powers, including the power to: (1) receive and consider evidence that would normally be inadmissible; (2) require a person to appear and give evidence or produce documents; and (3) "[e]xercise such other powers or make such other orders as may be necessary for or ancillary to the conduct of the proceedings or the carrying out of its functions."[8] The MMT may also order a person to pay to the Hong Kong Government an amount not exceeding the amount of any profit gained or loss avoided by that person as a result of the insider dealing, as well as the amount of costs incurred in connection with proceedings of the MMT.[9]

The Financial Secretary may refer any matter to the Secretary of Justice for criminal prosecution if it appears to the Financial Secretary that an offense under the criminal insider dealing provisions of the Ordinance has occurred.[10] A person who is criminally convicted of insider dealing may be liable for a fine of up to HK $10 million and imprisonment for up to ten years.[11] The criminal insider dealing provisions of the Ordinance are the same in substance as the civil provisions. For the purpose of simplicity, we cite only the applicable civil provisions in this article.

Section 270(e) of the Ordinance provides that insider dealing takes place "when a person who has information which he *knows is relevant information* . . . and which he received, directly or indirectly, *from a person whom he knows is connected with the corporation* . . ." deals, counsels or procures another person to deal in the issuer's stock.[12] Thus, Hong Kong law prohibits a tippee from trading on material nonpublic information if: (1) the information came from a person whom he knows is connected with the corporation; and (2) the tippee has reasonable cause to believe that his source held the information as a result of his connection with the corporation.

The Ordinance arguably provides a more detailed explanation of "relevant information" and "connected with the corporation," than Rule 10b-5 provides for the analogous components of U.S. insider trading law, "material nonpublic information" and "duty of trust or confidence." Pursuant to section 245 of the Ordinance, unless the context requires otherwise, "relevant information" means specific information about: (a) the corporation; (b) a shareholder or officer of the corporation; or (c) the listed securities of the corporation or their derivatives. Under the Ordinance, "relevant information" is also limited to information that is not generally known to the persons who deal in the listed securities of the corporation, but if it were generally known, would likely materially affect the price of the listed securities.[13] A person shall be regarded as "connected with" a corporation if: (a) he is a director or employee of the corporation or a related corporation; (b) he is a five percent or more shareholder of the corporation or a related corporation; (c) he occupies a position which may reasonably be expected to give him access to relevant information in relation to the corporation; (d) he has access to relevant information connected with another corporation regarding a transaction between the two corporations; or (e) at any time within the six months preceding any insider dealing, he was a person connected with the corporation by one of (a) through (d).[14]

By requiring Hong Kong regulators to show that a defendant knew that the source of his "relevant information" was "connected with the corporation" and that the defendant had reasonable cause to believe that his source "held the information as a result of being connected," the Ordinance imposes something akin to a watered-down version of the U.S. law duty requirement.[15] Unlike some other jurisdictions where duty is not a required element, the Ordinance might not render a trader liable who stumbles across "relevant information" not clearly traceable to any particular inside source.[16] The Ordinance does, however, cover some situations not necessarily covered by U.S. insider trading law. This includes situations in which a person trades on the basis of information selectively disclosed by a corporate executive or IR professional who did not receive any personal benefit for disclosing the information. In fact, as described below, the SFC recently won an insider dealing case against an employee of a U.S.-based manager involving precisely this set of facts.

In addition to potential civil penalties following a proceeding before the MMT, those who commit insider dealing on a Hong Kong exchange also face a very real threat of serious jail time. Although there was no criminal liability in Hong Kong for insider dealing before 2003, since 2009, five individuals have been sentenced to prison for insider dealing in Hong Kong, including professionals from global financial institutions. Most recently, the Court of Appeals upheld the insider dealing conviction of Du Jun, a former managing director at a major investment bank, ordering Mr. Du to serve a six-year prison sentence and pay a fine of $21.6 million.[17]

Potential Availability of a "Big Boy" Defense Under the Ordinance

Sophisticated investors should note that the Ordinance may provide them with some limited defenses to insider trading liability that might not exist under U.S. law. Perhaps most importantly, the Ordinance provides a defense to a person "connected with" the issuing corporation who trades while knowing he has "relevant information" about the corporation if, at the time of a trade, the person's counterparty knew, or ought reasonably to have known, that the person was "connected with" the issuer.[18] In essence, section 271(6) provides a defense similar to the defenses sought by those who enter into "big boy letters" under U.S. law.

In a big boy letter, one of the parties to a transaction informs the other party that it may possess material, nonpublic information regarding the issuer that has not been disclosed. The other party then affirms that it has made its own independent assessment of the transaction and has not relied on anything the party with the material nonpublic information has said or not said. In theory, one party's disclosure that he possesses material nonpublic information should negate the possibility that he perpetrated a fraud upon the *counterparty* by not disclosing the information before trading. In the U.S., however, big boy letters have not always succeeded in affording their drafters the protection from insider trading liability that they seek. For example, in 2007, Barclays Bank PLC and one of its proprietary traders paid a total of over $11 million to settle an enforcement action in which the SEC alleged that the trader had used big boy letters to advise his counterparties that he may have possessed material nonpublic information regarding the issuers of the bonds he was trading.[19] Moreover, since the Barclays settlement, SEC officials have made additional statements indicating that big boy letters may not provide a defense in enforcement cases brought under the misappropriation theory of insider trading.[20]

To date, the defense made available by section 271(6) has received little to no attention in published statements of the

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SFC and opinions of the MMT and the Hong Kong courts. In light of this fact, and the continuing uncertainty regarding the effectiveness of big boy letters under U.S. law, anyone who is considering using a big boy letter to invoke the defense afforded by Section 271(6) should have the letter vetted carefully by counsel before proceeding with the transaction.

Recent Enforcement Activity in Hong Kong Involving U.S. Investors

On April 26, 2012, the MMT found that George Stairs, a Fidelity Management & Research Company portfolio manager, had committed market misconduct in violation of the Ordinance by selling 374,000 shares of Chaoda Modern Agriculture Holdings Ltd. (Chaoda) three days in advance of the public announcement of a Chaoda share placement. Mr. Stairs learned of the June 2009 placement during a conference call with Chaoda's Chairman, Kwok Ho, and Chief Financial Officer, Andy Chan. Mr. Stairs participated in the conference call from his office in Boston. Chaoda had also provided the information regarding the share placement to Janus Capital Management, Wellington Management Company LLP and Black Rock. The Tribunal found that the sales ordered by Stairs allowed Fidelity to avoid losses of over $280,000. The Tribunal did not direct Stairs to disgorge the avoided loss, however, on the grounds that Stairs lacked any personal interest in the fund from which he sold the Chaoda shares. Stairs was required to pay $784,421 to the Government of the Hong Kong Special Administrative Region and $75,233 to the Securities and Futures Commission in order to compensate the costs they incurred during the investigation and litigation of the matter. In addition, the Tribunal barred Stairs from dealing in any securities traded on the Hong Kong Stock Exchange for two years.

The Chaoda case demonstrates at least two key points for U.S.-based fund managers. First, those accustomed to working within the constraints of U.S. insider trading laws should note that Stairs was found liable for insider dealing even though neither the Chaoda executives on the call nor Merrill Lynch, the financial adviser that arranged the call, made any attempt to impose a confidentiality obligation on Stairs. In his prior experiences receiving information from Chaoda, Merrill Lynch had alerted Stairs that Chaoda would be providing material nonpublic information and had given Stairs the choice whether or not to receive the information.[21] Before the call in question, however, Merrill Lynch made no mention of a potential transmission of material nonpublic information, instead advising Stairs via e-mail that the purpose of the call was for Chaoda management to give an update "about their business and financial status" to key shareholders.[22] The MMT report provided no indication that Merrill Lynch or Chaoda had an expectation that Stairs would keep the information confidential or refrain from trading. In the U.S., Stairs may have credibly argued that he had no reason to believe that he was violating a duty of trust or confidence to Chaoda by trading on the information.

Second, the Chaoda case demonstrates the more general point that the SFC and the MMT are ready, willing and able to test the limits of their regulatory powers in order to deter foreign market professionals from committing misconduct on Hong Kong markets. This includes market professionals who have never set foot on Hong Kong soil. Not content with its own disciplinary orders, the MMT invited the SFC to provide the SEC with a copy of the MMT's report so that the SEC could take disciplinary action against Stairs based on his trading in Hong Kong.[23] Moreover, Mr. Stairs is not the only U.S.-

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based investor to face aggressive regulatory action recently from the SFC. On February 23, 2012, the Court of Appeal for the Hong Kong Special Administrative Region ruled that the SFC had the right to seek civil remedies for alleged insider trading from Tiger Asia Management LLC (Tiger Asia), a U.S.-based hedge fund manager with no employees or physical presence in Hong Kong. See "Hong Kong Securities and Futures Commission Wins Appeal of Insider Trading Action Against New York-Based Hedge Fund Manager Tiger Asia Management," The Hedge Fund Law Report, Vol. 5, No. 10 (Mar. 8, 2012).

Significantly, the Court of Appeals made this determination without requiring the SFC to first prove its case before the MMT.[24] Soon after the SFC initiated its insider dealing case against Tiger Asia in August 2009, the SEC sent a subpoena to Tiger Asia requesting information regarding the same underlying conduct in order to determine whether U.S. securities laws had been violated. Tiger Asia ultimately settled with the SEC in December 2012 by agreeing to pay $44 million. See "SEC Settles Insider Trading Action against Tiger Asia Management," The Hedge Fund Law Report, Vol. 5, No. 48 (Dec. 20, 2012). Moreover, Tiger Asia also pled guilty to parallel U.S. criminal charges in federal court in New Jersey, agreeing to forfeit an additional $16.3 million.[25] Contrary to the expectations of many U.S. investors, this matter reflected the SEC's willingness to exercise its regulatory oversight on trades by U.S.-based investors trading in non-U.S. markets. In August 2012, prior to its settlements with the U.S. authorities, Tiger Asia shut down, returning remaining funds to its investors in light of its "prolonged legal situation."[26] Perhaps more than anything, Tiger Asia's inability to stay in business serves as a grim reminder to U.S.-based fund managers of the perils of trading in the Far East without being mindful of relevant treaty laws.

Those who receive potential material nonpublic information from an insider of a company listed on a Hong Kong exchange should notify a compliance officer or counsel immediately and refrain from trading in the company's securities. Investors should expect the SFC's successful track record in court over the last several years to increase the SFC's confidence as it seeks to use every tool at its disposal to punish those who violate Hong Kong's insider dealing laws, wherever the violator resides.

Basic Overview of Insider Trading Regulation and Enforcement in China

Not surprisingly, the regulatory picture on insider trading in Mainland China is evolving. Historically, criminal insider trading cases have been relatively rare and the fines imposed in administrative enforcement actions have rarely exceeded $25,000. The reporting of enforcement actions can also be somewhat sporadic giving the PRC's civil law regime. Despite limits on resources and the PRC's somewhat uncertain legal landscape, however, the China Securities Regulatory Commission (CSRC) appears to have committed to enforcing an aggressive interpretation of the PRC's insider trading laws. Furthermore, contrary to a handful of published reports in legal academia over the past few years, tipper-tippee liability does exist under China's regulatory regime. As discussed below, the CSRC has already obtained judgments against tippees who traded on information obtained from insiders even though they do not necessarily meet the criteria of an "insider." A prudent investor should accordingly proceed with caution and assume that the CSRC's interpretations are the law of the land.

The CSRC has primary responsibility for enforcing the PRC's insider trading prohibitions. The 2006 PRC Securities Law

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(Securities Law) provides civil penalties for insider trading and authorizes the CSRC to draft "guidance provisions" interpreting certain provisions of the Securities Law. In 2007, the CSRC issued the (Provisional) Guide for the Recognition and Confirmation of Insider Trading Behavior in the Securities Markets (Guidance Provisions). The Guidance Provisions greatly expanded the range of conduct subject to prohibition under the Securities Law, and the CSRC has aggressively prosecuted conduct prohibited under their terms.

Those who are held liable for insider trading in China may be forced to forfeit the profits of their illegal trades and pay a fine of up to 500% of illegal profits. For larger illegal trades, the trader could be criminally prosecuted and imprisoned for up to ten years.[27]

The PRC's general prohibitions for insider trading are spelled out in Articles 73 and 74 of the Securities Law. Article 73 prohibits "any insider who has access to any insider information of securities trading or who has unlawfully obtained any insider information" from "taking advantage of the insider information . . . to engage in any securities trading." "Inside information" is defined as "nonpublic information relevant to a company's business or financial affairs or which may have a major effect on the price of a company's securities."[28] Article 74 of the Securities Law states that "the insiders who have access to inside information of securities trading include" persons falling into seven different enumerated categories, including "directors, supervisors, and senior managers of an issuer"; "shareholders who hold more than 5% of a company"; "the personnel who may take advantage of their posts in their company to obtain any insider information of the company concerning the issuance and trading of its securities"; and "[a]ny other person as prescribed by the securities regulatory authority under the State Council."

None of the seven enumerated types of insiders explicitly covers tippees.[29] However, under Article 6 of the CSRC's Provisional Guidelines, an "insider" prohibited from trading on inside information includes "any person who obtain[s] inside information."[30] By creating the newly defined concept of an "insider" in Article 6 of the Provisional Guidelines, the CSRC appears to have created an additional category of persons deemed to "have access to insider information of securities trading" under Section 74(7) of the Securities Law. This new category covers not only anyone who would be a "tippee" under U.S. insider trading law, but anyone else who stumbles upon inside information.[31]

Recent Tippee Liability Cases in the PRC

On multiple occasions, the CSRC has commenced insider trading cases against tippees who would fall within the Provisional Guidelines' broader definition of "insider." Accordingly, traders should assume that, unlike the U.S., the PRC imposes liability on anyone who trades while in possession of inside information, regardless of how that information may have been acquired.

Specifically, in 2010, the CSRC released two administrative decisions in which it imposed liability for insider trading on individuals who received inside information only as tippees. Although the CSRC had brought successful insider trading cases involving similar factual scenarios in the past, the two cases discussed below both involved conduct that took place after the implementation of the most recent version of the Securities Law and the Guidance Provisions and are therefore particularly instructive. [32]

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Beifu Group (No. 40, 2010 Administrative Decision of CSRC, 2010)

In early 2008, Jiangsu Yinzhou Group (Yinzhou Group) planned to list on the Shanghai Stock Exchange through a reverse takeover of then listed company Shanghai Xingye Resources Holdings Co., Ltd. (ST Xingye). An intermediary aware of negotiations between the companies advised his friend, Chiwei Liu, of the confidential reverse takeover plan. Liu purchased shares of the listed company before trading was suspended in anticipation of the announcement of the plan. Despite the fact that the restructuring was aborted and Liu lost money on his trade, the CSRC found that Liu's activities constituted insider trading under the Securities Law and fined him approximately $5,000.

In its decision, the CSRC explicitly rejected Liu's argument that, as a tippee, he was not an "insider" pursuant to Article 74 of the Securities Law. In support of that determination, the CSRC cited the fact that Liu admitted during the investigation that he had learned about the restructuring from his intermediary and stated that Liu "was a person who obtained inside information illegally." By doing so, the CSRC appears to have skirted the issue of whether Liu would have been an "insider who has access to any insider information of securities trading" under Article 73 and Article 74 of the Securities Law. By failing to identify how Liu's method of obtaining the information was illegal, the CSRC seems to imply that it would be willing to consider any tippee who trades on inside information to have "obtained inside information illegally." As a result, the CSRC arrived at the same conclusion as if it had applied the Guidance Provisions' broad definition of "insider"– that anyone who trades while in possession of inside information may be liable for insider trading, regardless of how the inside information was obtained.

Xu Qin (CSRC Announcement of Administrative Decision, Aug. 27, 2010)

Likewise, in the Xu Qin case, a corporate secretary entrusted with the search for a reverse takeover target made several phone calls from his home phone regarding the eventual takeover target. The secretary's wife heard about the reverse takeover plan and passed the information to their niece. The niece then purchased the shares and made a profit of approximately $15,000.

Like Liu in the *Beifu Group* case, the niece was found to have committed insider trading and was forced to disgorge her profits and pay a fine of approximately $17,000. However, the CSRC opted to categorize the niece not as "a person who obtained inside information illegally" like Liu, but as a "person with access to inside information." By doing so, the CSRC appears to have cast the niece as an "insider with access to inside information" under Article 74 instead of a person who "unlawfully obtained any insider information" under Article 73. The enumerated list of "insider[s] with access to inside information" in sections (1) through (6) of Article 74 does not include extended family members, like the niece, of individuals who fall into one of the listed categories. As a result, it appears that the CSRC may have relied on the broad definition of "insider" in Article 6 of the Guidance Provisions, which includes "any person who obtains inside information," to subject the niece to the Securities Law's insider trading prohibitions.

Whether the CSRC is applying the broad definition of "insider" in its Guidance Provisions or is deeming all tippees to have "obtained inside information illegally" under Article 73 of the Securities Law, the message for fund managers is clear: trading on nonpublic information obtained from an insider of a PRC-listed company could result in insider trading liability. Investors should not bear this risk lightly. While China's enforcement regime lags well behind that of the U.S. and Hong Kong, there are strong indications that the CSRC is taking the problem seriously and will be looking for high-profile opportunities to demonstrate its enhanced capabilities. Moreover, other powerful institutions within the government of the PRC have also begun to exert influence to make insider trading enforcement a higher governmental priority and to enhance the enforcement efforts of the CSRC and criminal prosecutors.

For example, on March 29, 2012, the Supreme People's Court, the PRC's highest judicial authority, promulgated its Interpretation on Several Issues Concerning the Specific Application of Law in Handling Criminal Cases of Insider Trading and Leaking of Inside Information (Judicial Interpretation No. 6). Among other things, this interpretation provides that, in insider trading cases involving transactions of at least Rmb500,000 or profits or losses avoided of at least Rmb150,000, any person who trades on or leaks inside information after "communicat[ing] or interact[ing] with a well-informed person with inside information" will be deemed to have "illegally obtained inside information."[33] A person who trades or discloses inside information under the above circumstances will be *presumed to be guilty* of insider trading unless the person can prove that he or she had a justifiable reason to do so or has another legitimate source of the information.[34]

It remains to be seen whether PRC regulators will make effective use of their expanding array of tools for securing insider trading convictions. However, the prospect of PRC courts imposing harsher fines and prison sentences with increasing frequency should cause anyone who acquires potentially inside information regarding a PRC issuer to carefully consider the potential consequences before trading. Although foreign investors thus far have succeeded in avoiding serious fines and prison sentences for violations of PRC insider trading law, the CSRC has demonstrated that it is willing to investigate and punish large Chinese institutional investors.[35] One would suspect it is only a matter of time before a U.S.-based institution suffers a similar fate.

Mr. Asaro has extensive litigation and investigatory experience involving matters arising under the federal securities laws, including insider trading, market manipulation, accounting irregularities, Foreign Corrupt Practices Act (FCPA) violations, and broker-dealer and investment adviser regulation. He is a former assistant U.S. attorney for the Eastern District of New York, where he served as deputy chief of the Business and Securities Fraud Section. Earlier in his career, Mr. Asaro served as a branch chief in the SEC's New York office, where he supervised staff attorneys working on a wide variety of regulatory investigations and enforcement actions.

Mr. Rappaport's practice focuses on advising investment funds and other public and private companies on issues involving corporate governance, insider trading, market manipulation, corporate compliance, securities regulation, fiduciary duty and fund formation. He also regularly litigates complex commercial and securities disputes and represents clients in front of the SEC and other regulatory agencies. He has extensive experience in matters regarding fiduciary obligations, securities fraud, breach of contract, limited partnership interests, insider trading, tender offers, proxy contests, professional liability, insurance issues and bond defaults.

Mr. Mott's practice focuses on litigation, with experience in the areas of bankruptcy litigation and white collar criminal investigations.

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[1] As one of the two Special Administrative Regions of the PRC, Hong Kong has a legal system that is independent from the legal system of Mainland China. See The Basic Law of the Hong Kong Special Administrative Region of the People's Republic of China, Art. 2.

[2] *United States v. O'Hagan*, 521 U.S. 642, 651-52 (1997).

[3] See *Chiarella v. United States*, 445 U.S. 222, 230 (1980) (holding that "[w]hen an allegation of fraud is based upon nondisclosure, there can be no fraud absent a duty to speak," which arises based on "a fiduciary or similar relation of trust or confidence").

[4] See *Chiarella v. United States*, 445 U.S. 222, 226-30 (1980).

[5] *Dirks v. SEC*, 463 U.S. 646, 655 n. 2 (1983).

[6] *United States v. O'Hagan*, 521 U.S. 642, 652 (1997).

[7] *Dirks v. SEC*, 463 U.S. 646, 664 (1983). There are at least two important exceptions to the requirement of a breach of fiduciary duty. First, section 14(e) of the Exchange Act and Rule 14e-3 thereunder allow the SEC to bring insider trading charges where a "substantial step" has been taken to commence a tender offer and the trader possessed material nonpublic information about the potential transaction, regardless of whether any duty was breached. 17 C.F.R. 240.14e-3. Second, at least in the Second Circuit, one who uses deceptive means to steal material nonpublic information and then trades on the stolen information could be liable under section 10(b) of the Exchange Act even if the thief owed no duty to the owner of the information. See *SEC v. Dorozhko*, 574 F.3d 42 (2d Cir. 2009).

[8] Ordinance, Section 253.

[9] Ordinance, Sections 257(d) – (f).

[10] Ordinance, Section 252(10).

[11] Ordinance, Section 303(1)

[12] Ordinance, Section 270(e) (emphasis added).

[13] Ordinance, Section 246.

[14] See Section 247(1) ("[A] person shall be regarded as connected with a corporation if . . . he is a substantial shareholder of the corporation."); Section 247(3) ("'[S] ubstantial shareholder,' in relation to a corporation, means a person who has an interest in the relevant share capital of the corporation, the nominal value of which is equal to or more than 5% of the nominal value of the relevant share capital of the corporation."), Section 247(1).

[15] Like U.S. insider trading law, the Ordinance creates special rules applicable to information regarding potential tender offers. See Section 247(3)(d). For purposes of the Ordinance, potential takeover bidders and their tippees should be viewed as persons "connected with a corporation." Unlike SEC Rule 14e-3, however, which requires that a "substantial step" to commencement of a tender offer to have been taken in order for its heightened trading and disclosure provisions to apply, the Ordinance does not require the contemplated transaction to have reached any threshold probability. Instead, persons connected with the potential acquirer must argue that the information regarding the potential transaction was not "relevant information" because the proposed transaction never reached a sufficiently advanced stage.

[16] The foremost example of a jurisdiction with no duty requirement is the United Kingdom, which prohibits trading or tipping by any person who has acquired "inside information," regardless of how it was obtained. See "Perils Across the Pond: Understanding the Differences Between U.S. and U.K. Insider Trading Regulation," The Hedge Fund Law Report, Vol. 5, No. 42 (Nov. 9, 2012).

[17] SFC Press Release, *Court of Appeal Upholds Du Jun's Insider Dealing Convictions* (Sep. 20, 2012).

[18] Ordinance, Section 271(6). In order to be entitled to the defense, the person "connected with" the corporation cannot

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have "counseled or procured" the counterparty to enter into the transaction.

[19] See *SEC v. Barclays Bank*, Litigation Release No. 20132, 2007 WL 1559227 (May 30, 2007).

[20] See, e.g., Josh Stoffregan, *Big Boy Letters No Shield, Says SEC*, Compliance Rep., Nov. 16, 2007 (citing comments regarding ineffectiveness of big boy letters in misappropriation theory context from Doug Scheidt, associate director of the Division of Investment Management, and Thomas Biolsi, associate regional director of the New York Regional Office).

[21] The Report of the Market Misconduct Tribunal into dealings in the shares of Chaoda Modern Agriculture (Holdings) Limited on and between 15 June 2009 and 17 June 2009 (hereinafter, the MMT Report), 127.

[22] MMT Report, 129.

[23] MMT Report, 142.

[24] *Securities & Futures Commission v. Tiger Asia Management LLC & Ors* (CACV 178/2011).

[25] David Voreacos, *Tiger Asia Admits Guilt in $60 Million Court Settlement*, Bloomberg, Dec. 13, 2012.

[26] Katherine Burton, *Tiger Asia To Return Client Money Amid Government Probe*, Bloomberg Businessweek, Aug. 13, 2012.

[27] Criminal Law of the People's Republic of China, Art. 180 (Criminal Law).

[28] Securities Law, Art. 75.

[29] Some commentators have seized on this fact to argue, apparently incorrectly, that PRC insider trading law does not provide for tippee liability. The enforcement cases discussed in the following section, however, indicate that the CSRC has taken a different view.

[30] The Guidance Provisions may provide a limited defense for those who gain inside information through "other channels" but do not know the information is inside information. See Guidance Provisions, Art. 20(4).

[31] SeeNicholas Howson, *Enforcement Without Foundation? – Insider Trading and China's Administrative Law Crisis*, 60 Am. J. Comp. L. 955, 970 (2012).

[32] See, e.g., *Nanfang Securities Co Ltd and Beida Chehang Joint Stock Company* (1999), 10 China Securities Regulatory Commission Official Bulletin; *Xiangfan Shangzhen Case* (28 January 1994), 1 China Securities Regulatory Commission Bulletin; Yuan Gu, The Former Chair of Shenshen Fang Was Convicted of Insider Trading, ZHENGQUAN RIBAO [SECURITIES DAILY], 30 June 2003, at 2; Ying Yu, Insider Trading by the Chair of One Listed Company, ZHENGQUAN RIBAO ZHENGQUAN SCHICHANG ZHOUKAN [SECURITIES MARKET WEEKLY], 2 June 2003, at 6.

[33] Judicial Interpretation No. 6, Art. 2.

[34] Zhang & Zhong, *Clamping Down on Insider Trading*, 26 China L. & Practice 52 (Nov./Dec. 2012).

[35] See, e.g., *Nanfang Securities Co Ltd and Beida Chehang Joint Stock Company* (1999), 10 China Securities Regulatory Commission Official Bulletin.