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THE ADEQUACY AND EFFICACY OF CIVIL REMEDIES FOR INSIDER TRADING: A COMPARATIVE CRITIQUE

This article aims to consider the adequacy and efficacy of civil remedies for insider trading presently available in Singapore. The insider trading regimes in the USA, the UK and Australia will be looked at as potential sources of inspiration for reform. The term "civil remedies" refers to the civil relief available both under the common law and under specific legislation against the insider trader. This relief usually takes the form of monetary compensation. The focus of this article on civil remedies essentially excludes any discussion of the criminal penalties imposed upon a wrongdoer as a result of prosecution. The possible claimants for civil relief could be a securities regulatory authority, the corporate issuer of the securities that were subject to insider trading, or the counterparty to the insider in a securities transaction.

I. INTRODUCTION

"WHOEVER loves money never has money enough; whoever loves wealth is never satisfied with his income." *Ecclesiastes 5:10*

Insider crime appears to stand apart from other criminal activity by boasting an elite class of offenders, having in common *inter se* the bittersweet benefit of privilege. The exclusive group of potential offenders consists of persons involved in corporate management or ownership, in the financial services industry or in certain related professions, like law and accountancy. It is their position "inside" a corporate, a financial intermediary or a professional adviser that allows these persons as individuals to come into possession of privileged information that is unavailable to the public. In this respect, insider trading or insider dealing[1] is an elite crime available only to the select few "in the know".

[1] The two expressions "insider trading" and "insider dealing" are not legal terms of art but of general description. They are synonymous and in the course of this article, they are used interchangeably, for the sake of variety and for no other reason. Both expressions are not intended to relate back to any legal definitions of insider crime. Different jurisdictions have varying tests for what exactly constitutes the criminal activity of insider trading or insider dealing. A discussion of the legal parameters of insider crime is not within the ambit of this article.

To be of benefit to an insider, the pertinent information has to be price sensitive. In other words, the information must be capable of affecting the market price of a company's securities. Insider trading occurs when an insider uses that privileged information to make a financial gain through the purchase or sale of a company's securities. The gain could take the form of profit made. This occurs when the insider purchases shares with the benefit of "good news" which is unavailable to the public and the price of the shares subsequently rises due to the release of the "good news". The gain could also take the form of loss avoided. This occurs when the insider sells shares with the benefit of "bad news" which is unavailable to the public and the price of the shares subsequently drops due to the release of the "bad news".

For academic entertainment, it could be debated whether insider trading is behaviour that is to be considered so morally reprehensible or economically damaging to the securities markets as to warrant the attachment of criminal penalties. This article will not seek to embark or elaborate on such a debate.[2] In the jurisdictions of Singapore, the USA, the UK and Australia, the point as to whether insider trading should or should not be a crime is no longer moot. Insider trading is a distinct crime in these jurisdictions.[3] Furthermore, in addition to the criminalisation of insider trading, the statute books of Singapore, Australia and the USA have made provision for civil remedies in relation to insider trading. The UK does not have any such statutory provisions and any claims for loss or restitution in an insider trading context would have to be made to fit into a traditional common law cause of action.

From a purist's point of view, civil remedies do not and should not perform similar functions to that of criminal penalties. However, in insider trading jurisprudence, this functional differential has been blurred. Broadly speaking, the purpose of the civil law is to compensate for loss, or perhaps, provide for restitution. Yet, in the realm of insider trading legislation, specific civil remedies related to insider trading are also seen to be effective devices

[2] For a flavour of the debate, readable summaries of the arguments for and against the criminalisation of insider trading may be found in B Hannigan, *Insider Dealing* (2nd ed, 1994), at Ch 1, M Ashe and L Counsell, *Insider Trading* (2nd ed, 1993), at Ch 2 and R Baxt, HAJ Ford and A Black, *Securities Industry Law* (4th ed, 1993), at Ch 12.

[3] In 1934, the USA passed legislation penalising the use of fraudulent and deceptive devices in the trading of securities. This included insider dealing and since the 1930's, the USA has remained a jurisdiction which is determined and aggressive in its efforts to counter insider trading. By contrast, insider trading laws were not enacted in the UK until 1985. Australia passed its state insider trading laws in 1980 and Singapore, inspired by the Australian model, passed its laws in 1986. As mentioned in *supra*, note 1, the legal and technical definition of insider trading as a crime in the various jurisdictions are dissimilar and this article will not attempt to look into the differences.

to punish and deter, most notably by penalising the insider financially. After all, insider crime is almost always financially motivated. In this respect, used in pursuit of the objectives of punishment and deterrence, civil remedies appear to complement the criminal penalties. However, insofar as civil remedies are intended to provide for loss recovery or restitution, they are purposively independent of criminal penalties.[4] Statutory civil remedies then supplement the criminal penalties by giving a civil right of recourse to certain claimants against the wrongdoer that might not have been available under common law.

In assessing the adequacy and efficacy of civil remedies for insider trading in Singapore, the above-mentioned objectives of civil relief should guide the assessment. Insofar as civil remedies are aimed to further punish and deter insiders, do civil remedies and criminal penalties in tandem do so, or is one or the other thoroughly superfluous, adding nothing? Insofar as civil remedies are aimed to effect loss recovery and institute compensation or restitution, do they fulfill and facilitate that objective?

II. Juridical Bases for Legal Sanction

Before proceeding further, it would be helpful to consider the juridical bases for considering insider trading as behaviour that should be punished, deterred and hopefully eradicated. By doing so, it may be seen that the objective of civil remedies in the context of insider trading as a loss recovery mechanism is most likely a secondary one. The most often cited juridical bases are what may be conveniently labeled: (i) the element of fiduciary wrongdoing, (ii) the inherent unfairness objection, and (iii) the maintenance of confidence in the market.

(i) *The Element of Fiduciary Wrongdoing*

Insider trading as a wrong may, at the most fundamental level, be based on the concept that a fiduciary-insider is not allowed to use information obtained by virtue of his position as a fiduciary, at least without full and

[4] Criminal procedure may have already made allowance for the compensation of the victim, for instance, in Singapore, see s 401 of the Criminal Procedure Code (Cap 68) which provides the courts with the discretion to make compensation orders in criminal proceedings. Similarly, s 35 of the Powers of Criminal Courts Act 1973 in the UK provides likewise. However, compensation orders made under both the UK and the Singapore provision are made pursuant to the court's discretion upon a criminal conviction, and the victim does not have a right to claim the said compensation.

adequate disclosure, to obtain a personal profit or advantage.[5] This may be premised either on the well-established principle that fiduciaries should not place themselves in a position of conflict of interest or on the proposition that one who has used privileged information relating to a company for his own personal advantage has essentially misappropriated the property of the company.[6] It can therefore be seen that the initial recognition of insider trading as a wrong stems, not from notions of criminal justice, but from the equitable principles of fiduciary duty.[7]

It is emphasised, however, that at common law, an action for breach of fiduciary duty against a fiduciary-insider may only be pursued by the company of whom the insider is a fiduciary. An aggrieved purchaser or seller of shares would not have a personal cause of action against the fiduciary-insider.[8] In the case of surefire or traditional fiduciaries, such as the directors, senior managers, officers or professional advisers of a company, their liability to the company in a case of insider trading is clear, and the company need not suffer a loss to pursue the action.

Shareholders of a company are traditionally not considered fiduciaries of the company. However, particular insider trading legislation has expanded the class of potential insider offenders to encompass shareholders who trade with an informational advantage.[9] At the extreme, in Australia, the statute

5 An action for breach of fiduciary duty against the insider by the company is an established common law cause of action against the insider. In the UK, where there is no statutory civil action for insider trading, this common law cause of action remains purposeful and expedient. See *infra*, note 92 and the accompanying text.

6 Lord Hodson and Lord Guest in *Phipps* v *Boardman* [1967] 2 AC 46 at 107 and 115 respectively recognised that information could be regarded as property and thus misappropriated.

7 In *Exicom Pty Ltd* v *Futuris Corp Ltd* (1995) 18 ACSR 404 at 408-409, Young J made the following observation:

> [T]he theory behind insider trading is breach of fiduciary duty. One can see in the early United States cases, as analysed by Prof Loss in his article in (1970) 33 *Modern Law Review* 34, that even before the US Securities Act of 1933 the obtaining of insider information was considered to be an appropriation of corporate property and a breach of fiduciary duty owed to the corporation. Although the matter is now statutory, the earlier American cases on the statute did still continue to develop this particular line of thought.

8 It was held in *Percival* v *Wright* [1902] 2 Ch 421 that the fiduciary-insider does not owe any duty to the shareholders, but only to the company. See *infra*, note 93 and the accompanying text.

9 The definition of an "insider" under the Securities Industry Act of Singapore includes substantial shareholders. The Criminal Justice Act 1993 of the UK has a definition of an "insider" that includes shareholders, not limited to substantial shareholders, with access to price-sensitive information. In Australia, under Pt 7.11 of the Corporations Law, a person is an insider if he possesses material price-sensitive information that is not generally available.

does not stipulate the requirement of a nexus between the "insider" and the company whose shares are affected and theoretically *any* person who trades with the requisite informational advantage could be an "insider". Such a position appears to dilute the juridical basis for impugning insider trading based on an element of fiduciary wrongdoing.

It is noted that in jurisdictions such as Singapore, even though a pseudo-fiduciary "connection with" the company through whom privileged information is obtained is required to establish insider liability, tippee liability is recognised.[10] This extends liability for insider trading beyond traditional fiduciary-insiders. Tippee liability has been said to challenge the fiduciary duty origins of the perception of insider trading as a form of wrongdoing. Langevoort, in his treatise *Insider Trading Regulation*[11] stated:

> Once the law of insider trading included tippees (as well as tippees of tippees) based on an access to information standard for the obligation to disclose, it was clearly separated from its fiduciary duty origins, and indeed the fiduciary concept was disappearing rapidly as a significant topic in any discussion of insider trading doctrine. The law was plainly moving in the direction of dealing with the unfairness inherent in informational imbalances by prohibiting any trading on unshared material information except insofar as that advantage was attributable solely to the trader's superior foresight or skill.

It is submitted that in considering what is inherently unfair and therefore wrong, it may be necessary to revert to the fiduciary origins of the wrongful act. This has been the case in the USA and the US Supreme Court[12] has recently endorsed the "misappropriation theory" of insider trading which propounds that a breach of fiduciary or similar duty is a necessary constituent of the insider trading violation.

The mischief that insider trading laws endeavour to prohibit is the use of non-public information to trade, where such information has come about

[10] For the purposes of this article, references to an "insider" would include references to a "tippee" where the particular jurisdiction in question imposes liability upon a tippee. All the jurisdictions considered recognise a form of tippee liability although the liability differs in scope. In Singapore, s 103(3) of the Securities Industry Act requires that the tippee knew, or reasonably ought to have known, that his informant was an insider, and also that some sort of nexus between the tippee and the insider (either the insider and the tippee were "associated" or that they had some sort of arrangement for the communication of price-sensitive information) exists.

[11] As reproduced in Cox, Hillman & Langevoort, *Securities Regulation Cases and Materials* (1991), at 829.

[12] See *United States* v *O'Hagan* 117 S Ct 2199 (US Supreme Court, 1997).

through some form of impropriety and not through one's "superior foresight or skill". On what criteria is one to determine impropriety? The impropriety could be a breach of fiduciary or similar duty resulting from a relationship of trust and confidence. The problem then is in ascertaining whether a fiduciary duty exists[13] and to whom it should be owed. Under the American "misappropriation theory", a person could be considered an insider trader if he misappropriates confidential information in breach of a fiduciary duty owed to the source of the information, rather than to the company in whose shares he trades or to the persons with whom he trades.[14] In any case, whatever criteria for determining impropriety is adopted, the underlying moral rationale is that the information has somehow been improperly obtained or "stolen" by someone and anyone who then uses the information is in effect considered as one who has engaged in conduct akin to "handling stolen goods".

It is submitted that the reasons for the elevation of what was previously merely an equitable breach of fiduciary duty into a crime, the extension of the crime to encompass persons other than traditional fiduciary-insiders, and the imposition of civil liability on such persons where none existed before, cannot be attributed to the element of fiduciary wrongdoing itself. That would be circular reasoning. Credit for such an expansion can only be given to the animal of "policy" which in turn is influenced by considerations such as the "inherent unfairness" of insider trading and the importance of "maintaining confidence in the market".

[13] Since the categories of persons to whom fiduciary obligations attach are not closed. In *English* v *Dedham Vale Properties* [1978] 1 WLR 93 at 110, Slade J remarked:

> I do not think that the categories of fiduciary relationships which give rise to a constructive trusteeship should be regarded as falling into a limited number of strait-jackets or as being necessarily closed. They are, after all, no more than formulae for equitable relief.

[14] The following passage from a disciplinary proceeding of the Securities and Exchange Commission entitled *Re Cady Roberts & Co* 40 SEC 907 (1961) is often cited as an early expression of the misappropriation theory:

> Analytically, the obligation rests on two principal elements; first the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.

In *Re Cady Roberts*, the subject of the disciplinary proceedings was a broker who had sold shares for his customer after having been tipped by a director of the company (and it was the director who was in breach of his fiduciary duty to the company) that the company would be making dividend cuts. In *United States* v *Carpenter* 791 F 2d 1024 (2nd Cir 1986) a journalist who traded on advance knowledge of what stocks he was going to recommend in his column was convicted of insider trading. In *United States* v *O'Hagan, supra*, note 12, a lawyer who worked in a law firm representing a bidder who had bought shares and options in the target company was convicted of insider trading.

(ii) *The Inherent Unfairness Objection*

A state of affairs which serves the privileged and is seen to lead to "the rich getting richer" at the expense of the ordinary or average investor would conceivably meet with popular opprobrium. Whether with or without jurisprudential justification, it is unsurprising that the public perceives insider trading negatively as an activity that is "unfair".

This inherent unfairness objection against insider trading may be expounded and developed on a less emotional footing. The idea of "inherent unfairness" is inextricably linked to the ideal of a fair market.[15] A fair market would be one where all who invest thereon are given equal opportunities to obtain and evaluate information, before making an investment decision. Those with access to confidential information should not be allowed to use that information to gain an unfair advantage. These are the unwritten rules of the fair market game. The insider dealer is simply not playing fair.

As mentioned earlier, what is unfair or objectionable about insider trading seems to be the use of non-public price sensitive information to trade, where such information has come about through some form of impropriety and not through one's "superior foresight or skill." In other words, confidential or privileged information[16] is used to gain an informational advantage over the market. If no breach of confidence or abuse of privilege is alleged, there appears to be no objection to dealing on non-public information *per se*. Market players who have garnered information due to superior foresight or skill, for instance, by diligent investigation, research and analysis or by market acuity, sheer serendipity or good fortune, are generally allowed to profit by it.

A weakness of the inherent unfairness objection is that upon closer scrutiny, in the modern impersonal marketplace, insider trading may be seen as a "victimless" crime. In relation to transactions made on an anonymous and faceless stock exchange, it is very difficult to identify a victim. The

[15] One of the early allusions to the inherent unfairness objection may be found in the *Re Cady Roberts* case, *ibid*. In *SEC* v *Texas Gulf Sulphur Co* 401 F 2d 833 (2nd Cir 1968), the court elaborated on the inherent unfairness concept first aired in the *Re Cady Roberts* case and spoke of "the justifiable expectation of the securities marketplace that all investors dealing on impersonal exchanges have relatively equal access to material information."

[16] The idea of "confidence" or "privilege" and the breach or abuse thereof necessarily harps back to fiduciary concepts. Yet fiduciary concepts do not satisfactorily account for why certain conduct has only in recent times been considered improper in the marketplace, and therefore been made subject to sanction by legislative prescription. Could conduct that is proper or improper in the marketplace be measured by an absolute standard or is this a case for ethical relativists?

person who happens to deal with the insider, through a random matching of orders by the stock exchange, is a willing purchaser or seller at the market price at that point in time. He is neither misled nor induced by the insider into entering the transaction. Therefore, insofar as there is no victim, could such insider activity be described as unfair? The inherent unfairness perhaps lies not so much on harm impacted upon a victim but on the gain of the insider that is considered unfair. Furthermore, insofar as the market may be perceived to be the victim,[17] insider trading could be considered unfair to the market as a whole.

(iii) *The Maintenance of Confidence in the Market*

Unlike the previous two juridical bases for penalising insider trading, the argument relating to the importance of maintaining confidence in the market has a pragmatic rather than an ethical foundation. This argument postulates that a market "victimised" by insider trading is not a market primed for growth. A market where insider trading is prevalent lacks probity and investors would be less likely to have confidence and invest in it. Most investors would opt for a market where everyone plays by the rules, where they do not play with a built-in disadvantage or handicap.

To take the argument further, a market simply *perceived* to be riddled with insider trading would not attract investor confidence. As such, a jurisdiction which considers insider trading to be a punishable offence will be seen to be pro-active in eradicating insider trading and would be more likely to attract investor confidence than a jurisdiction which has no insider trading laws. These are pragmatic reasons why insider trading should be penalised.[18] To the cynic, these are reasons why insider trading should be *seen* to be penalised.

[17] That the market suffers in terms of volume because of insider trading is a suggestion that appears to remain unsupported by empirical evidence. When referring to the market as a "victim", oftentimes this is in reference to the reputation of the market and the confidence of present and potential investors in the market. These aspects are difficult to gauge and only anecdotal evidence has been offered in support.

[18] The authorities responsible for insider trading laws seem to unabashedly acknowledge the pragmatic and commercial implications of having insider trading laws. For instance, the recital to the European Communities Council Directive 89/592 on Insider Dealing emphasised the importance of the smooth operation of the market which is said to be dependent to a large extent on the confidence it inspires in investors and stated:

> The factors on which such confidence depends include the assurance afforded to investors that they are placed on an equal footing and that they will be protected against the improper use of inside information.

In 1981, the Committee of Inquiry into the Australian Financial System reported (in the Final Report of the Campbell Committee, cited in *Fair Shares for All: Insider Trading in Australia* (1989)):

In a global securities market where local exchanges are competing on a worldwide market, jurisdictions perceived as "fair" would be the ones in which international investors would place their funds. Some academics have argued that insider trading does not affect securities markets and could indeed be beneficial to the markets.[19] These arguments come to naught as more jurisdictions enact insider trading laws, taking the lead from the more sophisticated securities markets, like the UK and the USA. Jurisdictions that do not penalise insider trading would be considered backward and would encounter difficulties in attracting a rational investment base for their securities market.[20]

Furthermore, in a national context, since government policy, for instance in the UK and in Singapore, has been promoting wider share ownership, it is appropriate for the authorities to be seen as maintaining a securities market which is a level playing field for all types of investors. However, it is to be noted that apart from the USA where regulators have taken an aggressive stance against insider traders, other jurisdictions like Singapore, the UK and Australia have had few successful prosecutions. One criticism of the current insider trading laws in these jurisdictions is that they are merely showpieces, unsubstantiated by a determined enforcement policy.

III. The Gamut of Civil Remedies

The gamut of civil remedies available in Singapore as well as those available in the USA, the UK and Australia may be roughly divided into two categories.

> The objective of restrictions on insider trading is to ensure that the securities market operates freely and fairly, with all participants having equal access to relevant information. Investor confidence, and thus the ability of the market to mobilise savings, depends importantly on the prevention of the improper use of confidential information.

[19] For instance, in H Manne, *Insider Trading and the Stock Market* (1966), Manne provided insider trading with the most convincing defence to date. For a summary of his arguments, see Hannigan, *Insider Dealing*, at Ch 1. Briefly, Manne argued that trading on inside information performs a useful function by preparing the market and getting it started in the proper direction before the information is publicly announced. Otherwise, major announcements would cause wide price fluctuations that not only disrupt an orderly market but could cause more injury to outside investors than insider trading. He also argues that insider trading does no significant harm to long-term investors and is both a practical and appropriate method for compensating innovators and entrepreneurs within large companies.

[20] Once again, there is no empirical evidence to show that investors shy away from markets where insider trading is prevalent. It is submitted that investors take into account innumerable factors in deciding whether or not to invest in a particular market and the presence or absence of insider trading would neither be a dominating nor a decisive factor. As an aside, in Hong Kong, insider trading is not a criminal offence and it has a comparatively lax legal regime dealing with insider trading. However, Hong Kong has boasted a vibrant securities market marred recently only by the Asian economic crisis of 1998.

First, there are statutory rights of action specifically formulated to address insider trading and other statutory provisions which, although not specifically geared towards insider trading, are relevant thereto. The possible claimants under statute-based rights of action include the "victim", the corporate issuer of the securities which were the subject of insider trading or a securities regulatory authority. Next, there are common law remedies which may be applicable in an insider trading context although evidently, they were not developed with the insider trader in mind. Possible claimants include the "victim" and the issuer.[21]

Whether by virtue of statute or common law, a successful civil action generally results in a financial "penalty" being imposed on the insider.[22] The imposition and threat of such penalties could have a desired punitive and deterrent effect. At least on a theoretical level, the sweet incentive for succumbing to an insider trading opportunity would be suitably soured when potential offenders consider the unpalatable consequences of being sued for the spoils. Apart from the financial disincentive, the civil process could also have a desired punitive and deterrent effect by easing the impeachment process. Insofar as civil actions are subject to a lower standard of proof than criminal actions, put most simplistically, it should be easier to succeed in a civil action than in a criminal prosecution. Therefore, even though imprisonment is not a consequence of a successful civil action, the threat of being sued for monetary compensation and the use of the lower standard of proof in such an action, might be a potent dampener, more so than the threat of a criminal prosecution. In this way, civil remedies complement criminal penalties. This is not so, however, in Singapore, where the right to take out a statutory right of action against an insider is predicated on the insider's conviction.

This article's thesis is that the statutory regime governing civil recourse for insider trading in Singapore is highly lacking. The civil remedies do not appear to value-add to the criminal penalties. Neither do they seem to promote a victim's loss recovery or a company's restitution. They are superfluous. Having established such a thesis, one cannot shy away from making suggestions for reform. In this respect, it is suggested that the USA, the UK and Australia have provided approaches to be inspired by.[23]

[21] To state the obvious, a regulator would have no *locus standi* to take out a common law action.

[22] Save if the action is for injunctive relief or for rescission of the share transaction. Due to space constraints and the relative incongruity of such forms of relief as deterrent or loss recovery measures, they will not be discussed further in this article.

[23] The USA was chosen as a comparative regime because of its relatively long and influential history of insider trading regulation. Furthermore, in the 1980's, it has specifically legislated to provide civil remedies for insider trading. The UK was chosen for its close common

A. *Statutory Remedies*

(i) *The Victim as Claimant*

The term "victim" is and has been used to describe a person who has bought securities at a higher price or has sold at a lower price than he would have done had he known about the price-sensitive information that the insider knew.[24] The main problem a victim appears to face, in the context of modern day share trading on a faceless and anonymous stock exchange, is showing privity or some sort of contractual or transactional nexus with the insider.[25] Identifying the counterparty to a share transaction is virtually impossible in the computerised share trading effected on stock exchanges where orders are randomly matched. This issue must be ironed out for there is no point providing a civil cause of action in relation to which the basic facts can hardly be established.

(ii) *The Issuer as Claimant*

Under the common law, the corporate issuer would have an action for breach of fiduciary duty against a fiduciary-insider who trades on privileged information for his own benefit. In Singapore and Australia, insofar as directors or officers are concerned, such an action could also be pursued under statute.[26]

Singapore and the UK have not statutorily provided for any additional recourse against non-fiduciaries by the issuer. Australia, on the other hand, has. The relevant Australian provision[27] allows the company to claim when

law link. Although it has refrained from passing any specific statutory provisions dealing with civil remedies for insider trading, a lesson or two could be learnt from its regulation of the financial services sector insofar as it impacts on insider trading by financial intermediaries. Australia was chosen for its new and comprehensive statutory provisions pertaining to civil remedies for insider trading.

24 Disregarding any notion that insider trading is a "victimless" crime or that the market itself is the "victim", see *supra*, note 17 and the accompanying text, and disregarding the notion that the company may also be perceived as a "victim", see *infra*, note 28 and the accompanying text.

25 It was this very problem that caused the UK Parliament to shy away from providing statutory civil remedies for insider trading where dealing takes place on an anonymous stock exchange. The Jenkins Committee in its *Report of the Company Law Committee* (1962) (Cmnd 1749) and the Company Law Committee of Justice in its *Report* (1972) both acknowledged the difficulty of identifying a victim in such transactions.

26 See the discussion herein on s 157(2) of the Companies Act in relation to Singapore and s 232(5) of the Corporations Law in relation to Australia.

27 See the discussion herein on s 1013(5) of the Corporations Law.

a victim fails to take advantage of his statutory cause of action against the insider, where such insiders comprise traditional fiduciaries as well as non-fiduciaries. The company does not make the claim on behalf of the victims but on behalf of itself. This provision tacitly acknowledges that a company could be a "victim" in insider trading in that a company whose shares are constantly insider traded would be viewed negatively by the market.[28]

Insofar as the company is affected disadvantageously by insider trading, giving the company an opportunity to defend its honour and integrity seems justifiable. It is conceivably rare, however, that the company would seek to take such an action against insiders who might have some form of management or shareholding control. To take such action might suggest or even highlight that the company itself had lax internal controls. This could diminish investor confidence in the company and might even attract the attention of the regulatory authorities.

In the USA, there is an interesting provision in the securities legislation which deals with liability for "short-swing profits".[29] It provides that where directors or shareholders holding 10 per cent of shares in certain public companies purchase and sell (or sell and purchase) securities of the company within a period of less than six months, they are liable for any "profit" realised and the company is empowered to bring the action. The profiteer need not be shown to have taken advantage of or had access to inside information. By virtue of making a profit, a director or shareholder may be made liable. The rationale behind such a drastic provision is clearly to discourage short-term trading of shares by directors and shareholders and thereby bolster the upright reputation of the company's ownership and management. However, the provision is notoriously wide and it is not surprising that over the course of its existence, many exemptions have been developed.

[28] Yet again, suggestions such as these appear to be made without any empirical evidence to support it. In the case of *Diamond* v *Oreamuno* 24 NY 2d 494 (1969), the New York Court of Appeals held that a corporation "has a great interest in maintaining a reputation of integrity, an image of probity, for its management and in insuring the continued public acceptance and marketability of its stock." Further, it commented that when directors and officers engage in insider trading, "the effect may be to cast a cloud on the corporation's name, injure stockholder relations and undermine public regard for the corporation's securities."

[29] See the discussion herein on s 16(b) of the Securities Exchange Act.

(iii) *The Regulator as Claimant*

In Australia and the USA, the relevant securities regulator has the power to sue the insider for so-called "civil remedies". The "spoils" of the action are either given to the government treasury, the corporate issuer or distributed to the victims. Where the proceeds of the action do not revert to the victim, theoretically, it may be difficult to classify such a remedy as a traditional civil one. However, such a regulatory action cannot be described as a criminal action either and is probably more appropriately considered as a civil one since the civil standard of proof is utilised and the traditional criminal penalty of fines or imprisonment cannot be imposed.

There is much to say for empowering a regulator to take out a civil action. A private right of action against insiders may not, practically speaking, be of any effect since individuals with limited resources might not choose to litigate if the amounts involved are small. Putting the right of action into the hands of a regulator empowered to sue on behalf of a collective group of investors would address this concern. However, a *caveat* in this respect is that the efficacy of the remedy depends on regulatory initiative which may be either aggressive or half-hearted.

B. *Common Law Remedies*

The possible English common law remedies available in an insider trading scenario span from actions available to the company against the insider for breach of fiduciary duty or breach of confidence, to actions available to the victim against the insider for misrepresentation or breach of statutory duty. Since these remedies were not developed to address insider trading specifically, the remedies have inherent limitations which will be explored.

(i) *The Victim as Claimant*

Misrepresentation actions are only realistically discussed in relation to face-to-face transactions and not stock exchange transactions. Even in face-to-face transactions, a misrepresentation may be difficult to establish because positive representations are oftentimes lacking in cases of insider trading. The wrongness, as it were, of insider trading is the non-disclosure by the insider of his inside information. Under the common law, there is no general duty to disclose in a sale and purchase situation all relevant information about the product being transacted. It is recognised though that a duty to disclose may arise in particular circumstances where a fiduciary relationship exists between the seller and purchaser. However, in a most blatant example of insider trading involving directors who had allegedly bought shares at an undervalue from existing shareholders whilst in pos-

session of inside information, the English court in *Percival* v *Wright*[30] held that the directors did not owe any fiduciary duty to the shareholders of the company. The directors were therefore under no duty to disclose any inside information they had and the transaction could not be impugned. The difficulty facing a victim in pursuing a personal action against insiders under the common law is daunting.

As for an action for breach of statutory duty in the context of insider trading, this independent tort has been described as "diminishing"[31] and any reliance thereon as an effective civil remedy would be, in most likelihood, doomed. In contrast, on the American front, a private action based on breach of statutory duty took a more liberal course. Since the 1940's, victims of insider trading could maintain a common law action against insiders for breach of an anti-fraud regulation.[32]

(ii) *The Issuer as Claimant*

A claim for breach of fiduciary duty against the fiduciary-insider may be maintained only by the company. Yet, it is rare that the company suffers tangible loss due to insider trading of its shares by its fiduciaries, unless the insider trading occurs during a subscription of securities. In most cases, it is the counterparty in the securities transaction (for example, shareholders who have sold shares to or bought shares from the fiduciary-insider or members of the public who have bought shares from the fiduciary-insider) who would be the aggrieved party. Therefore, the common law action for breach of fiduciary duty is of limited benefit since it generally offers the counterparty-victim no recourse. Furthermore, insofar as the fiduciaries may have management or shareholding control of the company, such an action is academic unless there is a minority shareholder who is aggrieved enough and altruistic enough to take out a derivative action. Conceivably, a liquidator might have the greatest incentive to make the most of this cause of action.

30 See *supra*, note 8 and *infra*, note 93 and the accompanying text.

31 See M Fordham, "Breach of Statutory Duty – A Diminishing Tort" [1996] SJLS 362.

32 See *infra*, note 103 and the discussion on Rule 10b-5 private actions. The American judiciary are stereotypically perceived as being more liberal than their English counterparts. The development of the Rule 10b-5 action seems to be a testimony to this. However, even in the USA, private actions based on breach of statutory duty have been reined in, although in relation to insider trading and the use of Rule 10b-5 as a basis for private relief, the position has remained entrenched and uncontroverted.

IV. Statutory Civil Remedies

A. *Singapore*

Insider trading in Singapore is regulated by Part IX of the Securities Industry Act[33] (the "SIA"). The SIA provides for both criminal and civil penalties for insider trading. The Monetary Authority of Singapore (the "MAS") is the regulatory authority of the securities industry.[34] With only one stock exchange in Singapore, the Stock Exchange of Singapore Limited (the "SES") itself plays a large self-regulatory role. However, neither the MAS nor the SES have been empowered to bring civil actions against insiders.

The Attorney-General decides whether a prosecution for an offence under the SIA will proceed. Upon a successful prosecution, section 401(1) of the Criminal Procedure Code[35] (the "CPC") empowers the court to order the offender to pay compensation to any person injured by the offence. In practice, the court's power under section 401 of the CPC is rarely exercised. Any order made under section 401 does not prejudice any right to a civil remedy for the recovery of damages beyond the amount of compensation paid under the order.[36]

Insofar as directors and officers of companies are concerned, their duties and liabilities have been codified to an extent in the Companies Act[37] (the "CA"). Although such provisions were not drafted with insider trading in mind, an insider may breach them whilst engaging in insider trading.

(i) *Section 105(1) of the SIA: The Victim as Claimant*

Section 105 of the SIA provides specifically for civil liability to be imposed on offenders of the SIA's insider trading provisions.[38] Section 105(1) provides:

> A person who is convicted of an offence under this Part shall be liable to pay compensation to any person who, in a transaction for the purchase or sale of securities entered into with the first-mentioned person or

[33] Cap 289.

[34] However, unlike the US Securities and Exchange Commission or the Australian Securities and Investments Commission, the MAS regulates not only the securities industry but various other areas of the finance industry, including banks, insurance companies, financial institutions and the futures industry.

[35] Cap 68.

[36] See s 401(4) of the CPC.

[37] Cap 50.

[38] The section which creates the insider dealing offence is s 103 of the SIA.

> with a person acting for or on his behalf, suffers loss by reason of the difference between the price at which the securities were dealt in in that transaction and the price at which they would have been likely to have been dealt in in such a transaction at the time when the first-mentioned transaction took place if the contravention had not occurred.

Therefore, by virtue of section 105 of the SIA, a victim of insider dealing may pursue a civil action against an insider dealer who has been convicted under the SIA. Upon successfully establishing the loss due to the convicted offender's activities, the offender is then liable to pay compensation. The amount of compensation to be paid is the difference between the price which the victim paid or received, as the case may be, in respect of the securities and the price at which the securities "would have been likely to have been dealt in", had the offence not been committed. The price that the securities "would have been likely to have been dealt in" has been interpreted to mean the price which would have been reasonable, had the offence not been committed.[39]

Section 105 of the SIA has been described as a "dead letter".[40] Rather serious problems face the potential claimant under section 105. First, the requirement that the offender has to be convicted under Part IX of the SIA before a civil action may be instituted is a severe limitation to the section 105 right of action. As mentioned earlier, the decision whether or not to prosecute a suspect for an insider dealing offence depends entirely on the Attorney-General's discretion. The victim has no say in the criminal process.

Secondly, the limitation period for recovery of loss under section 105(3) of the SIA places the victim at a tremendous practical disadvantage. Section 105(3) provides that no action for recovery of loss under section 105 may be commenced after the expiration of 2 years after the date of completion of the transaction in which the loss occurred. Coupled with the requirement that a conviction is a prerequisite to civil recovery and the possibility that criminal proceedings may often not be completed within 2 years of the

[39] See Woon, *Company Law* (2nd ed, 1997) at 566.

[40] See *ibid* at 566-567 and the discussion therein of the problems related to s 105 of the SIA. It is noted that the problem of the burden of proof discussed in *ibid* at 568 has been addressed by the legislature. The new s 45A of the Evidence Act (Cap 97, as amended by the Evidence (Amendment) Act 1996) which came into effect on 8 March 1996 statutorily overturns *Hollington* v *Hewthorne* [1943]1 KB 587 as s 45A(1) makes it clear that a conviction is admissible in evidence and s 45A(3) provides that a person proved to have been convicted of an offence shall be taken to have committed the *actus reus* and to have had the *mens rea* which constitute the offence, unless the contrary is proved.

date of the transaction, the limitation period in section 105(3) presents a daunting and possibly insurmountable obstacle to a claimant.

Thirdly, in establishing an action for loss due to the offender's activities under section 105 of the SIA, the victim would have to show that he had contracted with the insider (the "privity" problem) and that his loss was caused by the offender's trading activities (the "loss causation" problem).

The Privity Problem

In transactions that occur on a faceless and impersonal stock exchange, the offender and the victim would have placed their orders to buy or sell through brokers who would then have executed the orders on the exchange. The exchange then randomly matches buy and sell orders. The parties to a matched transaction would not know who the other party was. In this respect, it would be virtually impossible for the victim to establish privity with the insider.

A solution to the privity problem could be to stipulate that privity is not required or to somehow deem privity into certain transactions. A blanket rejection of the privity requirement occurred in the American case of *Shapiro* v *Merrill Lynch, Pierce, Fenner & Smith, Inc.*[41] The Second District Court in the *Shapiro* case held that a class action could be brought on behalf of all persons who had purchased shares of a company on an exchange during the period that the insiders were selling those shares on the basis of inside information, that is, during the period of time from the insider's trade until the disclosure of the information. This stance would of course lead to the imposition of Draconian damages on the insider if all those persons could claim for their losses suffered. This problem of Draconian liability led the Sixth District Court in *Fridrich* v *Bradford*[42] to revert to the strict requirement of privity and to reject the possibility of establishing civil liability in a situation whereby shares are traded on an exchange.

Shapiro and *Fridrich* both take extreme all-or-nothing positions. The practical issue of Draconian liability on the insider as a result of the *Shapiro* decision could be ameliorated by placing a ceiling on the liability which may be imposed on the wrongdoer. This was suggested in *Elkind* v *Liggett*

[41] 495 F 2d 228 (2nd Cir 1974).

[42] 542 F 2d 307 (6th Cir 1976). In *Elkind* v *Liggett & Meyers, Inc* 635 F 2d 156 (2nd Cir 1980), the Second Circuit rejected *Fridrich* v *Bradford* and reaffirmed the position in *Shapiro* that a plaintiff in an insider trading case need not prove privity with the wrongdoer. *Fridrich* v *Bradford* has also subsequently been rejected by a US District Court which affirmed the *Shapiro* and *Elkind* decisions, see *O'Connor & Associates* v *Dean Witter Reynolds, Inc*, 559 F Supp 800 (SDNY 1983).

& Myers, Inc.[43] In that case, the court held that any affected investor could sue for the difference between what he paid or received for his shares and the market value that it reached a reasonable time after public disclosure of the inside information, but the total recovery by all such persons is limited to the amount of profit made by the insider.

Another mode of preventing Draconian liability on the insider, particularly when the period between the insider's trades and the release of the inside information is long, is to adopt a test of "contemporaneous trading" to provide the necessary privity or causative link. In *Wilson* v *Comtech Telecommunications Inc*,[44] the court held that an insider's liability was limited to those who traded "contemporaneously" with the insider.[45]

What then does "contemporaneous" mean? In the *Wilson* decision, it was held that there was no contemporaneous trading where the claimant purchased Comtech shares one month after the insider's sales.[46] The delineation of how far apart in time trades between a claimant and an insider may be, short of one month, to satisfy the contemporaneous trading requirement has not been clearly drawn by the American courts. It appears to be accepted at the US District Court level that a reasonable period of liability could be as short as a few days, but no longer than a month.[47]

Whether the "contemporaneous trading" test will be adopted under section 105 of the SIA remains to be seen. It appears unlikely that the Singapore courts would readily adopt the American concept. The language of section 105(1) clearly refers to "a transaction for the purchase or sale of securities entered into with the... person [convicted]" and makes no provision for deeming such a transaction to have taken place. There also appears to be an additional hurdle. Where many investors trade soon after the insider does, the insider could be subject to a crippling collection of damages actions. This practical problem may be dealt with, as was suggested in the *Elkind*

[43] See *ibid*.

[44] 648 F 2d 88 (2nd Cir 1981).

[45] This was an action taken under the implied private right of action against an insider based on Rule 10b-5. Such a right has been codified in s 20A of the Securities Exchange Act which creates an express private right of action against an insider trader. The test of "contemporaneous trading" is used explicitly in s 20A. See the discussion herein on s 20A of the Securities Exchange Act.

[46] In *Shapiro* and *Elkind* where the trades between the claimants and the insiders were held to have been made "during the same period," they had occurred within 4 and 2 days, respectively.

[47] See *Alfus* v *Pyramid Technology Corp* 745 F Supp 1511 (ND Cal 1990), *In Re Verifone Securities Litigation* 784 F Supp 1471 (ND Cal 1992) affirmed 11 F 3d 865 (9th Cir 1993) and *In Re Silicon Graphics, Inc Securities Litigation* 970 F Supp 746 (ND Cal 1997).

case, by imposing a ceiling matched to the insider's profit gained or loss avoided. However, it is questionable whether the courts are the appropriate forum, and indeed, whether the courts have the requisite discretion, to fix such a ceiling for damages. The clear wording of section 105(2) states that the gauge for damages should be the loss suffered by the victim. It could be said that if Parliament had intended a ceiling, or for that matter, a test of contemporaneity, it would have provided one.

The Loss Causation Problem

In face-to-face transactions, where privity could be established, the victim might face the additional problem of having to show that he had suffered a loss and that such loss was due to the insider's omission to reveal the inside information. In other words, the victim has to establish that the information, if disclosed, would have affected his judgment and he would not have dealt when he did, on the terms that he did, with the insider. This may be particularly difficult to establish if the victim had approached the insider to trade. However, in such a situation, Woon concludes that it seems "fairly clear" that the insider must reveal what he knows or run the risk of being called to account for insider trading and that a contract for the sale or purchase of securities under such circumstances will become almost a contract *uberrimae fidei* as far as the offender is concerned.[48] To take any other position would render section 105 recovery unattainable even in a face-to-face transaction.

In the case of stock exchange transactions, the loss causation problem is more acute and is linked to the privity problem. At the most basic level, a lack of privity suggests that the claimant's loss was not caused by the insider. Even after adopting a test of contemporaneity, it could be said that the victim would have entered the marketplace with the intention of buying and selling at a particular price, and would have bought or sold regardless of whom the counterparty was. After all, on an anonymous stock exchange, a buyer or seller would have no idea who the counterparty would be. It is observed that it is entirely fortuitous that one ends up trading with an insider.

It is submitted that if section 105 of the SIA is intended to be an additional deterrent to potential offenders, to require strict proof of privity or loss

[48] See Woon, *Company Law* at 567. This suggestion that a securities transaction results in a contract *uberrimae fidei* should be contrasted to the position in a common law action for misrepresentation. The courts in the UK have been unwilling to impose a duty of disclosure in securities transactions and to consider such contracts *uberrimae fidei*, see *infra*, notes 108 and 109 and the accompanying text.

causation logic would defeat such a purpose. However, too much importance need not be placed on the problem of privity and loss causation as these are probably the least of section 105's problems. The more disabling obstacles facing a section 105 claimant are the prerequisite of a criminal conviction and the unrealistic limitation period.

(ii) *Section 157(2) of the Companies Act: The Issuer as Claimant*

Section 157 of the CA is a statutory enactment which codifies the civil liability for the breach of certain duties on the part of directors and officers of a company, and stipulates criminal sanctions for the breach thereof. Specifically, section 157(2) of the CA provides that "an officer or agent of a company shall not make improper use of the information acquired by virtue of his position to gain an advantage for himself or for any other person or to cause detriment to the company." Section 157(3)(a) of the CA then provides that any officer or agent who breaches the said provision is liable to the company for any profit made by him or for any damage suffered by the company as a result of the breach.

Section 157 of the CA is not intended to replace common law remedies as it is expressly provided it is "in addition to and not in derogation of any other rule of law relating to the duty or liability of directors or officers of a company."[49] In practical terms, insofar as civil liability for the breach of section 157(2) is concerned, it is unlikely that section 157(2) adds very much to the common law position.[50] Under the common law, the relevant breach of fiduciary duty of misappropriating corporate information would have resulted in the wrongdoer having to disgorge any profits or pay damages.

It is noted that section 157(2) is not limited to insider trading situations and was certainly not developed in the context of insider trading. As a result, it has yet to be decided whether insider trading would be "improper use" of corporate information as contemplated by section 157(2). Woon suggests that whatever the precise definition of "improper use" may be, insider trading will be an improper use.[51]

A practical limitation in respect of an issuer taking out a section 157 action against its directors and officers is that if the office-bearers are majority shareholders, it is unlikely that they would cause the issuer to sue themselves.

49 See s 157(4) of the CA.

50 S 157 of the CA, however, supplements the common law remedies by criminalising such conduct. See s 157(3)(b) of the CA.

51 See Woon, *Company Law* at 563. The argument is that this is because insider trading is prohibited by the SIA and the use of information in a manner contrary to law must be an improper use of that information.

In Singapore, a minority shareholder in such circumstances may be able to begin a derivative statutory action under section 216A[52] of the CA in the name of the company against the wrongdoing director or officer. A notable restriction of section 216A is that it does not apply to listed companies. Minority shareholders of listed companies who intend to bring a derivative action, would have to pursue such action by the common law route, that is, by showing a "fraud on the minority" exception to the *Foss* v *Harbottle* rule.

What could possibly motivate a minority shareholder, albeit a victim of insider trading, to pursue such a derivative action is a teaser since any proceeds from a successful action would be awarded to the company in which the insider holds the majority of shares! An alternative would be for the minority shareholder to pursue an oppression action under section 216[53] of the CA. The relief provided under section 216 may be more appropriate insofar as a victim-member may ask for *inter alia*, the securities transaction to be cancelled or varied, or where appropriate, that the insider or the company purchases the victim-member's shares. Furthermore, section 216 is not limited to unlisted companies and applies to listed companies as well.

B. *USA*

The authority responsible for regulating the securities market in the USA is the Securities and Exchange Commission (the "SEC"). The SEC has no criminal enforcement powers, but has wide regulatory and civil enforcement powers. Enforcement actions by the SEC could take the form of administrative proceedings[54] or they could take the form of judicial proceedings in the US federal courts.[55] Upon recommendation by the SEC, or on its own initiative, the US Department of Justice or state prosecutorial agencies can institute criminal proceedings.

[52] S 216A of the CA requires the complainant to give notice to the directors of his intention to apply thereunder, to show that he is acting in good faith and that the proposed action "appears to be prima facie in the interests of the company." Where a statutory derivative action under s 216A is available, there is no longer any need to show the "fraud on the minority" exception to the rule established in *Foss* v *Harbottle* (1943) 2 Hare 461.

[53] It is an open question whether insider trading amounts to acts or conduct falling within any one or more of the oppression, disregard of interests, discrimination or prejudice categories in s 216 of the CA.

[54] For example, see *Re Cady, Roberts & Co*, a disciplinary proceeding, *supra*, note 14.

[55] For example, see *SEC* v *Texas Gulf Sulphur*, an application for injunctive and ancillary relief, *supra*, note 15.

For a jurisdiction renowned for its focused and aggressive stance against insider trading, the USA has no bespoke insider dealing legislation. Instead, the general anti-fraud provisions of the 1934 Securities Exchange Act (the "SEA") have been used to battle insider trading. The particular provision invoked most often is Rule 10b-5 which was promulgated in 1942 under section 10(b) of the SEA. Rule 10b-5 makes no explicit mention of insider trading and generally provides:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange:
>
> (1) To employ any device, scheme or artifice to defraud,
>
> (2) To make any untrue statement of a material fact or omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (3) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person.[56]

A significant development in the 1980's was the introduction of specific statutory provisions in the federal securities laws to codify the remedies for insider trading. Section 20A of the SEA was enacted as part of the Insider Trading and Securities Fraud Enforcement Act 1988 (the "ITSFEA"). Section 20A provides an express private right of action thereby codifying the private plaintiff's implied right of action under Rule 10b-5. Earlier on, in 1984, the Insider Trading Sanctions Act 1984 (the "ITSA") enacted section 21A of the SEA which codified the SEC's right of action against insiders. Prior to the ITSA, the SEC could apply to the courts under section 21(d) of the SEA for injunctive and ancillary relief against violators of Rule 10b-5. Section 21(d) is still used by the SEC and any ancillary relief granted thereunder affects recovery under the new sections 20A and 21A. The ITSFEA bolstered section 21A by specifically addressing the liability of employers and controllers and widened the SEC's right of action against them.

[56] S 102 of the SIA is based on Rule 10b-5. Although the SIA has specific insider trading legislation (ss 103 to 105), s 102 presumably acts as a catch-all section designed to prohibit any other abuses that has not specifically been dealt with in the other sections.

The developments of the 1980's do not appear to enhance the corporate position though. Rule 10b-5 would seem to enable the company or a shareholder suing derivatively on its behalf a right of action to recover the insider's profits. However, one significant court-imposed limitation on private rights under Rule 10b-5 is that the person bringing the action must be a purchaser or seller of the securities thereby, in most cases, ruling out the corporate claimant.[57] Nonetheless, the corporate issuer has an ostensibly potent weapon to recover an insider's profits and to discourage insider trading in its shares in section 16(b) of the SEA, which deals with liablity for "short-swing profits".

(i) *Section 20A of the SEA: The Victim as Claimant*

Section 20A of the SEA creates an express right of action for individuals who traded "contemporaneously" with insiders who have contravened Rule 10b-5 by purchasing or selling a security while in possession of "material nonpublic information". The limitation period for an action to be brought under section 20A is 5 years.[58]

The test of contemporaneity adopted in section 20A appears to be inspired by the *Wilson* decision. Section 20A does not clarify what "contemporaneous" means and instead, the drafters sought to adopt the definition of the term "which has developed through the case law"[59] citing *Shapiro, Wilson* and *O'Connor & Associates* v *Dean Witter Reynolds, Inc*[60] as examples of cases which have developed the definition of "contemporaneous".[61] Furthermore, although no measure of damages is stipulated in section 20A, it is provided that the total amount of damages imposed should not exceed the profit gained or loss avoided. The ceiling adopted in section 20A might well have been inspired by the *Elkind*[62] decision. Both *Wilson* and *Elkind* were cases brought under the common law private right of action based

[57] See *Blue Chip Stamps* v *Manor Drug Stores*, 421 US 723 (1975). This is in direct contrast to the English common law position where a breach of fiduciary duty may only be pursued by the company against fiduciary-insiders, and the purchaser or seller of securities cannot maintain a personal action, see *infra*, note 92.

[58] See s 20A(b)(4) of the SEA.

[59] HR Rep No 910, 100th Cong 2d Sess 27 (1988) reprinted in 1988 USCCAN 6043, 6064 and cited in *In Re Verifone Securities Litigation, supra*, note 47.

[60] See *supra*, notes 41, 42 and 44.

[61] Note that in *Wilson*, one month was too long to constitute contemporaneous trading. In *Shapiro*, 4 days, and in *O'Connor*, 2 weeks, could amount to contemporaneous trading.

[62] See *supra*, note 43 and the accompanying text.

on Rule 10b-5.

Does the statutory remedy under section 20A of the SEA supplant the plaintiff's traditional common law right of recourse under Rule 10b-5? Section 20A(d) of the SEA states that nothing in it shall be construed to limit or condition the right of any person to bring an action implied from the SEA, which would include a common law action under Rule 10b-5. However, in *T Rowe Price New Horizons Fund, Inc* v *Preletz*,[63] a US District Court held that section 20A(d) was intended to preserve certain implied rights of action for persons other than contemporaneous traders. Therefore, where the plaintiffs allege that they are contemporaneous traders, they cannot alternatively plead section 20A and Rule 10b-5. One of the reasons for not allowing the alternative pleading of section 20A and Rule 10b-5 is because section 20A has a ceiling on the recovery of damages. It was said in *T Rowe Price New Horizons Fund* that the damages limitation in section 20A reflects the concern of Congress to balance the plaintiff's need for relief and the fairness to defendants who might otherwise be subject to multiple awards for damages far exceeding the extent of their wrongful profit.[64] To allow the pleading of remedies under section 20A and Rule 10b-5[65] in the alternative would defeat Congress's concerns.

A further limitation on damages recoverable under section 20A is the requirement that damages awarded be diminished by any amounts the violator is required to disgorge under a section 21(d) action taken by the SEC.[66] As a result, what the victim may claim is first capped by a ceiling of the violator's profit and then further offset by any disgorgements ordered under a separate SEC action.

The SEA regime extends insider trading liability to "controlling persons" in certain circumstances. "Controlling persons" are persons such as the employers, including the officers, managers and other supervisory personnel, of an insider trader. As far as controlling persons liability under section 20A is concerned, section 20(d) of the SEA governs the position. In brief, under section 20(d), a controlling person is liable if he had acted in bad faith and had induced another under his control to violate the insider trading provisions.

63 749 F Supp 705 (D Md 1990).

64 *Ibid* at 710.

65 Although the Second Circuit Court in *Elkind* had suggested such a ceiling in a Rule 10b-5 action, the courts of the other Circuits were not bound by the decision.

66 See s 20A(b)(2) of the SEA.

(ii) *Section 21A of the SEA: The Regulator as Claimant*

Under section 21A of the SEA, the SEC may bring an action against insiders who have purchased or sold a security while in possession of "material non-public information" in violation of any provision in the SEA. The limitation period for an action to be brought under section 21A is 5 years.[67]

Under section 21A, the SEC may bring an action to seek and the court has the jurisdiction to impose a civil penalty to be paid not only by the person who committed such a violation but also by "controlling persons" in certain situations where:

(1) the controlling person knew or recklessly disregarded the fact that a controlled person was likely to trade on material non-public information and failed to take appropriate preventive measures before it occurred, or

(2) the controlling person is a broker-dealer or investment adviser who knowingly or recklessly failed to establish, maintain or enforce the "Chinese Wall" procedures required by the SEA and the Investment Advisers Act 1940.

In the case of the person who committed the violation, the amount of the penalty shall not exceed three times the profit gained or loss. In the case of "controlling persons", the amount of the penalty which may be imposed shall not exceed the greater of US$1,000,000 or three times the amount of the profit gained or loss avoided as a result of the controlled person's violation.

The amount of the penalty payable under section 21A is reduced by any amount the defendant is required to disgorge in an injunction action brought by the SEC under section 21(d) of the SEA. Penalty monies collected under section 21A are paid to the US Treasury. An interesting provision is section 21A(e) which provides that bounties to informants are payable in the discretion of the SEC, to an amount up to 10 per cent of any civil penalty imposed by the SEC under section 21A.[68]

[67] See s 21A (d)(5) of the SEA.

[68] The decision to award a bounty lies in the sole discretion of the SEC. Persons associated with the SEC, the Department of Justice, or a self-regulatory organisation are not eligible. See s 21A(e) of the SEA.

(iii) *Section 21(d) of the SEA: The Regulator as Claimant*

Section 21(d) of the SEA authorises the SEC to bring an action to injunct violations of the securities laws by any person. In addition to an injunction against further violations, the SEC will often ask the court for "ancillary relief" appropriate to the type of violation committed.[69] Where the insider has profited from insider trading the court may require him to make a rescission offer or to turn over his profits to the corporate issuer or to a court-appointed trustee for distribution to persons entitled to them. Any disgorgement of profits made hereunder impacts upon recovery under sections 20A and 21A of the SEA.

(iv) *Section 16(b) of the SEA: The Issuer as Claimant*

Section 16(b) of the SEA is a specialised insider trading provision which imposes liability for "short-swing profits" upon officers, directors, and beneficial owners of more than 10 per cent of any class of equity security which is traded on a national exchange and registered with the SEC. These statutory insiders must disgorge to the corporate issuer any "profit" realised as a result of a purchase and sale or sale and purchase of covered securities occurring within any six month period. Section 16(b) applies regardless of whether the person who made the profit used or possessed material non-public information in trading. It should be noted however that the SEC has provided extensive regulatory exceptions and provisos to section 16(b) liability.[70]

The SEC has no enforcement powers under section 16 of the SEA. Liability can be asserted only in a suit brought by the corporation or a shareholder suing on its behalf. Actions under section 16(b) are governed by the specific provisions of that section which require prior demand on the directors. The company, through it directors, then decides whether or not to bring the suit. If the company does not act, suit may be filed by a shareholder. An action under section 16(b) must be brought within 2 years after the insider

[69] See *SEC* v *Texas Gulf Sulphur, supra*, note 15 and *SEC* v *Golconda* 327 F Supp 257 (SDNY 1971).

[70] For a summary of the exemptions from s 16(b)'s disgorgement provisions, see Hazen, *The Law of Securities Regulation* (2nd ed, 1990), at Ch 12. Although the purpose of s 16(b) was to prevent the unfair use of inside information, in practice, it is applicable only to specified combinations of transactions by specified classes of people due to the numerous regulatory exemptions and provisos. S 16(b) of the SEA, therefore, represents a specialised and highly technical aspect of US insider trading laws and it is not appropriate to deal with it in any detail here.

realised his profit.

Oftentimes, corporate management will not be inclined to sue its directors and the financial benefit to any individual shareholder bringing a suit on the issuer's behalf will be small. Thus, the principal incentive to enforcement of section 16(b) is the fee that the court would award to the plaintiff's attorney out of the profits recovered by the company. Even though the principal financial interest in such a suit is that of the attorney rather than the shareholder, the courts have refused to bar such actions on the basis of improper motivation or unprofessional conduct.[71]

C. *UK*

The centre-piece of the anti-insider dealing regime in the UK is Part V of the Criminal Justice Act 1993 (the "CJA").[72] The CJA represents the UK's implementation of the EC Directive of Insider Dealing.[73] Upon a conviction under the CJA,[74] a compensation order may be made against a convicted insider trader under section 35 of the Powers of Criminal Courts Act 1973. However, such a remedy depends on a conviction and the victim has no control over the recovery process.

The UK has no specific statutory provisions for civil remedies in cases of insider dealing. This is a deliberate omission. The difficulty in identifying a particular victim where the dealing takes place on an anonymous stock exchange was an important consideration.[75] In face-to-face transactions, it appears to be the view amongst the lawmakers that the parties should take steps to protect themselves and that the presently available civil actions are appropriate to provide redress.[76] As a result, there is a mismatch between potential criminal offenders and those against whom civil liabilities could attach. The latter is a disappointingly small subset of the former.

A victim of insider trading in the UK is not left entirely without statutory civil remedy. He has indirect and limited statutory civil recourse in that he may be able to recover losses from the insider, where the insider is

[71] See *Magida* v *Continental*, 176 F Supp 781 (SDNY 1956).

[72] The relevant provisions came into force on 1 March 1994, superseding the previous provisions dealing with insider dealing in the Company Securities (Insider Dealing) Act of 1985.

[73] Dir 89/592 [1989] OJ L334/30.

[74] The section which creates the offence of insider trading is s 52 of the CJA.

[75] See *supra*, note 25 and the accompanying text.

[76] In the Department of Trade and Industry's Consultative Document preceding the Criminal Justice Bill, it was stated at para 2.12 that "[t]hose seeking such remedies can have recourse to the various civil sanctions which exist at common law, on the grounds of fraudulent misrepresentation, breach of fiduciary duty, or breach of confidence."

a person who is involved in the financial services industry and who is within the jurisdiction of the Financial Services Act 1986 (the "1986 Act"). The provisions in the CJA complement the 1986 Act which established an entirely new regulatory structure for the financial services industry.

Under the regime of the 1986 Act, the power to regulate investment business lies with the Treasury.[77] These powers have been delegated to a designated agency, the Financial Services Authority (the "FSA")which prior to 28 October 1997 was known as the Securities and Investments Board. As a result, the FSA is the overall regulator of the financial services industry.[78] Amongst its other functions, the FSA makes rules and issues statements of principle as well as codes of practice with respect to the conduct expected of persons authorised to conduct investment business. Under the regulatory umbrella of the FSA are self-regulating organisations[79] ("SROs") and recognised professional bodies ("RPBs").

Rule 28 of the FSA's Core Conduct of Business Rules[80] specifically addresses the problem of insider dealing. Rule 28(1) provides that "a firm must not effect (either in the UK or elsewhere) an own account transaction when it knows of circumstances which mean that it, its associate, or an employee of either, is prohibited from effecting that transaction by the statutory restrictions on insider dealing." Where there is a breach of the FSA's Core Conduct of Business Rules, civil liability may arise under sections 61 and 62 of the 1986 Act.

Furthermore, Rule 28(2) places an obligation on firms to use their best endeavours to ensure that they do not knowingly effect a transaction which would constitute insider dealing. Rule 34 requires authorised firms to take reasonable steps to ensure that their officers and employees comply with the responsibilities which the law, particularly the law relating to insider

[77] Originally, the 1986 Act vested regulatory powers in the Secretary of State for Trade and Industry. The Secretary of State's functions under the 1986 Act and certain other legislation were transferred to the Treasury on 7 June 1992 by the Transfer of Functions (Financial Services) Order (SI No 1315). As a result, although the Department of Trade retains its policy role over company matters, financial services and insider trading are now within the remit of the Treasury.

[78] For an overview of the regime under the 1986 Act, see further G Brazier, *Insider Dealing: Law & Regulation* (1996), at Ch 2, S Morris, *Financial Services: Regulating Investment Business* (2nd ed, 1995), at Ch 2, Hannigan, *Insider Dealing*, at Ch 6 and Ashe and Counsell, *Insider Trading*, at Ch 6.

[79] Presently, there are three SROs, namely, the Investment Management Regulatory Organisation (the "IMRO"), the Securities and Futures Authority (the "SFA") and the Personal Investment Authority (the "PIA"). Broadly speaking, the IMRO covers investment managers, the SFA covers brokerages, banks and corporate finance advisers, and the PIA covers those who are involved in an investment business dealing with private investors. New laws are in the process of being introduced to merge these SROs into the FSA.

[80] For the Rule Books, see *CCH Financial Services Reporter.*

dealing, places upon their employers. This creates a form of "controlling person" or "employer" liability in that an employee's conduct could lead to civil liability being imposed upon the employer.

(i) *Section 61 of the 1986 Act: The Regulator as Claimant*

Under section 61(1) of the 1986 Act, the FSA is given the power to apply to court for injunctive relief and for compensation or restitution orders against persons who have breached the specified conduct of business rules made pursuant to the 1986 Act. The relevant rules include the FSA's Core Conduct of Business Rules or the rules of an SRO or an RPB.[81]

Under section 61(1) of the 1986 Act, the FSA may apply to court for an order to "remedy the contravention". Under section 61(4), the court may make an order requiring sums to be paid into court where it is satisfied that profits have accrued to any person as a result of his contravention of the rules, or that one or more investors have suffered loss or have otherwise been adversely affected as a result of the contravention. It is noted that for a disgorgement of profit order, there needs only be shown that there has been a contravention of the rules and that profits have accrued to a person as a result of the contravention, that is, no loss by the victim is required.

Section 61(6) of the 1986 Act then provides that any amount paid into court by a person in this way shall be paid out to such persons as the court may direct. Such persons are those "appearing to the court to have entered into transactions with" the contravenor as a result of which profits have accrued to the contravenor or loss or adverse effect has been suffered by such persons.

(ii) *Section 62 of the 1986 Act: The Victim as Claimant*

Section 62(1) of the 1986 Act provides that if a person suffers a loss because an investment business has contravened the conduct of business rules made pursuant to the 1986 Act applicable to it, then that person may claim in tort against the business for compensation for the loss which he has suffered, as if it were a claim for breach of statutory duty. Section 62 overcomes the problematic argument that the conduct of business and other rules are unenforceable by third party customers because there is no privity of contract between the claimant and the SRO or RPB. However,

[81] The rules of certain SROs repeat the FSA's Core Conduct of Business Rule 28 on insider trading. However, insofar as a breach of the rules of an SRO or RPB are concerned, no application may be made by the FSA under s 61(1) of the 1986 Act unless the relevant SRO or RPB is unwilling to take appropriate steps to restrain the contravention. See s 61(2) of the 1986 Act.

the claimant under section 62 has to show tangible loss due to the contravention of the relevant rules. This position may be contrasted to that in section 61 where only profit accruing to the contravenor as a result of the contravention has to be shown.

D. *Australia*

The principal Australian legislation relating to insider trading is contained in Division 2A of Part 7.11 of the Corporations Law (the "CL") which came into force on 1 August 1991.[82] Each state and territory of Australia has adopted the CL. The Australian Securities and Investments Commission (the "ASIC") which prior to 1 July 1998 was known as the Australian Securities Commission, is the regulatory authority administering the securities provisions of the CL. In addition to the specific provisions of the CL geared towards insider trading,[83] there are more general provisions in section 232 of the CL dealing with the duties and liabilities of officers or employees of a corporation which may cover instances of insider dealing by such persons.[84]

Section 1005 of the CL is a general provision that affords a civil right of action to a person who has suffered loss or damage by reason of conduct in contravention of the insider trading provisions. To utilise section 1005(1), it is not necessary that the insider trader be first convicted before the innocent party can exercise his civil rights. Section 1332 of the CL, which deals with the standard of proof required in such cases, provides that it is sufficient for the innocent party to show on a balance of probabilities that a contravention has occurred. Section 1005(2) provides that the statutory civil action may be begun at any time within 6 years after the day on which the cause of action arose.

Section 1005 of the CL is to be considered in relation to section 1013(2) whereby an issuer of the securities may bring an action, in relation to section 1013(3) and (4) whereby the buyer or seller of securities may bring an action, and in relation to section 1013(6) whereby the ASIC is authorised to bring an action. Section 1005 has been described as the "doorway" through which a civil action instituted under the specialised civil liability provisions for insider trading in section 1013 must pass.[85]

[82] The Corporations Law itself came into effect on 1 January 1991. It combined the Companies Codes, Companies (Acquisition of Shares) Codes, Securities Industries Codes and Futures Industries Codes of each Australian jurisdiction into one piece of comprehensive corporate legislation.

[83] The section which creates the insider trading offence is s 1002G of the CL.

[84] S 232 of the CL was a source of inspiration for s 157 of the SIA, although there are differences between them.

[85] See *CCH Australian Corporations & Securities Law Reporter* at para 236-100. See also *Ampolex* v *Perpetual Trustee Company (Canberra) & Ors (No 2)* (1996) 14 ACLC 1,514 where the argument that s 1005 and s 1013 provided two separate causes of action failed.

(i) *Section 1013(2) of the CL: The Issuer as Claimant*

Under section 1013(2) of the CL, if an insider contravened the relevant insider trading laws in the subscription of securities, the issuer of the securities may bring an action under section 1005 of the CL against the insider to recover the amount by which the subscription price was less than the price at which the securities would have been likely to be sold in a sale at the time of the subscription, if the information had been generally available. It is not a defence to an action for damages brought by an issuer under section 1013(2) that the issuer possessed the relevant information at the time of the subscription.

(ii) *Section 1013(3) and (4) of the CL: The Victim as Claimant*

Under section 1013(3) of the CL, if an insider contravenes the relevant insider trading provisions by purchasing securities, the seller may bring an action under section 1005 of the CL. Similarly under section 1013(4) of the CL, if an insider contravenes the relevant insider trading provisions by selling securities, the buyer may bring an action under section 1005. The amount recoverable is the price at which the securities were purchased or sold (as the case may be) by the insider was less or more (as the case may be) than the price at which they would have been likely to be purchased or sold (as the case may be) at that time if the information had been generally available. Such an action may only be brought if the seller or buyer did not possess the relevant information. It is noted that recovery by the innocent party under these provisions does not require that he suffer any loss.[86] In relation to section 1013(3) and (4), it is a defence to an action for damages brought by the claimant that the claimant himself possessed the relevant information at the time of insider trading. This may be contrasted to the position in section 1013(2) where it is not a defence.

The utility of the private action based on section 1005 in relation to section 1013(3) and (4) is severely threatened by the basic problem of proving

The position appears to be that s 1005 would be regarded as a procedural vehicle while s 1013 supplied the elements that have to be satisfied to bring a claim under s 1005, the defences to a claim and the measure of loss or damage.

86 The reference point is the profit gained or the loss avoided by the insider. It has been suggested that theoretically, an innocent party who purchased shares from an insider trader could recover the statutory loss even though he decides to retain the shares and ultimately makes a profit on their sale. See Marie McDonald, "Australia", *International Insider Dealing* (M Sharp and C Welsh, eds, 1996) at 458.

privity between the insider and an alleged victim with respect to stock exchange transactions. Proving privity is difficult if not well nigh impossible on a computerised stock exchange with large trading volumes. The American solution[87] has been to limit the class of insiders to those who had traded "contemporaneously" with the claimant, and to place a ceiling upon the insider's liability to avoid penalising the insider in too Draconian a manner. Whether the Australian courts would be inspired by the contemporaneity test as well as the imposition of a limit on damages against the insider remains to be seen. Suffice it to say that without resolving the privity issue, section 1013(3) and (4) would effectively be a "dead letter" in relation to stock exchange transactions.

(iii) *Section 1013(5) of the CL: The Issuer as Claimant*

Under section 1013(5) of the CL, if an action could have been brought by the seller or buyer of securities under section 1013(3) and section 1013(4) of the CL respectively, the body corporate which is the issuer of the securities is entitled to recover damages in an action under section 1005 of the CL. The amount of damages would be similar to that recoverable by the seller or buyer. The effect of section 1013(5) is that even if no investor brings an action, the insider may still be liable to the issuer. However, it appears that the problem of privity between the investor and the insider may still be a live one for the issuer. Furthermore, since an action by the company under section 1013(5) is limited to the circumstances where an action may be brought by a seller or buyer under section 1013(3) or (4) respectively, the company has no action available under section 1013(5) if the seller or buyer of the securities possessed the relevant information at the time of the transaction.

It is noted that the ability of the issuer to recover damages against an insider when combined with the ability of a seller or buyer of securities to recover the same measure may result in a situation whereby the insider may be liable for twice the amount of his gain. Section 1015(1) of the CL sets out a "first come first served" principle which is intended to avoid the insider being liable for the same amount to various persons under section 1013, including the regulator under section 1013(6).

[87] See *supra*, notes 41 to 47 and the accompanying text. Although the American decisions in *Shapiro, Wilson, Elkind* and *Fridrich* v *Bradford* have been far from clear or consistent as to whether a test of contemporaneity should be applied and what it entails, the issue has since been resolved by statute since s 20A of the SEA covers explicitly only situations of "contemporaneous trading" although the boundaries of what is "contemporaneous" still remains unclear. S 20A has also codified the limit on damages that may be claimed against an insider. Australian commentators have acknowledged these American developments. See Baxt, Ford and Black, *Securities Industry Law* at 322-323.

(iv) *Section 1013(6) of the CL: The Regulator as Claimant*

Where a breach of the insider trading provisions has occurred, section 1013(6) of the CL authorises the ASIC to bring an action for damages in the name of and for the benefit of the issuer of the securities, if it considers that it is in the public interest to do so. This representative action taken out by the ASIC would be based on the company's right to take action itself under section 1013(2) and (5) of the CL.

(v) *Section 1325 of the CL: The Victim or the Regulator as Claimant*

If any criminal, civil or injunction proceeding has been instituted against an insider for conduct in contravention of Part 7.11 of the CL, section 1325 of the CL allows a person who has suffered or is likely to suffer loss or damage because of that conduct to apply to the court for additional orders against the party in contravention. The section empowers the court, *inter alia*, to make orders against the person who engaged in the conduct that contravened Part 7.11 or a person who was involved in the contravention, so as to compensate the party who made the application for any loss or damage suffered, thereby conferring upon the court a wide discretion as to the nature of orders which will be made in particular circumstances. The types of orders[88] which a court can make include an order directing the person who engaged in the conduct to pay the amount of the loss or damage to the person who suffered the loss or damage, or to refund money or return property to the person who suffered the loss or damage.

Under section 1325(3), the ASIC, in proceedings instituted for a contravention of Part 7.11 or in injunction proceedings by the ASIC,[89] the ASIC may make an application on behalf of persons who have suffered or are likely to suffer loss by the insider's conduct. However, the ASIC shall not make such an application except with the consent in writing given before the application is made by the person or persons on whose behalf the application is made.

(vi) *Section 232(5) of the CL: The Issuer as Claimant*

Section 232 of the CL is the statutory codification of the common law

[88] See s 1325(5) of the CL.

[89] Pursuant to s 1324 of the CL, a general provision which allows the ASIC or any person whose interests have been, are or would be affected by actions in contravention of the CL, to apply for an injunction.

position with regard to certain breaches of fiduciary duty on the part of officers and directors of the company. Section 232(5) of the CL prohibits officers and employees of a corporation from making improper use of information acquired by virtue of their positions or making improper use of their positions to gain an advantage for themselves or another person.

V. Common Law Remedies

In Singapore, although section 105 of the SIA provides for statutory civil recourse in cases of insider trading, section 105(4) of the SIA preserves the rights of the victim to seek redress under the common law. An advantage of pursuing the common law remedy rather than the statutory remedy provided in section 105(1) of the SIA is that under a common law action, no previous conviction is necessary and the normal limitation period of 6 years would apply.[90] In Australia, section 1005(2) of the CL provides that civil liability under that section does not affect liability under any other law. However, because of the comprehensive and wide-ranging provisions in the CL specially geared towards persons affected by insider trading, a victim or corporate in Australia would be more likely to sue under the CL than to rely on the common law remedy.

Since Singapore, the UK and Australia share the same English common law tradition, the common law remedies will be discussed together, albeit briefly as it is acknowledged that common law remedies are not tailored to, and therefore are not best suited to deal with, an insider trading scenario. The success of these remedies in adapting to insider trading would depend largely on judicial policy and approach. Nevertheless, the limitations of the common law concepts would challenge even the most adventurous judicature. Relatively little will be said about the common law position in the USA, save in respect to the tortious action for breach of statutory duty, where American developments have had a great impact on the insider trading laws of Singapore, the UK and Australia. Otherwise, the American common law tradition has developed quite separately from the Commonwealth jurisdictions.[91]

[90] See s 6, Limitation Act (Cap 163).

[91] The term "common law" used in reference to the USA evidently does not refer to the Commonwealth common law body of rules and principles, but to the American body of judge-made and uncodified law, at the federal and state level.

A. *Breach of Fiduciary Duty*

Under the common law, a fiduciary who uses insider information for his own benefit breaches his fiduciary duty.[92] The categories of persons to whom fiduciary obligations attach are not closed. Traditionally, the directors, senior managers, officers, or professional advisers would, in unexceptional circumstances, be fiduciaries of the company. They must not let their duty to the company and their self-interest conflict.

Such fiduciaries who gain from their position will be under an equitable obligation to account for those gains to the company. Fiduciaries in breach must account to the company for any benefits enjoyed or obtained as a result of a breach of the fiduciary duty. Where a company claims for "secret profits" due to a breach of fiduciary duty, it is irrelevant whether the company has in fact suffered loss. Apart from an account of profit, damages may be awarded for a breach of fiduciary duty, where the company does suffer loss. Furthermore, a fiduciary who abuses his fiduciary position by insider trading might be liable to hold any gains made on constructive trust. The principle of constructive trust is sufficiently wide to apply, not only to a fiduciary who abuses his position by insider trading, but also to a third party who assists the fiduciary. A third party can become liable as a constructive trustee if he knowingly receives or deals with trust property or knowingly assists in a dishonest and fraudulent design.

Fiduciaries owe duties to the company only and therefore, only the company can maintain an action for breach of fiduciary duty. A company's fiduciaries do not owe duties to individual shareholders (and certainly not to non-shareholders). This "rule" was established in the case of *Percival* v *Wright*.[93] *Percival* v *Wright* has been questioned in the New Zealand case of *Coleman* v *Myers*.[94] Woodhouse J, commenting on the application of the fiduciary principle in *Coleman* v *Myers* stated:[95]

[92] For a fuller discussion on fiduciary duties in relation to insider trading, see Hannigan, *Insider Dealing* at 132-144, Ashe and Counsell, *Insider Trading* at 116-127 and Ashe, Rider and Counsell, "Civil Liability for Insider Dealing," *The Fiduciary, the Insider and the Conflict* (B Rider and M Ashe, eds, 1995) at 179-186. It should be borne in mind that the effectiveness of the breach of fiduciary duty action is severely impaired where the fiduciaries are also the majority shareholders of the company. It is unlikely that they would cause the company to sue themselves. In this regard, minority shareholder's remedies to counter such an unsatisfactory situation have to be considered. The position in Singapore is cursorily alluded to at *supra*, notes 52 and 53 and the accompanying text.

[93] See *supra*, note 30.

[94] [1977] 2 NZLR 225.

[95] *Ibid* at 324 to 325.

> [T]he standard of conduct required from a director in relation to dealings with a shareholder will differ depending upon all the surrounding circumstances and the nature of the responsibility which in a real and practical sense the director has assumed towards the shareholder. In the one case there may be a need to provide an explicit warning and a great deal of information concerning the proposed transaction. In another there may be no need to speak at all. There will be intermediate situations.

Woodhouse J continued to say that the factors that may decide whether a director owes a fiduciary duty to the shareholders depends upon "information and advice, the existence of a relationship of confidence, the significance of some particular transaction for the parties and, of course, the extent of any positive action taken by or on behalf of the director or directors to promote it." In *Coleman* v *Myers*, the plaintiffs were minority shareholders who had sold their shares to the defendant directors. The company in question was a private family-held company where members of the family habitually looked to the defendant directors for business advice and the defendants had withheld information affecting the true value of the shares. The defendants were accordingly held liable to compensate the plaintiffs. On the authority of *Coleman* v *Myers*, it appears that a victim-shareholder may have a common law case against a fiduciary-insider, in particular circumstances.[96]

B. *Breach of Confidence*

A director, professional adviser or employee may also be liable for damages under the common law of confidence where as an insider, he has disclosed confidential information and caused detriment to the company or the owner

[96] *Coleman* v *Myers* was discussed *obiter* by Browne-Wilkinson VC in *Re Chez Nico* [1992] BCLC 192 where he said at 208:

> Like the Court of Appeal in New Zealand, I consider the law to be that in general directors do not owe fiduciary duties to shareholders but owe them to the company: however, in certain special circumstances fiduciary duties, carrying with them a duty of disclosure, can arise which place directors in a fiduciary capacity *vis-à-vis* the shareholders. *Coleman* v *Myers* itself shows that where directors are purchasing shares in the company from outside shareholders such duty of disclosure may arise dependent on the circumstances of the case.

[97] For a fuller discussion on the law of confidence in relation to insider trading, see Hannigan, *Insider Dealing* at 145-153, Ashe and Counsell, *Insider Trading* at 127-130 and Ashe, Rider and Counsell, "Civil Liability for Insider Dealing," *The Fiduciary, the Insider and the Conflict* at 186-189.

of the information.[97] To succeed in such an action, the plaintiff company must show that the information has a quality of confidence (that is, it is not public property and public knowledge), a relationship of confidence exists between the plaintiff and the defendant (such a relationship exists when a reasonable person who had received the information would realise that an obligation to maintain confidentiality was imposed on him or it may arise by virtue of the office or position held) and the defendant must have used or intends to use the confidential information to the detriment of the plaintiff.[98]

Although there is considerable overlap between an action for breach of fiduciary duty, in particular, misappropriating corporate information, and an action for breach of confidence, an action for breach of confidence requires detriment to the company. In the case of fiduciary breach, it does not matter that the company suffers no loss. In an insider trading scenario, it is rare that a company suffers tangible loss. However, the requirement of a detriment may not be too onerous if one considers that insider trading may cause intangible loss to the company as was noted in the American case of *Diamond* v *Oreamuno*.[99]

C. *Breach of Statutory Duty*

The civil right of action for breach of statutory duty is a tort action arising at common law. In such an action the plaintiff must establish a breach of statutory obligation which, on the proper construction of the statute, was intended to be a ground of civil liability to a class of persons of whom he is one. Three things must be shown: first, that the legislation contemplated that civil liability might be imposed; secondly, that the legislation was passed for the benefit or protection of a certain class of persons; and thirdly, that the plaintiff was within the protected class.[100] The emphasis is on the construction of the statute by the courts.

In the UK, there is a view that "given the clear intention of Parliament not to provide express civil liability for insider dealing...it is most unlikely that a court would find such a cause of action."[101] In Singapore, since there is express civil liability, *a fortiori*, it would not have been the intention of Parliament to provide for other additional or wider civil sanctions based

[98] These three elements were set out by Megarry J in *Coco* v *Clark (AN) Engineers Ltd* [1969] RPC 41 at 47.

[99] See *supra*, note 28.

[100] See *Lonrho Ltd* v *Shell Petroleum Co Ltd* [1981] 2 All ER 456 and *Cutler* v *Wandsworth Stadium Ltd* [1949] 1 All ER 456.

[101] See Ashe, Rider and Counsell, "Civil Liability for Insider Dealing," *The Fiduciary, the Insider and the Conflict* at 190.

on a breach of the insider trading provisions since if they had intended to provide such expansive liability, they would have done so. Similarly, in Australia, since the statutory regime is so comprehensive, a litigant would be hard pressed to say that a particular civil liability peculiar to his case, although omitted, was actually intended by the legislature. It appears safe to assume that Singapore courts would not be overly enthusiatic to expand the ambit of the tort of breach of statutory duty.[102]

The Position in the USA: The Rule 10b-5 Private Action

On the other hand, the American courts have successfully developed a private right on the part of a victim in an insider trading scenario to bring a tortious action against the insider for breach of Rule 10b-5. This was done by applying to Rule 10b-5 the common law tort rule that a person who violates a legislative enactment is liable in damages if he invades an interest of another person that the legislation was intended to protect.[103]

One important judge-made restraint to private litigation under Rule 10b-5, was that the plaintiff must be either a "purchaser" or a "seller" of the securities in the impugned transaction.[104] Other than that, the contours of the tort remained rather fluid and there was room for the various Circuits to disagree with each other. For instance, the Second Circuit in *Shapiro* and *Wilson* dispensed with any requirement of privity whereas the Sixth Circuit in *Fridrich* v *Bradford* refused to do so. Nonetheless, this area of disagreement has now been resolved as the express right of action codified in section 20A of the SEA adopted the *Shapiro* and *Wilson* test of contemporaneity.

With the onset of section 20A of the SEA, it appears that Rule 10b-5 actions will now have limited application. In *T Rowe Price New Horizons Fund*,[105] it was held that insofar as the victim alleges that he was a contemporaneous trader, then section 20A governs recovery. This may work

[102] Whether breach of statutory duty will survive as an independent tort has been a topic of discussion, see *supra*, note 31. Due to the many problems with establishing liability under s 105 of the SIA, it could be remembered that s 102 is based on the American Rule 10b-5, see *supra*, note 56. As will be discussed, the breach of Rule 10b-5 has been interpreted by the American courts to give rise to civil liability. Could s 102 be similarly interpreted expansively so as to result in the creation of civil liability? It is unlikely. S 105 SIA has been legislated to deal with civil liability in the context of insider trading. The fact that it does so inadequately is not a basis to transform s 102 into a section rivalling s 105 in application.

[103] *Kardon* v *National Gypsum* 69 F Supp 512 (ED Pa 1946).

[104] See *Blue Chip Stamps* v *Manor Drug Stores, supra*, note 57.

[105] See *supra*, note 63.

against the claimant insofar as section 20A contains limitations on recovery that the common law action did not have. However, the 5 year limitation period stipulated in section 20A appears more generous than the common law position where the courts have held that the appropriate limitation period for actions under Rule 10b-5 is one year from the discovery of the fraud and 3 years from the date of violation.[106]

D. *Misrepresentation*

Where there is a misrepresentation made by the insider trader, the innocent counterparty could pursue a common law action for misrepresentation based on either contract or tort.[107] A misrepresentation generally involves a false or untrue statement, either by words or conduct, which induces the other party to enter into a contract or to otherwise act in reliance thereto. With regard to transactions performed anonymously on a stock exchange, it is often impossible to establish a positive misrepresentation. Therefore, misrepresentation as a cause of action in insider trading will only be of use in a very limited range of circumstances, namely in direct personal transactions or face-to-face deals and where some form of representation by the insider may be established.

The problem of insider trading is essentially one of non-disclosure. Unless there is a duty to disclose, mere silence does not, generally, amount to a representation. As to whether the courts are willing to impose a duty of disclosure in securities transactions, the UK courts have not been. It was contended in *Chase Manhattan Equities Ltd* v *Goodman*[108] that since the criminal law and various self-regulatory rules impose a duty on certain persons not to take advantage of inside information, an insider, by the very

[106] See DL Ratner, *Securities Regulation in a Nutshell* (4th ed, 1992), at 264.

[107] In Singapore, the misrepresentation action could be framed either in terms of tortious liability (negligent or fraudulent misrepresentation), statutory liability (non-negligent misrepresentation under the Misrepresentation Act (Cap 390) which is based on the Misrepresentation Act 1967 of the UK) and contractual liability (innocent misrepresentation). Depending on the type of misrepresentation and the circumstances, the innocent party could claim damages, rescission and/or an indemnity. The position is similar in the UK save that reference would be made to the Misrepresentation Act 1967. The Australian position is different insofar as only South Australia and the Australian Capital Territory have legislation based on the UK Misrepresentation Act 1967. For a fuller exposition on misrepresentation in Singapore and the UK, see A Phang, *Cheshire, Fifoot and Furmston's Law of Contract* (1994), at Ch 10.

[108] [1991] BCLC 897.

[109] Knox J rejected the argument, *ibid* at 929, stating:

> In my judgment there is too long and tenuous a chain of legal obligation between the duty of a director under the Model Code to report a proposed dealing in a security to

fact of dealing, represents that he is not in possession of information which would breach these obligations. This contention was unsuccessful.[109]

However, a notable exception to the general rule that there is no obligation on one party to disclose material facts known to him and not to the other party is where there can be established a special or fiduciary relationship between the parties which require full disclosure. The question then is could such a special or fiduciary relationship arise between directors and shareholders. *Percival* v *Wright* stands for the proposition that a director does not owe any duties to the shareholders. The New Zealand Court of Appeal in *Coleman* v *Myers* has thrown new light on the correctness and desirability of the proposition in *Percival* v *Wright*. It was held, in *Coleman* v *Myers*,[110] that the directors of a company can owe fiduciary duties to their shareholders in an insider dealing scenario which obliges the directors to disclose material facts in share transaction negotiations. To establish such a special or fiduciary relationship between directors and shareholders, something additional to a mere director-and-shareholder relationship is required. In determining whether the additional element was present, the court in *Coleman* v *Myers* took into account all the surrounding circumstances and the nature of the responsibility which the directors had assumed towards the shareholders. The reaction of other Commonwealth jurisdictions like Singapore, the UK[111] and Australia to the general rule in *Percival* v *Wright* being so tempered by the approach in *Coleman* v *Myers* remains to be seen.

VI. Conclusion

A. *The Prerequisite of a Conviction*

The requirement in Singapore's section 105 of the SIA that civil remedies may be pursued only against an insider convicted of insider dealing seems to defeat the purpose of the statutory civil remedy. Oftentimes, it is argued that the provision of civil remedies against insiders ensures that a wide range of potential claimants have an interest in taking legal action against

the board at one end and a market maker in that security at the other end to justify the finding of a duty owed to the latter by the former to speak. The director's duty is to the company under a code which the Stock Exchange is empowered to require and does require the company to impose on its directors as a condition of the listing of the securities in question. A market maker is only one category of persons who would have an interest in the due observance of the Model Code, and I see no sufficient justification for implying a duty to speak in favour of that category.

110 See *supra*, note 95 and the accompanying text.

111 See *supra*, note 96.

the insider and this maximises the risk that the insider will be subject to litigation and potential financial penalties. Furthermore, the lower burden of proof in civil actions is supposed to work in favour of the claimants. By the simple prerequisite of a conviction, this rationale for the provision of statutory civil remedies is undermined.

If the aim of the section 105 civil liability provision is to deter the insider by the imposition of additional financial penalties, this could be done more effectively by increasing the fines in the criminal action. The fine could always be based on the insider's profit gained or loss avoided. If more severe financial consequences are contemplated, this figure could be further increased by an appropriate multiplier. On the other hand, if the aim of the section 105 provision is to facilitate loss recovery by the victim, the prerequisite of a conviction, the attainment of which is beyond the victim's control, works against the claimant. It could be argued that this requirement promotes fairness and discourages frivolous or potentially oppressive litigation. However, the prerequisite of a conviction coupled with a two year limitation period in section 105 has a debilitating effect on possible civil claims. It is observed that the Australian CL and the American SEA, both of which provide statutory civil remedies to the individual claimant, do not require a prior criminal conviction.

B. *Unreasonable Limitation Period*

As mentioned earlier, the two year limitation period in section 105(3) is unrealistically short. Criminal proceedings are oftentimes not completed within 2 years of the date of the transaction. Ordinarily, under the Limitation Act, the limitation period for contractual or tortious actions is 6 years. There appears to be no rationale in shortening this period especially since there is no limitation period to criminal actions. It is observed that the CL in Australia provides for a 6 year limitation period and the SEA in the USA provides for a 5 year limitation period, in respect of their statutory civil actions in relation to insider trading.

C. *The Problem of Privity and Loss Causation*

The problem of privity in stock exchange transactions could be dealt with by adopting a test of contemporaneity as has been done in the USA. Coupled with a presumption in a contemporaneous trade that a claimant would not have traded had he known of the inside information, the issue of loss causation would also no longer be a hindrance to recovery in stock exchange dealings. Further, the problem of extensive liability then being foisted on the insider by a potentially limitless number of claimants may be avoided by adopting

a limit on the insider's liability, regardless of the number of claimants. This limit could be based on the insider's profit gained or loss avoided, and could be increased by an appropriate multiplier to achieve the desired punitive and deterrent effect.

It would take great judicial courage to use the abovementioned tests and techniques in relation to section 105 of the SIA as presently drafted. The privity and loss causation problems are best dealt with by the legislature. Indeed, the USA eventually adopted the appropriate measures through legislative prescription, although the legislature was inspired by judicial initiative in tackling the problems of privity and loss causation, under the common law.

D. *The Issuer as Enforcer?*

Litigation is a prospect many would seek to avoid. Suing someone may turn out to be a time-consuming and costly exercise, the outcome of which is riddled with uncertainty. It would seem that the chance of individual insider trading victims taking out civil actions is slight. Therefore, if civil remedies are intended to maximise the deterrent effect of the criminal penalties, its efficacy is called into question.

There is a case for placing the civil action in the hands of the corporate issuer of the affected securities. The rationale is that the corporate would have the incentive, the motive and the resources for clearing its name. It is argued that potential investors view a corporate whose securities are subject to insider trading negatively. The Australian CL has provided that a corporate can take action in cases of insider trading in addition to the rights of individual claimants. Under the CL, the measure of damages is measured according to the differential between the price at which the insider had bought or sold shares with the benefit of inside information and what the price would have been if the information had been generally available. The focus is not on the victim's loss. Therefore, the "transfer" of the right of action to the corporate is conceptually acceptable. In contrast, the measure in section 105 of the SIA focuses on the loss sustained by the victim and the emphasis of the provision is compensation to the claimant.

The problem of double recovery by the corporate issuer and the individual victims may be dealt with by provisions stipulating either a division of the proceeds amongst the parties or by stipulating a "first-come-first-served" approach. The Australian CL adopts the latter approach. The intention, one supposes, is that the corporate will step in only when individual investors do not take any action. It is noted that the corporate initiative to sue insiders may be predictably hampered where the insiders have some form of management or shareholding control. Such insiders are in a position to prevent or derail any proceedings against themselves. Where the alleged insider traders have no controlling interest over the company, the company may still be reluctant

to take action. In particular, listed companies are subject to disclosure requirements and regulatory control. To take action against an insider trader might highlight flaws in their internal procedure that could have led to the insider trading occurring in the first place, and this may draw unwanted attention from the regulatory authorities. In the case of non-listed companies, to highlight an incidence of insider trading might create an unfavourable impression of the company amongst investors. It appears that the corporate issuer would be the least perturbed when considering action against insider traders with no management or shareholding link, for instance, professional advisors of the company.

E. *A Regulator as Enforcer?*

It could be suggested that civil remedies given to either individual victims or affected corporates in cases of insider trading may not have any significant deterrent value. Australia and the USA have placed the right of action against an insider for civil penalties into the hands of the ASIC and the SEC respectively. The ASIC's right of action is a derivative of the corporate's right of action and although the action is managed by the ASIC, it would be taken out in the name of and for the benefit of the corporate issuer. The CL provides that the ASIC may take such a representative action if it considers that it is in the public interest to do so. This perhaps acknowledges the possibility that affected corporates might not take action against insiders for reasons that may be contaminated by corporate self-interest.

In the USA, the SEC could take out injunction proceedings against an insider and in so doing, claim ancillary relief in the form of a disgorgement of profits. Orders made by the court in relation to ancillary relief are flexible and have included orders to turn the profits over to the corporate issuer or to a court-appointed trustee for distribution to victims. Any disgorgement of profits made under such injunction proceedings is necessarily offset against any other action an individual or the SEC may take under the new provisions sections 20A and 21A of the SEA. The SEC's right of action under section 21A of the SEA allows it to recover a penalty against insiders up to 3 times the profit gained or loss avoided. The punitive purpose of the SEC's right of action is clear. Penalty monies recovered thereunder are paid to the Treasury and not to the corporate issuer nor to victims.

It is stressed that the empowerment of a regulator to take civil proceedings would only be an effective deterrent if the regulator has in place an efficient investigation and surveillance mechanism as well as a determined enforcement policy. It is noted that the ASIC and the SEC are specialist securities regulators. The SEC has a long history of aggressive enforcement and the nascent ASIC has yet to prove its mettle. Unlike the ASIC and the SEC, the MAS is a general regulator of the financial industry although nonetheless,

it would necessarily have a specialist securities arm.

F. *Liability for Controlling Persons*

Section 21A of the SEA gives the right to the SEC to claim civil penalties from the insider as well as from "controlling persons" where liability attaches to such controlling persons on a test of knowledge and reckless disregard rather than bad faith. This provision is of practical significance as many professional advisors are privy to inside information in relation to a corporate. Such advisors may consist of legal, financial or consultancy organisations. Imposing "controlling persons" liability based on a test of knowledge and reckless disregard fosters greater responsibility on such service providers to keep in place adequate checks to protect confidential information.

If any inspiration is going to come from the UK, it could be from the conduct of business rules applicable to financial investment or brokerage businesses. The rules state that such businesses should not only use their best endeavours to ensure that they do not knowingly effect a transaction which would consitute insider dealing but that they take reasonable steps to ensure that their officers and employees do not deal with confidential information. Indeed, these are but self-regulatory rules. However, the very contravention of such rules opens the businesses to regulatory action by the FSA as well as a private right of action.

There is much to say for imposing such "controlling persons" liability particularly on financial or other professional institutions and businesses who daily come across inside information pertaining to corporate clients. The battle against insider trading is most effectively won by prevention rather than cure.

G. *The End*

The prevention of insider trading is ideally achieved by the effective control and preservation of confidential information and a vigilantly supervised disclosure regime which efficiently releases information to the market thereby depriving the insider of a time differential to deal with inside information. It is when insider traders permeate the net of corporate and regulatory controls that legal sanctions have to step in to cure the situation. Insofar as civil sanctions are concerned, it is recognised in Singapore that common law remedies are inadequate and these have been supplemented by statutory provisions. However, as discussed, the present provisions are far from being an adequate and efficacious cure. In its current form, it neither deters insiders

nor provides victims of today's stock markets with much hope of recovery. It is, at best, a prime example of "showpiece legislation" and insofar as it purports to project an image of anti-insider trading sentiment on behalf of the jurisdiction, it might just fulfill that superficial purpose.[112]

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[112] It is reassuring to note that reform is in the air. The Corporate Finance Committee (a 14 member team formed in December 1997 and headed by Lim Yong Wah) established under the Financial Sector Review Group (formed in August 1997 and headed by Deputy Prime Minister Lee Hsien Loong) has looked into legal sanctions for insider trading as part of their review of the corporate finance architecture in Singapore. The Report of the Corporate Finance Committee was released on 9 November 1998. The recommendations pertaining to insider trading have been endorsed by the Government and the MAS are in the process of studying the recommendations, see "Corporate Finance Committee Report: Recommendations and Government's Response" *The Straits Times*, 10 November 1998. Since this article was written before the release of the Report, this article does not explore the implications of the recommendations. As further food for thought, the recommendations, in summary, are:

(a) A civil right of action for insider trading, which is independent of a criminal conviction, should be created to enable persons to obtain compensation for losses suffered as a result of insider trading.

(b) The plaintiff must show that the trading was contemporaneous with the insider trading, but not that the counterparty who dealt with the plaintiff's shares was the insider.

(c) The securities regulator should be allowed to intervene in or commence civil actions for insider trading.

(d) The insider trader should be liable for all losses suffered by all contemporaneous counterparties, up to a certain maximum value. If the losses claimed are more than the maximum value claimable, the maximum value is to be distributed to the claimants on a pro-rata basis. Where the civil action is pursued by the securities regulator, it should be allowed to retain the damages awarded unless and until valid claims are made against it by investors.

Recommendation (a) supports the abolishment of the unsatisfactory requirement of a conviction before a civil action for insider trading may be pursued. In the civil action, the problem of privity is addressed in recommendation (b) by the adoption of a contemporaneity test. However, the challenge in adopting a test of contemporaneity is in its interpretation. It is further suggested in the body of the Report that this task be left to the courts who would interpret the same "in the light of changing market practices and trading technology." The problem of Draconian liability which arises from using a contemporaneity test is dealt with in recommendation (d). Recommendation (c) proposes that the regulator, but not the corporate issuer, be given a right to initiate civil actions.

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