Application No. 5 of 2008

IN THE SECURITIES AND FUTURES APPEALS TRIBUNAL

IN THE MATTER OF a Decision made by the Securities and Futures Commission under section 194 of the Securities and Futures Ordinance, Cap. 571

AND IN THE MATTER OF section 217 of the Securities and Futures Ordinance, Cap. 571

BETWEEN

LI KWOK WAH — Applicant

and

SECURITIES AND FUTURES COMMISSION — Respondent

Tribunal: Hon Mr Justice Stone, Chairman

Dr Tsui Fuk Sun, Michael, Member

Mr Wong Yuen Fai, Stanley, Member

Date of Hearing: 9 September 2008

Date of Determination: 9 September 2008

Date of Reasons for Determination: 14 October 2008

REASONS FOR DETERMINATION

This application

1. This was an application for review by the applicant herein, Mr Li Kwok Wah, otherwise known as Ricky Li, of the decision of the SFC, dated 20 March 2008, to revoke his licence and to fine him the sum of HK$21,400.00.

2. This application was due to be heard together with another application arising out of the same factual matrix, SFAT No 6 of 2008, wherein the applicant had been one Mr Wong Shu Cheung, also known as Leo Wong, a friend and former colleague of Mr Li, whom at the material time had been a licensed representative accredited to JP Morgan, and whom the SFC found had colluded with Mr Li in connection with the conduct now in question in this review.

3. However, by letter received on 3 September 2008, but a few days prior to the hearing of his application for review, Mr Leo Wong formally gave notice of the abandonment of this application “for personal reasons”, this abandonment being acknowledged and approved by letter from the SFAT dated 4 September 2008.

4. Thus the only application as proceeded before this Tribunal was concerned solely with the conduct of Mr Li, whose Notice of Application for Review was dated 8 April 2008.

5. At the conclusion of the hearing, this Tribunal unanimously dismissed Mr Li's application, with costs of the application to the SFC, such costs to be taxed if not agreed.

6. At the same time the Tribunal undertook to provide written reasons for so doing.

7. These are those Reasons.

The factual background

8. Mr Ricky Li, the applicant herein, was licensed to carry out Type 1 activities, that is, dealing in securities.

9. He first was registered as a securities' dealer's representative on 24 April 1986, and between 21 January 1986 and 21 March 1996 he was a securities dealer's representative accredited to JP Morgan. It was, we apprehend, during his employment with JP Morgan that Mr Li came to know the other erstwhile applicant, Mr Leo Wong, who on the SFC case played a central role in the alleged collusion with Mr Li, conduct which at the outset was investigated by JP Morgan, and thereafter, upon that house notifying the SFC, by the regulator.

10. Since 7 May 1999, Mr Li had been a licensed representative of a broker named Hing Shing.

11. In substance, Mr Li stood accused by the SFC of 'front running'; indeed, we are told by Mr Beresford, counsel for the SFC, that this is the first 'front running' case to have come before this Tribunal since its establishment on 1 April 2003.

12. The term 'front running' is used in common parlance because the substance of the activity is that the broker takes advantage of his confidential knowledge of his client's dealing intentions by trading in advance (that is, 'running' in front of the client's orders); in practical terms, therefore, a broker who knows his client is going to buy a substantial amount of a particular stock may wrongfully move to buy up the same stock at a lower price *prior to* placing his client's buy order, and then resell the stock as thus earlier purchased to his client, thereby making a profit on the differential between the lower stock purchase price and the subsequent, and higher, stock resale price.

13. The gravamen of the particular 'front running' allegations as found established by the regulator against Mr Li – a conclusion which is firmly challenged upon this application for review – represents a variation on this theme, in that two brokers were involved: on the basis of confidential information obtained from a former JP Morgan colleague, Leo Wong, Mr Li was able to anticipate known share market orders from Mr Wong by going into the market on his own account and buying the like shares *in advance of* such orders, and thus was able to make a profit, in the two instances

presently under scrutiny, of the sum of HK$21,400, consequent upon the resale of the shares he earlier had purchased.

14. In fact, it is established that Mr Li had resold the very shares he earlier had purchased to Mr Wong, who upon his entry into the market was executing 'buy orders' for these shares from one of his JP Morgan clients; thus the profit differential – which the regulator now has required Mr Li to disgorge – represented the differential between the lower market price as earlier obtained by Mr Li and the higher re-sale price he obtained for these shares when Mr Wong's subsequent 'buy orders' were placed and fulfilled.

15. Two particular transactions on the part of Mr Li were investigated by the regulator; as earlier noted, these transactions had been brought to its attention by JP Morgan, wherein a colleague of Mr Leo Wong in that house had noticed certain oddities about Mr Wong's trading pattern, which was outwith its usual parameters, and thereafter had caused an internal investigation to be mounted; the investment house subsequently contacted the SFC with its findings, and the regulator in turn thereafter investigated the matter.

16. Such investigations included perusing the primary data relating to the two share transactions in question, and further to interviewing, *inter alia*, Mr Leo Wong and Mr Ricky Li.

17. As a consequence of its own investigations, the SFC took the view that a case of 'front running' indeed had been made out against Mr Li,

and also against Mr Wong, albeit this latter finding now is no longer challenged.

18. The conclusion of the regulator as to the activities of Mr Li was reflected in a Notice of Proposed Disciplinary Action ('NPDA') under section 194 of the SFO, dated 6 December 2007, which contained a detailed account of "certain suspicious front running activities conducted by …Wong Shu Cheung and [Mr Li] on 18 and 27 September 2006", the SFC noting that at the material time Wong was a licensed representative of JP Morgan and that Mr Li was and still is a licensed representative accredited to Hing Shing.

19. In this NPDA, the SFC indicated that its findings suggested that Wong had divulged details of his clients substantial buy orders in the shares of *Heng Tai Consumables Group Limited* (stock code: 197) and in *China Shipping Container Lines Company Limited* (stock coded: 2866) to Li "in order to facilitate you to buy ahead of or closely following his clients on 18 and 27 September 2006 respectively", and that Mr Li had made a total profit "of approximately $21,400 before the transaction costs". Thereafter the SFC condescended to details, the particulars of which do not greatly matter for the purpose of this Determination: indeed, this NPDA speaks for itself.

20. In response, on behalf of the present applicant for review, Mr Li, his solicitors, Messrs Edward Ko & Company, by letter dated 10 January 2008, made written representations on his behalf in terms of the content of the NPDA. Once again, the content of these representations speak for themselves; suffice to say that the case as put up by the solicitors upon

Mr Li's behalf was that the 'front running' allegation was denied, that the evidence did not suffice to substantiate the burden and standard of proof, that is, the balance of probabilities, which undoubtedly lay upon the regulator to make good the disciplinary allegation, that in the instant case the SFC had failed to distinguish between mere speculation and the drawing of legitimate inference from the available evidence, and that when the two share purchases in question properly were analysed, the explanations advanced by Mr Li as to the reasons for these purchases (that is, hearing positive news in the market and immediately acting thereon, *without* having obtained any confidential information from Mr Wong) were not inherently improbable, and that since there was no positive contrary evidence, the SFC should not in the circumstances have come to the conclusions as were set out in the NPDA.

21. In addition, without prejudice to the assertion that Mr Li was not guilty of the alleged misconduct, in the same letter his solicitors also made submissions in relation to the penalty proposed by the SFC, namely revocation of licence and the imposition of a fine of HK$21,400, and suggested that the proposed revocation of Mr Li's licence was in the circumstances "a manifestly excessive penalty", and that none of the reasons put forward by the SFC in the NPDA justified the imposition of such a heavy sanction. The solicitors' letter concluded that in terms of penalty, that either "to impose a fine should already be a sufficient penalty" or, alternatively, that there should be a reprimand or a suspension of Mr Li's licence for a defined period, but certainly not revocation.

22. This letter concluded with the request that the SFC should "consider seriously" these representations before deciding whether to take any disciplinary action against Mr Li. It also reserved Mr Li's right to appeal or to seek a judicial review against any such decision that the SFC might make.

23. We apprehend that the SFC indeed did seriously consider these representations by Mr Li's solicitors, and subsequent thereto, by Notice of Decision dated 20 March 2008, the regulator confirmed its decision to revoke Mr Li's licence as a representative, and to fine him the sum of HK$21,400.

24. This letter containing the formal Notice of Decision was accompanied by a further document, also dated 20 March 2008, wherein the regulator set out in detail its Reasons for the view it had taken.

25. This document followed the usual pattern in such instances: the representations as made by the applicant were repeated, analysed and commented upon, including a further review of the available evidence in terms of Mr Li's proffered explanation regarding the two share transactions in question, and thereafter the regulator commented upon the representations which were made as to the proposed penalty, including the following observation (at paragraph 29):

> "Licensed persons have a fundamental duty to act in the best interests of both their clients and the integrity of the market. Your act of front running is seriously dishonest and adversely affected the integrity of the market and the confidence of the investing public. As such, we consider that our proposed disciplinary

> sanction against you is commensurate with the seriousness of your misconduct, and is in line with the disciplinary sanction that we imposed in previous similar cases."

26. Accordingly, the SFC stated that having considered all the material placed before it, including the representations made on behalf of the applicant, that its view of Mr Li's conduct remained unchanged, and stated (at paragraphs 30-33):

> "We find that you breached General Principle 1 of the Code of Conduct by failing to act honestly, fairly, and in the best interests of the integrity of the market…
>
> We conclude that you have been guilty of misconduct for the purposes of section 194 of the SFO. This also calls into question whether you are fit and proper to remain licensed.
>
> We do not consider that the Representations demonstrate any valid mitigation circumstance which detracts from the severity of your misconduct and therefore justifies an adjustment in the sanction originally proposed.
>
> We have decided to revoke your licence as a representative and fine you $21,400 under the Securities and Futures Ordinance."

27. Also by letter of the same date, the SFC gave Notice of its Decision to Mr Wong, the JP Morgan broker, and revoked his licence as a representative under the SFO.

28. Initially, both Mr Wong and Mr Li were aggrieved at these decisions, and duly filed Notices of Application for Review to this Tribunal.

29. As earlier noted, however, Mr Wong now has abandoned his own application, and thus the instant Determination focused solely upon Mr Li's application.

Viva voce evidence

30. No *viva voce* evidence was called in this application, which as the result was conducted solely on the papers as were placed before the Tribunal.

The argument

31. The argument on behalf of Mr Li – whom, as I have noted, did not elect to give evidence before the Tribunal – was conducted by Mr Edward Ko, his solicitor, who was the person responsible for the initial written representations made on behalf of his client to the SFC.

32. If we may say so, Mr Ko did his best with what was a difficult brief.

33. His submissions essentially mirrored the submissions he earlier had advanced to the regulator at the time of the response by his client to the NPDA, and now were contained, in outline form, within the Notice and Grounds of Application for Review, dated 8 April 2008, which were filed with the SFAT on behalf of Mr Li.

34. It is fair to say that the thrust of the submissions advanced was that, upon reviewing the known circumstances surrounding the disciplining

of Mr Li, in terms of the applicable burden and standard of proof the regulator was unable to establish to the requisite standard that the evidence was sufficient to demonstrate that Mr Li was guilty of the alleged misconduct, which was denied, namely, that he had colluded with Mr Wong to take advantage of confidential information by trading ahead of the orders which he knew were to be placed by Wong on behalf of Mr Wong's clients, and thereby, on the two occasions in question, thus to have obtained a pecuniary benefit of HK$21,400.

35. In the course of his submission Mr Ko referred in some detail to the circumstances surrounding the sale and purchase of the shares in Heng Tai on 18 September 2006, and the subsequent purchase, of shares in CSCL on 27 September 2006, and argued that the defendant's explanations as to the phone calls as had been established to have passed on a mobile phone between himself and Mr Wong of JP Morgan did not establish that the figures mentioned in those calls had referred to the transactions in question, nor that there had been any implied or secret mutual understanding between the applicant and Mr Wong that they referred to the share prices, as was alleged by the SFC; moreover, Mr Ko said, even if the applicant's explanations as to the phone conversations were to be rejected, nevertheless there was no positive evidence before the Tribunal in order to justify the finding of guilt to which the regulator had arrived. In a nutshell, therefore, the fundamental contention was that a mere suspicion as thus aroused was insufficiently probative to confirm the adverse finding of the SFC against his client.

36. We are sure that Mr Ko expressed the matter more elegantly, but that at least was the thrust.

37. And even if, Mr Ko had continued, the Tribunal was to uphold the SFC finding of misconduct, the revocation of Mr Li's licence, which was the predominant element of the SFC sanction, could not be justified in the circumstances; his client would not cavil about the fine of $21,400, but he certainly took exception to the revocation, which was "manifestly excessive" within the circumstances as may be held to be established. Moreover, he said, the SFC had been wrong to pay any attention whatever to Mr Li's earlier plea of guilty to an entirely unrelated allegation of short selling in March 2007, which had been of a "completely different nature" to the misconduct now in question.

38. For the SFC, Mr Beresford adopted his usual balanced and fair approach; indeed, he focused solely on the facts of the case as they related to Mr Li's actions, and – we consider entirely properly and correctly – did not ask the Tribunal to take into account the admission of wrongdoing in this matter as had been made by Mr Wong to the SFC, which Mr Beresford rightly observed could have been made for any one of a number of disparate reasons.

39. Accordingly, and for the avoidance of doubt, in reaching our conclusion in this case as to the culpability of Mr Li, and in dismissing his application, we paid no regard whatever to such admission by Mr Wong.

40. Instead, Mr Beresford concentrated upon the known matrix of facts, which, he submitted, amounted to the following propositions:

(i) Mr Li had admitted knowing Leo Wong as both a friend and as a former colleague;

(ii) Mr Li did not dispute undertaking the relevant trades forming the substance of this allegation;

(iii) The relevant trades clearly fell outside the normal pattern of Mr Li's trading activities;

(iv) Two recorded mobile telephone conversations contained a price and a number corresponding to the relevant prices of the shares in question;

(v) The mobile phone records showed calls between Leo Wong and Mr Li around the dates of the alleged 'front running'. In particular, on Sunday 17 September 2006, at 5.17pm, Leo Wong was called by Ricky Li mobile to mobile, when they had not previously communicated by mobile telephone since 1 September 2006, and this call was followed by the first trades on the market as soon as the market opened on the following day; and second, whilst Mr Li had denied talking to Mr Wong prior to the market opening on 27 September 2006, the telephone records revealed that on Wednesday 27 September 2006 at 9.06am, shortly after receiving the CSCL orders, Leo Wong had called Mr Li's mobile twice, one call lasting 74 seconds, and that a further call, at 9:59:53, was recorded between the two men on the same day;

(vi) As to penalty, counsel submitted that in arriving at their decision the SFC had considered four specific factors: the

seriousness of the conduct, Mr Ricky Li's experience and position, the degree of his evasiveness in responding to the SFC queries and his lack of co-operation, and his prior criminal conviction for 16 counts short selling.

The Tribunal's determination

41. On the evidence before it, this Tribunal was in little doubt but that the case against Mr Ricky Li, and the regulator's consequent conclusion as to his guilt, was entirely well-founded to the requisite standard of proof.

42. We agreed with Mr Beresford that, at bottom, the only question for decision was whether, on the factual matrix, the inference properly could be drawn that, notwithstanding his denial, and his assertion that he had got the information from others, that Ricky Li indeed had received the relevant information from Leo Wong, and, if so, whether, in considering the burden and standard of proof, such inference was sufficiently compelling in order to overcome any inherent probability (arising from the seriousness of the conduct in question) that he had not got the news from Leo Wong.

43. In the circumstances we did not find this a difficult question to answer.

44. We agreed with the contention that when a broker makes an unusually large speculative purchase after receiving a telephone call from the very broker to whom he shortly thereafter proceeds to sell the stock at a profit, in circumstances wherein there is no regular communication between

the two, and that where this phenomenon happens twice within the same month, and wherein there are recordings of the telephone conversations in which figures corresponding to the price of the stock are mentioned, that this is powerful evidence in support of the inference.

45. In addition, in analyzing the probative effect of the circumstantial evidence in terms of the drawing of relevant inference, we also consider that we are entitled to take into account the fact of Mr Li's denial, during interview with the regulator, that he had talked to Leo Wong at any time before the market opened on 27 September 2006, a denial which specifically was contraverted by evidence of the relevant telephone records.

46. We also bore in mind that we had not had the opportunity to see and hear Mr Li in the witness box – as earlier observed, he pointedly declined to give evidence to explain his conduct, leaving his legal representative to mount purely legal arguments in terms of the regulator's inability to discharge the burden of proof – and we took the view, in light of the evidence as a whole, that the regulator was perfectly entitled to reach the conclusion that Mr Li had obtained the relevant information from Mr Wong in breach of the confidentiality which Mr Wong/JP Morgan owed to its clients in terms of the share trades which Mr Wong had been instructed to undertake.

47. We further agreed with, and accepted the submission on behalf of the regulator, that in terms of the severity of the penalty, the SFC was entitled to take the view that it did as to the revocation of Mr Li's licence, and the disgorgement of the wrongfully obtained profit from the two 'front

running' trades in question, and that, whilst Mr Li was being disciplined for the 'front running' offences, nevertheless it was not incorrect also to have taken into account Mr Li's prior 'short selling' conviction. Such clearly must be relevant to the issue of 'fitness and properness' to remain licensed, and for that purpose we are in no doubt that the regulator is entitled to take into account such present or past conduct of the regulated person as it considers appropriate to the circumstances of the case: see section 194(3) of the SFO, a provision which is both disciplinary and regulatory in nature.

48. Finally, there is one additional point worthy of mention.

49. In his submission – wherein, as earlier observed, Mr Ko did not have a great deal of room for manoeuvre – he made the argument that in the circumstances of this case it would be wrong and inappropriate for this Tribunal (and, we suppose, the SFC) to have considered these two alleged instances of 'front running' conduct together, when in fact each should have been regarded in isolation. We are quite unable to understand why this should be so, and fundamentally disagree with the premise. It strikes us that it would be nonsense indeed if what is characterised as 'similar fact' conduct could not be taken into account, and evaluated by the regulator, and indeed by the SFAT, as part and parcel of the overall factual matrix.

50. Accordingly, when looked at in the round, we took the firm view that in the circumstances of this case that the SFC was entitled both to find, and to punish, as it did. In this connection, our attention has been drawn by Mr Beresford to other 'front running' cases, which were not been the subject of review by this Tribunal, and wherein the regulator had

imposed sanctions; in one of these cases, involving one Kwok Wai Keung, SFC Press Release dated 6 May 2003, the trader's licence was suspended for a period of 12 months, whilst another far more recent case, involving one Chung Yu Kit and one Ding Lai Leung, SFC Press Release dated 4 January 2008, had resulted in revocation of the licences of these two gentlemen, with the latter also being fined the sum of $128,000.

51. Each and every case, of course, is peculiarly 'fact sensitive', but we are satisfied that the circumstances of the present application warranted the sanction imposed, and could not possibly be characterised as 'plainly wrong' or outwith prevailing contemporary practice or as being based upon incorrect application of principle or incorrect application of fact.

52. Indeed, when looked at in the round, we go so far as to say that we consider this application to have been manifestly without merit, and had the substantial penalty of revocation of his licence already not been visited upon Mr Li, we otherwise should have been minded to have awarded indemnity costs against him to reflect our view as to the unmeritorious nature of this application; in the event, however, we chose not to do so in this instance, and, for the avoidance of doubt, the costs which Mr Li, as unsuccessful applicant, now has been ordered to pay to the SFC, are to be taxed and paid on the normal 'party and party' basis, with the matter certified as fit for counsel.

53. At the outset of these Reasons for Determination, we observed that perhaps this was the first 'front running' case to have come before this Tribunal since its establishment in April 2003.

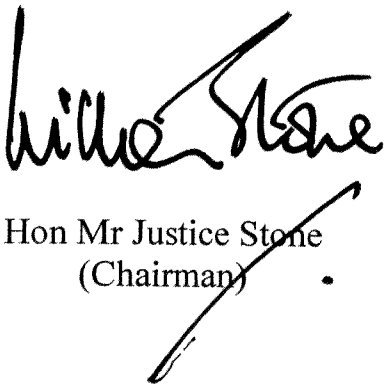
54. We take this opportunity to state as firmly as we may that we consider that the offence of 'front running' not only represents a serious breach of the obligations placed upon licensed dealing personnel to conduct themselves honestly, and to ensure their 'fitness and properness' in so acting, but by its very nature represents also an egregious misuse of confidential information regarding a client's trading intentions in order to make a profit, often at the client's expense, and thus acts as a potential threat to the integrity of a market place in which the avowed aim is to ensure open and free trading and the absence of anything that may be construed as a 'rigged market'.

55. In this regard, in his helpful submissions Mr Beresford drew the attention of the Tribunal to a case in the United States Court of Appeals, 7th Circuit, namely *USA v Dial & anr, 757 F.2d 163 (1985)*, which was an appeal by Mr Donald Dial and his accomplice, one Horace Salmon, against a conviction in the United States District Court of mail and wire fraud in connection with the trading of silver futures in the commodities market. The conviction of the appellants was affirmed, but the relevance of this case in the instant context lies in the observations of Court of Appeals Judge Posner, who took the opportunity in the judgment to make some observations as to the venality of the market being rendered an uneven playing field by reason of some participants having preferential access to information, with particular reference to brokers trading on their own account as well as on account of their customers, but with, of course, the knowledge of the trades to be executed on behalf of their customers – in other words, a species of 'front running' wherein the client's own broker himself obtains profits from confidential information imparted by his client.

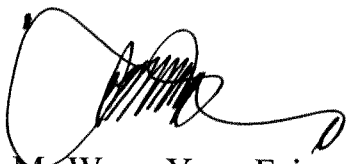
56. In his judgment, *op cit.*, at 165, Judge Posner observed as follows:

> "Traders on a commodity futures exchange will, however, want some assurance that there are no people in the market who have preferential access to information. If there are known to be such people, the other traders will tend to leave the exchange for other exchanges that do not have such people – and several commodity exchanges besides the Board of Trade offer trading in silver future contracts. If trading is 'rigged' on all commodity futures exchanges, there will be less commodity futures trading, period, and the social benefits of such trading, outlined above, will be reduced. **The greatest danger of preferential access comes from the brokers, who often trade on their own account as well as for their customers. Brokers have more information than any of their customers because they know all their customers' orders.** Suppose a customer directs his broker to buy a large number of silver futures contracts. The broker knows that when he puts this order in for execution the price will rise, and he can make it rise further if he waits to execute the order until he can combine it with other buy orders from his customers into a 'block' order that will be perceived in the market as a big surge in silver demand. **If, hoping to profit from this knowledge, the broker buys silver futures on his own account just before putting in the block order and then sells at the higher price that the block order generates, he will hurt his customers. His purchase (if substantial) will have caused the market price to rise just before the block order went in, and thus the price that his customers pay will be higher than otherwise; and his sale will cause the price to fall, and thus reduce the value of his customers' contracts. So if 'trading ahead' – as the practice of a broker's putting in his own orders for execution ahead of his customers' orders is called – became widespread, customers would realize that the market was rigged against them.** And trading ahead serves no social function at all. The broker obtains a profit from information that he has not invested in producing but that comes to him automatically in his capacity as a broker. It is like a lawyer's discovery that his client is about to make a takeover bid for another company and rushing out and buying some of that company's stock before the bid is made public…"(emphasis added)

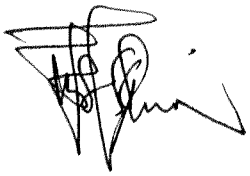
57. We agree with and accept these observations, which we anticipate future Tribunals will bear in mind when considering further 'front running' cases which may be the subject of future applications for review.



Hon Mr Justice Stone
(Chairman)



Mr Wong Yuen Fai
(Member)



Dr Tsui Fuk Sun
(Member)

Mr Edward Ko of Messrs Edward Ko & Co, for the applicant

Mr Roger Beresford, instructed by the SFC, for the respondent