Transparency of information in the market:
the CITIC case before the Market Misconduct Tribunal

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Abstract

This paper briefly identifies some of the more important issues raised by the finding of the Market Misconduct Tribunal that CITIC's non-disclosure of price sensitive information at a time when it made a no material adverse change statement did not amount to market misconduct for the purposes of section 277 of the Securities and Futures Ordinance. It is suggested that the causal relationship between "no change" public announcements and maintenance is inadequately explored, and that the Tribunal's interpretative process and approach to the listing rules is inappropriately circumscribed. The case has left the market in an unsatisfactory situation in a number of regards.

The Market Misconduct Tribunal recently found that a no material adverse change ("no-MAC") statement published by CITIC Limited in 2008 did not constitute market misconduct under s. 277 of the Securities and Futures Ordinance ("SFO") because the statement was unlikely to influence the market price of CITIC securities, and because it was not materially false or misleading.

This came as a surprise to many because at the time of the statement, directors of CITIC were aware of but had not disclosed to the market that it was facing significant mark-to-market losses on foreign currency derivative contracts. When disclosed to the market weeks later, CITIC's share price plunged, wiping out around HK$20 billion, or two-thirds, of its market capitalisation.

This article identifies some of the more important issues raised by the Tribunal's findings and the SFC's decision not to appeal.

The "Likely To" Element

For a breach of s. 277 to be established, the no-MAC statement must have been likely to, *inter alia*, maintain, increase, reduce or stabilize the price of CITIC's securities. This requires a potential causative effect in the market. The Tribunal understood this to mean likely to induce the investing public to deal, so as to undermine the open and honest workings of the market. Given the absence of any measurable effect of the no-MAC statement on CITIC's share price, the Tribunal's focus fell on the concepts of maintaining or stabilizing.

The purpose of a no-MAC statement is presumably to facilitate shareholders evaluate the merits of a transaction against the background knowledge that it is "business as usual" in relation to all other aspects of the company's affairs. Hence it is logical to focus on the concept of "maintenance" when considering the likely effect of a no-MAC statement. However, because maintenance seeks to preserve an existing state of affairs, the assessment of causality requires careful consideration.

The Tribunal concluded that the no-MAC statement was not likely to have the effect of maintaining CITIC's share price because it was a routine statement relating to a transaction that was very likely to pass unnoticed by the market, and because of the absence of any prevailing trend or volatility in CITIC's share price at the time of the statement. This view appears to be inconsistent with the practice of listed companies and their advisers relating to MAC statements – they are generally considered to be a significant requirement, are not made lightly and are subject to rigorous internal procedural controls (as was the case with CITIC). Given this, it is hard to accept that they are not at least potentially important in terms of their market effect. In other words, a company's comment on its MAC position is the type of information that the market pays attention to – open markets rely on a continuous assessment of the total mix of available information and a no-MAC statement is a confirmation no less than is a statement there has been a MAC.

Recognising this requires a developed appreciation of the causal relationship between "no change" public announcements and maintenance. The Tribunal in *Sunny Global* (2008) accepted that "no change" announcements could underpin investor sentiment and maintain or stabilize share prices. The SFC has also warned that negative confirmations may be misleading because they can mask the impact of other factors (newsletter April 2015). One might compare this to the position of the captain (the decision maker) of a ship: his receipt of confirmation that the tide remains the same "maintains" his decision to stay on the present course just as an omission to provide him with information that an iceberg lays dead ahead does. The US Supreme Court long ago recognised the importance of omissions to shareholder behaviour without requiring anything more than asking whether there would be a reasonable likelihood that the omitted fact would have assumed tangible significance in its deliberations (*TSC Industries v Northway* 426 US 438 (1976), which has been judicially approved in the Singapore Court of Appeal).

Interpretative Process

An important step in the Tribunal's reasoning was that CITIC's no-MAC statement had been made pursuant to a requirement in the listing rules, which provided no definition of the term.

Undertaking an interpretation that sought to give the words their natural and ordinary meaning, unless the context and purpose points to a different meaning, the Tribunal concluded the MAC phrase meant that the financial integrity of the company must have been undermined for an enduring period. It is unclear why the Tribunal's analysis of MAC phrases used in a loan default scenario, such as the *Grupo Hotelero* case, is germane to its use in an equity context. No analysis was undertaken of the background to the listing rule inclusion of the MAC statement requirement, nor of the major and connected transaction scenarios provided for in the listing rules that trigger MAC statements, nor the Exchange's guidance on the phrase in its HKEX-GL41-12. Moreover, no account was made of how the Tribunal's interpretation would serve the needs of shareholders assessing a proposed transaction – that it would be of little assistance suggests the Tribunal's interpretation may be inconsistent with a core purpose of the listing rules.

That the MAC requirement in LR Chapters 14/14A does not contain the same language as LR13.09 appeared relevant to the Tribunal's treatment of the MAC requirement as an "independent obligation". However, unlike legislation, listing rules are far more directive in nature. LR13.09 is a continuing obligation and the listing rules do not treat information disclosures as existing in segregated silos: LR2.13 specifically requires information in any announcement to be complete, not misleading or deceptive, or present risk factors in a misleading way.

The primary question of course is not breaches of the listing rules but whether CITIC's no-MAC statement was false or misleading or omitted material facts for statutory purposes. If the obligation to make a MAC statement was not an independent one then omitting other information the market would expect to be disclosed in compliance with the listing rules would be relevant to consider for this purpose – much like the ship captain's position in the analogy above. In *SFC v. Wong Shu Wing and Another* [2013] HKCFI 2302, the court recognised that listing rule disclosure requirements are relevant to the information a shareholder might reasonably expect to receive for statutory purposes (s. 214 SFO). Alternatively, if one followed the Tribunal's approach, would a circular issued pursuant to LR Chapter 14 not be misleading even though it failed to mention a connected party element as required by LR Chapter 14A?

The Tribunal's position leaves the market in an unsatisfactory situation. The utility of MAC statements to equity investors has been greatly diminished, and much uncertainty is introduced as to whether a statement pursuant to one provision of the listing rules has any bearing on compliance with other requirements. These are concerns that continue following the introduction of Part XIVA SFO particularly where a disclosure may be made pursuant to the listing rules to facilitate a corporate transaction at a time when the issuer is also withholding inside information pursuant to an applicable safe harbour.

The Macroscopic Perspective

When considering the *CITIC* case, one can also reflect on the *Andrew Left/Citron* case earlier this year in which a short seller was found by the Tribunal to have committed market misconduct under s. 277 as a result of issuing a report without conducting adequate due diligence. That case raised concerns related to the potential stifling of negative commentary in the market. In contrast, to find that CITIC is able to engage in corporate opacity of considerably greater proportions while at the same time pursuing other corporate objectives presents a macroscopic anomaly – company insiders acting opaquely appear to be held to lower standards than are applied to negative commentators. This suggests an erratic valuation of the free flow of information in a transparent market.

In the pre-Part XIVA context of the *CITIC* facts, the decision to use s. 277 was likely motivated by the lack of hard sanctions available for a breach of LR13.09 and the possibility of obtaining compensation under s. 213 SFO for shareholders who had incurred losses. However, the failure before the Tribunal and the SFC's decision not to appeal has left shareholders without a real prospect for a remedy. It also leaves the market with an interpretation of how the listing rules operate that is at odds with commercial practice and lacks investor utility, putting the Exchange and the SFC in something of a conundrum as to whether to clarify the operation of the MAC statement requirement for it to service investor interests, or just to rewrite the disclosure requirement more unequivocally. The decision not to appeal also appears to sit uncomfortably with the SFC's recent efforts to highlight an enforcement priority as being corporate wrongdoing that wipes out market value and impacts the integrity of the market. Further clarification of s. 277 will need to wait.