MARKET MISCONDUCT TRIBUNAL

IN THE MATTER OF DEALINGS IN THE LISTED SECURITIES OF EVERGRANDE REAL ESTATE GROUP LIMITED

Date of Delivery of Ruling: 27 October 2015

RULING

1. On 21 June 2012, Andrew Edward Left, the publisher of an Internet website called Citron Research, published a report ('the report') concerning a company listed on the Hong Kong Stock Exchange, that company being Evergrande Real Estate Group Limited ('Evergrande'). The report, which, on the material before the Tribunal, appears to have been presented in a direct, easily digestible manner – similar to a PowerPoint presentation – was nevertheless lengthy, containing a detailed overview of Evergrande's finances and its various operations. The report informed readers that, on the basis of analysis and primary research, it could be said inter alia that, first, Evergrande was insolvent and, second, that "at least 6 accounting shenanigans" had been undertaken by the Company's management in order "to mask Evergrande's insolvency."

2. On 15 December 2014, the Securities and Futures Commission (the 'SFC') issued a notice pursuant to s.252 (2) and Schedule 9 of the Securities and Futures Ordinance, cap 571, requiring this Tribunal to determine whether, in publishing the report, Mr Left may have contravened section 277(1) of the Ordinance and therefore engaged in market misconduct. Expressed broadly, and in the context of the present case, the section directs that a person shall be

guilty of market misconduct if he disseminates false or misleading information as to material facts about a corporation, knowing the information to be so or being reckless or negligent as to whether it is so, if that information is likely to induce others to deal.

3. In this regard, the notice alleged that the information contained in the report "was false or misleading as to a material fact, or was false or misleading through the omission of a material fact" in that Evergrande was not insolvent and nor had it consistently presented fraudulent information to the investing public. The notice alleged that Mr Left either knew or was reckless or negligent as to whether the information contained in the report was false or misleading. The notice further alleged that on the day of publication of the report "the turnover of Evergrande shares was exceptionally high and the share price fell significantly".

4. At this juncture, it needs to be emphasised that the report was based on an analysis of Evergrande's own published material (for example, its balance sheets) considered in conjunction with other relevant material in the public domain (for example, newspaper reports and internet sources). By way of illustration, one page of the report (page 41) states:

> "CRISIS RED FLAG #2: While Evergrande shamelessly touts its "Cash Is King" fiscal policy, its debt balances continue to explode. Evergrande is overleveraged and the Company has no margin for error.
>
> Evergrande continues to haemorrhage case despite showing huge growth in reported revenues and profitability. Since December 31, 2008, total reported debt has exploded from RMB 15bn to RMB 95bn. As outlined earlier, Evergrande's off-balance sheet debt is at least RMB 23bn, bringing total on-and-off-balance sheet debt at 12/31/2011

> to RMB 118bn. Even if Evergrande's assets were not overstated, its ratio of debt to equity would be 291%."

These assertions are followed (on the same page) by a table headed 'Debt Summary'.

5. In an application dated 17 September 2015, Mr Left applied to the Tribunal for an order for the production of documents under s.253(1)(b) of the Ordinance or, alternatively, for a stay of proceedings under s.253(1)(i) of the Ordinance. The application was opposed.

6. On behalf of Mr Left, his counsel, Laurence Li, submitted that, on the basis of the SFC case, the central issue for determination by the Tribunal would be whether the information disseminated by Mr Left in the report was in fact false or misleading or, put another way, contrary to what Mr Left had published, "whether Evergrande was actually solvent and whether in fact it had been presenting true accounts". This, submitted Mr Li, required an enquiry into Evergrande's true financial position and in turn this demanded a review of its records and documents. It was for this reason, said Mr Li, that an order for production of relevant records and documents was being sought. The exact terms of the order – or perhaps successive orders – would be subject, of course, to the guidance of the Tribunal.

7. As the Tribunal sees it, in practical terms, if it grants the order, it would mean that Evergrande would have to make available to those representing Mr Left all of its records spanning a relatively extensive period of time. These records would be unlikely to be limited to purely financial records as the report

spoke of a broad range of matters.[1] Mr Duncan SC, who appeared for the SFC, informed the Tribunal that these documents were spread across the Mainland in numerous repositories. The clear implication was that it would be a mammoth task to make all the documents available and indeed an equally mammoth task for those representing Mr left to be able to conduct a coherent study of them. Although nothing was said of delay, the Tribunal notes that the potential for delay would have to be alarming.

8. Mr Li, however, saw no alternative. The SFC, he said, relied on three matters of evidence in order to prove its case. First, it relied on the audited financial statements of Evergrande; second, it relied on certain analyst reports which themselves assumed the truthfulness and completeness of the audited financial statements and, third, it relied on an expert opinion, that expert also assuming the truthfulness and completeness of the audited financial statements. In short, at the end of the day everything was reduced to the audited financial statements. Audited financial statements, however, said Mr Li only went so far. Audited financial statements were not themselves proof that there had been no fraud. Fraudulent activities were often – perhaps invariably – hidden from the auditors.

9. In addition, as Mr Li put it, when a research report sets out an analysis of the finances of a company and the report is drawn to the conclusion that the company is essentially insolvent and/or has been presenting fraudulent information to the public, this means, of course, that the report calls into question the degree of assurance that the relevant audits are capable of giving. Accordingly, "citing the audited figures is no logical answer. It is not even

[1] For example, among many other matters, the report spoke of Evergrande's off-balance sheet debt related to "JV buybacks and unpaid land deals" exceeding RMB23 billion. That issue alone – potentially – would require a study of numerous contracts and correspondence related to those contracts in addition to pure accounting documents.

meeting point." That being the case, there was only one way to determine whether the information disseminated by Mr Left in the reports was false or misleading, that was to look *beyond* the audited statements into primary documents: hence the request for an order for the production of relevant documents pursuant to s.253(1)(b).

10. In opposing the application, Mr Duncan said that the SFC case was not as openly structured as Mr Li appeared to suggest. It did not require that there be a return to the fountainhead of Evergrande's primary documents. The matter fell to be determined on the basis only of what information was in the public domain at the time of the report. It was *that* information which Mr Left used to compile his report and it was accordingly on *that* information that his culpability should be determined.

11. As the Tribunal understands it, it was implicit in Mr Duncan's submissions that the SFC accepts that market commentators are entitled, on the information available in the public sphere at the relevant time, to disseminate their analysis of the strengths or weaknesses of a particular listed corporation. That is fair comment, no matter the perceived cogency or weakness of the comment. What market commentators are not permitted to do, however, is to distort that information so that, knowingly or being reckless or negligent as to whether it is the case, what is published constitutes false or misleading information about the corporation. As the Tribunal understands it, it is within that last sentence that the SFC case is contained. Hence paragraph 7 of the synopsis which appears under the heading of 'Information False or Misleading' and which states:

> "*Neither the materials on which Mr left relied (as referred to in the Citron Report) nor any other available information* justified a conclusion that Evergrande was insolvent or had consistently presented fraudulent information to the investing public." [emphasis added]

12. Properly understood, said Mr Duncan, the SFC case does not, therefore, depend on the production of the myriad documents that lie behind the published audited financial statements of Evergrande. The SFC case is limited to the assertion that Mr Left created false or misleading information out of what was publicly known about the corporation at the time. Any defence, he said, was to be similarly restrained.

13. Mr Duncan submitted that such restraint would not act unfairly to Mr Left. To the contrary, only in those circumstances would the enquiry by this Tribunal be able to look to matters within their true context. At the time when he made his comments, Mr Left did not have access to Evergrandes's accounting material nor other private documents possessed by the corporation. The best that he could do in the circumstances was to analyse available information, including the financials of the corporation and available market information, and then arrive at an educated opinion. It was on that basis that his culpability should in fairness be judged. That basis, however, did not require an exploration of Evergrande's archives.

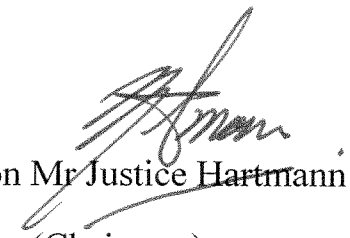
14. The Tribunal is satisfied that Mr Duncan's submission must be correct. At the time when Mr Left compiled his report – as a market commentator and not an 'insider' – the only information available to him was information in the public domain. It was that information that he used as the basis for asserting that Evergrande was for all practical purposes insolvent and that it had consistently presented fraudulent information to the investing public. The SFC is therefore obliged to present its case on the basis of that information just as Mr Left is obliged to do so.

15. In the view of the Tribunal, one way of testing the validity of Mr Duncan's submission is to view the matter through the prism of an SFC case premised on the basis of all primary documents being available to it. It would clearly be wrong for the SFC to issue a notice on the basis that, while, based on the information in the public domain at the relevant time, Mr Left was entitled to come to the findings and to draw the inferences that he did, nevertheless a study by the SFC of the primary documents in the possession of Evergrande now proved that those findings and inferences were false or misleading. In that instance, Mr Left would be found culpable not on the basis of what was in the public domain, and what was therefore available to him, but on the basis of what had been dug out of archives containing the private property of Evergrande and being known only to insiders. Equally, in the view of the Tribunal, it would not assist Mr Left to say that, although on all the information known to him at the time, he knew or was reckless or negligent as to whether his published comments were false or misleading, nevertheless, he should be given the opportunity to trawl through the primary documents in the archives of Evergrande to see whether or not there is some vindication to be found in them.

16. Although not determinative, the Tribunal also takes into account the essential mischief that s.277 seeks to avoid. It is not of itself the publication of false or misleading information about a listed corporation by a person who knows or is reckless or negligent as to that fact. The mischief lies in the fact that such information is likely to induce the investing public to deal in the securities of the listed corporation and thereby innocently undermine and/or distort the open and honest workings of the market. The section is there to protect the integrity of the market. It would, however, for all practical purposes, become almost impossible to employ as a regulatory tool if market commentators (many of whom wield considerable influence) who are accused under the section are able to ignore all information in the public domain at the relevant time, despite the fact that that is the information out of which their indicted comments arose, and demand instead the right to trawl through the

primary documents in the possession of a corporation in the hope that somehow those primary documents will exonerate them.

17. For the reasons given, the application must be dismissed. There will be an *order nisi* awarding costs to the SFC, that order to be made final at the expiration of 90 days from the date of this ruling, unless an earlier application is lodged for a different costs order.



The Hon Mr Justice Hartmann
(Chairman)