

# Short circuit – short seller guilty of Hong Kong market misconduct

Hong Kong's Market Misconduct Tribunal (MMT) has found short seller Andrew Left culpable of market misconduct, in a case marking the Securities and Futures Commission's (SFC) first direct action against short sellers.

**Short selling analysts such as Left's Citron Research, Glaucus and Muddy Waters, set out to find problems with the accounts of listed companies and rely on the media to disseminate their reports.**

## The report

Left, who heads *Citron Research*, published a negative article in June 2012 concerning *Evergrande Real Estate Group Limited* (Evergrande), the Chinese property developer. An SFC investigation found that Left started selling Evergrande shares short two weeks before the article was published and began buying them back on the day of publication, making him a net profit of HK\$1.6 million. Shares in Evergrande closed 11.4 per cent down on the day compared with a drop of 1.3 per cent in the market as a whole.

The Citron report said that Evergrande, now renamed China Evergrande Group, was insolvent and had engaged in fraudulent accounting. Evergrande came to Left's attention in March 2012 when he received a package in the US with no return address and no indication of who had sent it. The documents contained in the package made the same serious allegations of insolvency and accounting fraud later made by Left who wrote in an email that he thought it "*was a story that should be told*".

## MMT Finding

The MMT found that Left had made allegations that were "*false and misleading*" and that were likely to frighten ordinary investors. The Tribunal criticised Left for not familiarising himself with relevant accounting standards and for not having sought comment from Evergrande ahead of publication, a step often taken by professional journalists but not one routinely adopted by market commentators.

## Determined Action

Market commentators had voiced fears that the ruling could harm freedom of speech in Hong Kong. Investors though, concerned about unsourced and misleading information being spread in the market, have generally welcomed the finding, not least because short sellers profit from the market decline they themselves have prompted.

In March 2015, the SFC's former Executive Director of Enforcement Mark Steward made clear the approach the authority would take when he promised to take action against short sellers using false reports to drive down share prices. It is clear the SFC intends such action to have wide-ranging geographical effect, since Left himself is based offshore in the US.

## Key issues

- The Market Misconduct Tribunal has found Andrew Left culpable of market misconduct.
- The case marks the SFC's first direct action against short sellers.
- The Tribunal will decide on appropriate action at a later stage.
- The SFC's Executive Director of Enforcement Thomas Atkinson has pledged to maintain investor protection as a priority.

The Tribunal will decide on an appropriate sanction at a later stage. Left faces the prospect of a ban from trading Hong Kong shares for up to five years and having to pay back the profit he made from his trades in *Evergrande*.

## Previous action

In an earlier case involving published commentary, the SFC won a case in April 2016 against ratings agency *Moody's* in the Securities and Futures Appeals Tribunal (SFAT) over a report that set out to identify risk factors (or "red flags") of PRC rated companies. The SFAT affirmed the

SFC's findings that Moody's had failed to provide sufficient explanations for the red flags it had assigned and had failed to ensure their accuracy.

With the new SFC Executive Director of Enforcement Thomas Atkinson promising to maintain investor protection as a priority, it seems the SFC's targeting of published commentary which it deems likely to pose a threat to the market, is likely to continue.

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