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SENDING THE RIGHT SIGNALS ON CORPORATE LIABILITY FOR EMPLOYEE INSIDER TRADING

ALEXANDER F.H. **LOKE***

The recent enforcement action taken by the Monetary Authority of Singapore ("MAS") against three employees of the Government of Singapore Investment Corporation ("GIC") is the first publicized case in Singapore involving cross border insider trading under the *Securities and Futures Act*. The present article looks at the impact of the new insider trading provisions on enforcement across borders, and more substantially, the apparent Singapore legal position on corporate liability for insider trading by corporate agents. While the three GIC employees were made to pay civil penalties, the MAS took the position that GIC itself was not liable because its senior executives were unaware of the transactions. One implication is that a corporation is legally entitled to keep the fruits of its agents' unlawful activity. Such a result was, fortunately, avoided in the GIC case by the corporation volunteering to turn over its gains to the MAS. The author argues that a more purposive and holistic reading of the statutory provisions permits a wider interpretation, one that would result in a more coherent law on insider trading. Even if the narrow position is the right one to adopt, the untenable consequence prompts legislative amendments to reverse the position. The author argues first for necessary clarification in the law on corporate liability for insider trading. Second, he argues for rules to conduce corporations toward taking robust safeguards against insider trading by its employees. Third, he argues for a distinct rule to deprive corporations of the fruits of unlawful activity, this notwithstanding the fact that the employee was on a frolic of his own and that the corporation is not blameworthy.

I. INTRODUCTION

The recent civil penalty action for insider trading taken by the Monetary Authority of Singapore ("MAS") against three employees of the Government of Singapore Investment Corporation ("GIC") gives the occasion for a critical examination of the rules of attribution employed in Singapore. The reason given by the MAS for not proceeding against the employer-corporation reflects a narrow construction of the rules of attribution which, in the view of this author, fails to take into account the approach taken by the Privy Council in *Meridian Global v Securities Commission*. In this article, the author makes two principal suggestions for improving the Singapore regime on insider trading. First, insofar as the position taken by the Singapore regulator suggests that the employer-corporation is not liable to disgorge the fruits of the employees' unlawful actions, there is a need to devise a disgorgement regime distinct and separate from the civil penalty regime—one which does not rest on corporate fault. The author then argues that while the present legislative scheme produces incentives for the corporation to devise controls over information flows, it

* Associate Professor, Faculty of Law, National University of Singapore. I am grateful for the comments and assistance of: Professor Stanley M H Yeo, Tracey Evans Chan, John Kluver and participants at the Corporate Law Teachers Conference (Sydney, February 2005). I also wish to acknowledge the helpful comments of the anonymous referee. The views expressed in the article remain my responsibility.

can do better by creating incentives for sound internal controls. In other words, the author suggests that the legislative model shift from the present "information barriers" or Chinese Walls approach for corporations, to one that promotes the adoption of sound and rigorously observed internal controls against insider trading.

II. The GIC Enforcement Action

On 21 October 2004, the Monetary Authority of Singapore announced that it had taken a civil penalty action against three employees of the Government of Singapore Investment Corporation for insider trading.[1] The three employees had received material, non-public and price sensitive information regarding a proposed offering of preferred stock by Sumitomo Mitsui Financial Group ("SMFG"). Anticipating a decline in the price of SFMG following an announcement of the offering, the trio sold SMFG shares on behalf of GIC on 13 February 2003—before the formal announcement by SMFG on 17 February 2003. In the result, GIC avoided a loss amounting to S$710,000 (¥48.6 million).[2] The unusual trade was detected by the Securities and Exchange Surveillance Commission of Japan ("SESC"). The Japanese regulator made a request to the Singapore authorities for investigation and for information based on the bilateral Memorandum of Understanding ("MOU") on the sharing of information on securities matters signed by the two regulators. Following investigations by the MAS, the three employees—Lim, Teng and Choo—agreed to pay civil penalties under *Securities and Futures Act*[3] ("*SFA*") section 232 in the amounts of S$400,000, S$240,000 and S$75,000 respectively, account having been taken of the fact that they did not personally benefit from their actions.[4]

The insider trade related to a Japanese stock and took place on a Japanese exchange. But it was not the affected jurisdiction that took the enforcement action. Instead, the enforcement action was taken by the Singapore authorities on whose soil the trade execution order presumably commenced. The trade execution order having originated in Singapore, *SFA* section 213(a)(ii) provides the jurisdictional basis for taking enforcement action even though the securities in question are traded on a stock exchange located overseas.[5] Before the coming into force of the *Securities and Futures Act 2001*, there would have been legitimate doubts over the jurisdictional reach of the insider trading provisions then found in the *Securities Industry Act* ("*SIA*")[6] section 106. Under the presumption of territoriality,[7] one might credibly argue that the insider trading prohibition contained in *SIA* section 106 did not reach

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1 MAS, Press Statement, "MAS Takes Civil Penalty Enforcement Action" (21 October 2004).

2 Japanese Securities and Exchange Surveillance Commission (SFSC), Press Release (Provisional Translation), "A civil penalty enforcement action has been taken by MAS against employees of GIC for insider trading involving Japanese securities market" (21 October 2004).

3 Cap. 289, 2002 Rev. Ed. Sing.

4 The GIC further punished the trio by suspending them without pay for three months, starting 1 December 2004. "More penalty slapped on GIC trio", *Business Times* (27 November 2004).

5 *Securities and Futures Act 2001*, s. 213: "This Division [insider trading] shall apply to (a) acts occurring within Singapore, in relation to—(ii) securities listed for quotation or quoted on a securities market in Singapore or elsewhere …"

6 Cap 289, 2002 Rev. Ed. Sing. Repealed by *Securities and Futures Act 2001*, s. 342(3).

7 *Public Prosecutor v Taw Cheng Kong* [1998] 2 Sing. L. R. 410; *Public Prosecutor v Pong Tek Yin* [1990] Sing. L. R. 575, [1990] 3 M.L.J. 219. See further Loke, "The Internet and Antifraud Regulation of Securities Markets" (2001) 5 S.J.I.C.L. 647 at 664-672 (which includes a discussion on jurisdiction over cross-border acts and whether the act needs to be completed within jurisdiction).

trades relating to a foreign stock traded on a foreign stock exchange. The GIC enforcement action is therefore a laudable example of sovereign states co-operating to help police market abuse on one another's securities markets.

To the present author, the one unsatisfactory aspect of the GIC enforcement action involves the conclusion that the employer-corporation was not liable to a civil penalty action. In its public statements, the regulator explained that the employer-corporation could not be liable for civil penalty as no senior management was involved in the trading decision.[8] The consequence is a fairly odd one—the employer-corporation who benefits from the insider trades made on its behalf may be legally entitled to keep its tainted gains. This consequence was avoided in the GIC case by the corporation volunteering to turn over its gains to the MAS.[9]

As the gatekeeper of the capital markets regulatory regime, the regulator's position sends important signals to the market. Its attitude toward enforcement materially determines market perception of how the law is applied. This, in turn, affects market confidence, one of the principal justifications for insider trading rules. As will be seen, private enforcement plays only a negligible role in policing insider trading in Singapore. Accordingly, the weight of maintaining market confidence rests on the shoulders of the regulator, whose decisions whether or not to commence an enforcement action affects market perception of how the law takes effect in Singapore.

That the GIC enforcement action does not constitute a judicial decision and is thus not "law" should not blind us from appreciating the fact that the regulator's decision shapes how law is effectuated. Without the regulator initiating an enforcement action, the courts do not get to rule on a legal issue. Using a positivist conception of law, one might credibly argue that the legal position is uncertain and awaits clarification by the courts. The view of the law taken by the regulator nonetheless impacts on how the market regards the workings of the legal system. The legal realist, while acknowledging the potential for judicial clarification, will point to the intuition that the law as currently perceived is an indication of what the law is. In short, legal actors apart from judges play an integral role in shaping the nature of the law. Insofar as their perceptions and attitudes influence how the law is applied and takes effect, a failure to consider their influence detracts from a realistic appreciation of the law and its application.

III. Is there Room for Arguing that a Corporation is Liable to Disgorge its Gains Under a Civil Penalty Action Even if its Senior Management is Not Involved?

A. *Doctrinal Construction of Corporate Criminal Liability*

The theoretical conception of criminal liability invariably uses as its starting point individuals or natural persons. Reflective of this is the basic doctrinal construct that

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[8] MAS, Press Statement, *supra* note 1. MAS "did not find any breach of the SFA by the GIC". Further elaboration was given later: see "Why GIC was not liable in insider trading case", *Business Times* (19 November 2004): "Given the clear evidence of the conduct of the senior management of GIC responsible for GIC's investment functions, and that the three GIC employees did not have executive capacity functions within GIC, MAS considered that there was not a sufficient basis for attributing liability to GIC given the specific facts and circumstances of this case."

[9] The MAS intends to use the funds for additional consumer financial education programmes. MAS, Press Statement, *ibid*.

criminal liability presumptively rests on two elements: a blameworthy act (*actus reus*) and a blameworthy state of mind (*mens rea*). This doctrinal construct sits uncomfortably with the prospect of corporate liability. The methodological individualist would maintain that all social and economic phenomena find their causes in human agency[10]; accordingly, moral responsibility can only attach to a substantive moral agent.[11] In the absence of statutory direction, criminal offences formulated with individuals in mind do not attach to corporations. The methodological individualist would therefore lean against construing crimes designed for natural persons to cover legal entities. The notion that moral responsibility undergirds criminal liability then creates a doctrinal obstacle against extending criminal liability to corporations.

The notion that criminal liability rests on moral responsibility is a doctrinal construct and should be recognized as such. There is nothing inexorably about the linkage between the two. The legislature has, in strict liability crimes, dispensed with the *mens rea* requirement. It has just as often expressly provided for penal liability of corporations. There has not been a suggestion that there is any norm requiring the legislature to justify why these have been done.[12] Similarly, if one takes the view that criminal law serves to deter antisocial behaviour, the attribution of criminal liability to a corporation will serve to provide it with significant incentives to monitor and exercise greater control over the activities of its employees. From a theoretical viewpoint, there are equally good reasons for extending criminal liability to a corporation in order to conduce behaviour compliant with the underlying rationale of a criminal proscription. U.S. federal crimes permit the application of *respondeat superior* along the lines of vicarious liability in tort; vicarious liability, by rendering a corporation liable for the wrongs committed by its employees, serves to incentivize corporations to take measures to ensure that its employees comply with the law. This too is a defensible use of the criminal law.

The English approach—which Singapore, for historical reasons, tends to adopt—charts a middle path.[13] Where the element of mens rea is dispensed with—i.e. in strict liability crimes—criminal liability attaches if an employee engages in the prohibited act in the course of his employment. In essence, the principle of vicarious liability applies in considering whether the corporation is criminally liable.[14] However, where criminal liability is predicated on proof of *mens rea* <u>and</u> *actus reus*,

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[10] J W N Watkins, "Historical Explanation in the Social Sciences" (1957-69) 8 British Journal for the Philosophy of Science 104.

[11] Wolf, "The Legal and Moral Responsibility of Organisations" in Pennock & Chapman, ed., *Criminal Justice* (New York: NYU Press, 1985) 267; A P Simester & G R Sullivan, *Criminal Law: Theory and Doctrine* (Portland, Oregon: Hart Publishing) 245.

[12] In the U.S., the constitutionality of a statute prescribing corporate criminality was settled early on in *New York Central & Hudson River Railroad Co v United States* 212 U.S. 481 (1909). No similar issue has arisen in the Singapore context.

[13] It should be noted that the approach taken by the American Law Institute in the *Model Penal Code* bears greater similarity to the English identification doctrine than to the vicarious liability approach adopted under U.S. federal law. A corporation can be criminally liable for the conduct of its board of directors or any "high managerial agent" acting on behalf of the corporation: ALI *Model Penal Code* s. 2.07 (proposed Official Draft 1962). A "high managerial agent" is an officer or an agent "having duties of such responsibility that his conduct may fairly be assumed to represent the policy of the corporation": s. 2.07(4)(c).

[14] E.g. *R v British Steel* [1995] ICR 586; *National Rivers Authority v Alfred McAlpine Homes East* [1994] CLR 760. In the words of Celia Wells, "the general understanding is that … vicarious liability … applies to strict liability offences and … direct (liability) to offences requiring a mental element.": Wells,

it must be shown that an individual who can be taken to represent the "directing mind and will"[15] of the corporation possesses the blameworthy state of mind. The individual's blameworthy state of mind is attributed to the company. This identification doctrine therefore contemplates corporate criminal liability only when the board or a manager sufficiently high in the corporate hierarchy possesses a blameworthy state of mind. This anthropomorphic approach to constructing corporate criminal liability therefore places a high premium on finding a blameworthy state of mind in individuals representing the "directing mind and will" of the corporation.[16]

The strict methodological individualist sees little place for doctrinal extension of "ordinary" crimes to the corporation. In practical terms, this theoretical construct creates a "penalty default" in corporate criminal liability.[17] The legislature needs to specify and set out the terms of corporate crimes. In the absence of such specification, the courts will not by doctrinal extension adapt ordinary crimes for application to the corporation.[18] By contrast, the identification doctrine through its anthropomorphic approach permits translation of ordinary crimes to the corporation. The room for attaching criminal liability to corporations is a narrow one though. A blameworthy state of mind in higher management may not be easily found in an organization, given that delegation of operational and other decisions takes place as a matter of course.[19] In effect, then, the strict identification embodied in the "directing mind and will" approach allows a delegation of decision-making to subordinates and importantly, the insulation of the corporation from criminal liability due to the information or decision chain by-passing higher management. In operational matters, then, where

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Corporate Liability and Consumer Protection: *Tesco v Nattrass Revisited*" (1994) 57 MLR 817. See also A P Simester & G R Sullivan, *supra* note 11.

[15] This phrase is found originally in the celebrated speech of Viscount Haldane L.C. in *Lennards's Carrying Co Ltd v Asiatic Petroleum Co Ltd* [1915] AC 705 at 713. Over time, the doctrine was applied with increasing liberality: see *The Lady Gwendolen* [1965] 2 All ER 283. This stopped with *Tesco Supermarkets Ltd v Nattrass* [1972] AC 153, where the House of Lords ruled that only the knowledge of officials at the apex of the corporate hierarchy could be attributed to the corporation. These officials had to possess plenary authority over a corporation's affairs; it was insufficient if the official possessed only delegated authority.

[16] Lord Denning's characterization is often quoted:
A company may in many ways be likened to a human body. It has a brain and nerve centre which controls what it does. It also has hands which hold the tools and act in accordance with directions from the centre. Some of the people in the company are mere servants and agents who are nothing more than hands to do the work and cannot be said to represent the mind or will. Others are directors and managers who represent the directing mind and will of the company, and control what it does. The state of mind of these managers is the state of mind of the company and is treated by the law as such. (*H.L. Bolton Engrg Co v T J Graham & Sons* [1956] 1 QB 159, 172.)

[17] Ian Ayres & Robert Gertner, "Filling Gaps in Incomplete Contracts: An Economic Theory of Default Rules", 99 Yale L.J. 87 at 91-93 ("Penalty defaults are designed to give at least one party to the contract an incentive to contract around the default rule and therefore to choose affirmatively the contract provision they prefer. ... [P]enalty defaults are purposefully set at what the parties would not want–in order to encourage the parties to reveal information to each other or to third parties. ...") The concept of penalty default can similarly be applied to statutory construction. See text to note 17.

[18] The historical position in France, which exerted considerable influence over other European jurisdictions, was that a corporation cannot commit crimes ("*societas delinquere non protest*"). This changed with the adoption in 1992 of the *Nouveau Code Penal* (92d ed. Dalloz 199495) (effective 1994): Article 121-2 of the *Nouveau Code Penal*. See further L Orland/C Cochera, "Corporate Crime and Punishment in France: Criminal Responsibility of Legal Entities (Personnes Morales) Under the New French Criminal Code (Nouveau Code Penal)" 11 Conn. J. Int'l L. 111 (1995).

[19] See for example, *Redfern* [1993] Crim L R 43, *P & O Ferries (Dover) Ltd* (1990) 93 Cr App R 72.

the decisions are taken by employees lower down the hierarchy, it will be difficult to find a blameworthy state of mind in the higher management. Unless the operational decision is taken by higher management or the matter is one requiring the decision of the board, the "directing mind and will" approach does not attach criminal liability to the corporation. The possibility of delegation as a means of avoiding criminal responsibility points to a shortcoming in the identification approach. In delimiting corporate criminal liability to instances where the higher management possess a blameworthy state of mind, the identification doctrine confines corporate criminal liability only to cases where one can point to those in charge of steering its policies or operations possessing a blameworthy state of mind. While laudable for guarding against the over-extension of criminal liability to the corporation, such an approach provides precious little incentives for senior managers to supervise the operational decisions delegated to lower level managers.

This was the problem that confronted the Privy Council in *Meridian Global Funds Management v Securities Commission*.[20] In *Meridian Global v Securities Commission*, the company was an investment management company which had vested Koo, its chief investment officer, and Ng, its senior portfolio manager, with the authority to acquire securities on behalf of the company. Unknown to the board of directors and the managing director, Koo and Ng made a substantial acquisition in Euro-National Corporation Ltd, which acquisition triggered an obligation under the *(NZ) Securities Amendment Act 1988* ("*SAA*") section 20(3) to file notice of its substantial interest in the latter company.[21] Meridian Global's liability under the *SAA* depended on whether Koo and Ng's knowledge of the company's substantial acquisition could be attributed to the company. If the court was to insist that only the knowledge of the board or the managing director may be attributed to the company, the legislative intent behind enactment of the substantial shareholder reporting requirements would be defeated. The Privy Council opined:

> [Where insistence on the primary rules of attribution would defeat the legislative intent behind the proscription], the court must fashion a special rule of attribution for the particular substantive rule. This is always a matter of interpretation: given that it was intended to apply to a company, how was it intended to apply? Whose act (or knowledge or state of mind) was *for this purpose* intended to count as the act etc of the company? One finds the answer to this question by applying the usual canons of interpretation, taking into account the language of the rule (if it is a statute) and its content and policy."[22]

The Privy Council construed the policy behind *SAA* section 20 as the immediate disclosure of the person's identity when he becomes a substantial security holder in a corporation. Under *SAA*, notice is to be given as soon as that person knows that he is a substantial shareholder. What rule of attribution is appropriate for the company? If knowledge is to be attributed to the company only when the board or

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[20] [1995] 2 AC 500.

[21] A person who acquires 5% or more of the voting securities in a company listed on the New Zealand Stock Exchange is obliged to give notice in a prescribed form to first, the listed company and second, the stock exchange: *Securities Amendment Act 1988*, ss. 20(3), 20(4). Where a company has not complied with its obligations under s. 20, a court may make a variety of order ranging from an order to comply, to an order to forfeit the shares: *Securities Amendment Act 1988*, ss. 30, 32.

[22] [1995] 2 AC 500 at 507

the managing director comes into possession of the information, the purpose behind enacting *SAA* section 20 is likely to be defeated. Companies may then delegate acquisition decisions to lower level employees. By doing so, it avoids the risk of liability for failing to file the requisite notification—unless, of course, the board or a senior manager comes into knowledge of the substantial acquisition. In the words of the Privy Council, "This would put a premium on the board paying as little attention as possible to what its investment managers are doing."[23] Accordingly, the Privy Council held that on a true construction of *SAA* section 20(4)(e), the company is attributed the requisite knowledge when the information is known to the person having the authority to make the acquisition.

The *Meridian Global* decision is significant, not least because it repudiates the previously held notion that the "directing mind and will" theory constitutes *the* way knowledge is to be attributed to the corporation.[24] *Meridian Global v Securities Commission* indicates that the rules of attribution are more nuanced. It is a matter of statutory construction whether the offence is intended to apply to companies; or for that matter, whether it is to apply to the company only on the basis of its primary rules of attribution. The attribution rule that better prosecutes the purpose of the statutory prohibition is to be preferred over one that does not. Accordingly, if attribution premised on "directing mind and will" is likely to defeat the statutory objective, it should be eschewed in favour of one that better effectuates the policy motivating the proscription.

Meridian Global v Securities Commission is, strictly, a New Zealand case—albeit one decided by the Privy Council. There is, however, no reason to think that it is to be confined to the circumstances of New Zealand. The Privy Council's direction to choose a rule of attribution that is sensitive to the content and purpose of the legislation makes good sense. There is much to commend it over a doctrinaire position that corporate liability is to be determined by the "directing mind and will" theory.

In analyzing the doctrinal flexibility introduced by *Meridian Global v Securities Commission*, its import should not be missed. The corporation was, in effect, made vicariously liable for the actions of its employees. By attributing to the corporation the knowledge of the agent who was authorized to carry out the transaction, the corporation was rendered liable for the acts of its agents performed in the course of employment. The doctrinal route is admittedly somewhat different. The end result is, however, the same.

B. *What Rule of Attribution should be applied to the Singapore Insider Trading Regime?*

There is no question that the insider trading proscriptions found in the *Securities and Futures Act* contemplate corporate liability for insider trading. Under *SFA* section 226(1)(a), a corporation is taken to possess any information which an officer of the

[23] [1995] 2 AC 500 at 511

[24] See, for example, L C B Gower, *Principles of Modern Company law,* 5th ed. (London: Sweet & Maxwell, 1992) 193-194; G R Sullivan, "The Attribution of Culpability to Limited Companies" (1996) 55 Cambridge L.J. 515.

corporation possesses. Thus if a corporation trades when inside information can be found to be in the possession of any of its officers, the corporation contravenes the insider trading proscription. Under this rule of attribution, it matters not that there is no linkage between the information held by an officer of the corporation and the trading decision. The corporation does not have a defence by merely showing the inside information in its possession did not lead to the trading decision. To establish a defence, the corporation needs to show more. It needs to show that:

> … it had in operation at that time arrangements that could reasonably be expected to ensure that the information was not communicated to the person who made the decision and that no advice with respect to the transaction or agreement was given to that person by a person in possession of the information…[25]

In other words, it needs also to establish that it had in place a "Chinese Wall" that effects an information barrier between those receiving the information and those making the trading decision.

A corporation avoids the wide dragnet cast by *SFA* section 226(1) only by satisfying all the elements of the defence found in *SFA* section 226(2): first, that there was in place a Chinese Wall,[26] second, that the person making the decision to trade did not possess the inside information,[27] and third, that the persons possessing the inside information did not advise the transaction or communicate the inside information.[28]

The corporation is thus "strongly incentivized" to adopt information barriers within its organization. Indeed, that would be an understatement. In a large organization that habitually or periodically receives market sensitive information, the institution of a "Chinese Wall" cordoning off the division receiving such information from its trading or advisory divisions is the only way that the corporation can prudently operate without the risk of deemed inside trading liability under *SFA* section 226.

The rule of attribution found in *SFA* section 226(1) serves a prophylactic purpose. A corporation may not in fact be trading on inside information. But unless it can also show that it had in place the requisite information barriers, it risks constructive liability under *SFA* section 226.

Who is an officer for the purposes of *SFA* section 226(1)? *SFA* section 2 directs one to the definition found in *Companies Act* section 4(1). The term "… includes—(a) any director or secretary of the corporation or a person employed in an executive capacity by the corporation …". [29]

What if an employee, not being an officer, possesses the information and trades upon it? Is the corporation to be treated as possessing the information and trading on it? Here, there is a coincidence of knowledge and action in an employee; indeed the employee acts on behalf of the corporation and for its benefit. There is no question that the employee is guilty of insider trading. Can the employee's wrongdoing be attributed to the corporation? In other words, can both the employee's knowledge and act be attributed to the corporation? One would have thought the answer is yes.

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[25] *SFA*, s. 226(2)(b).
[26] *SFA*, s. 226(2)(b)
[27] *SFA*, s. 226(2)(a), (b).
[28] *SFA*, s. 226(2)(b), (c).
[29] *Companies Act* (Cap. 50, 1995 Rev. Ed. Sing.), s. 4(1).

After all, the act was done in the course of employment, for the purposes of the corporation.

In fact, one would have thought this a stronger case for corporate liability. If a corporation, under the deemed knowledge provision in *SFA* section 226(1), does not have a legal defence by establishing there is no linkage between the inside information it holds and the trade, how much more should the corporation be liable when its employee having the authority to trade engages in insider trading for its benefit. The sheer incongruity of an over-extension by constructive liability and the under-inclusion resulting from excluding corporate liability for the insider trade of an employee suggests that legislative intent does not intend this.

Such a result arises from reading *SFA* section 226 as the sole rule of attribution for the corporation. If, however, *SFA* section 226(1) is seen as linked to the prophylactic purpose of inducing corporations to adopt Chinese Walls between officers expecting to receive information and those making the trading decision, the room for additional rules of attribution opens up.

The approach taken by the Privy Council in *Meridian Global v Securities Commission* is instructive. Just as the "directing mind and will" approach to the (NZ) *Securities Amendment Act* section 20 would have led to perverse incentives, so too reading *SFA* section 226(1) as the sole rule of attribution. Management will have little incentive to institute procedures for supervising the activities of its traders. By delegating the trading decision to lower level employees and insulating "officers" from knowledge of the wrongdoing, the corporation stands to reap the benefits of insider trading without risking insider trading liability. Such a construction undermines the legislative intent behind insider trading. It is difficult to believe that the legislature contemplated permitting such perverse incentives while it, at the same time, intended an over-inclusive liability predicated on interposing section 226(1) with the offence definition sections.

Such a construction will also entail reading the legislative intent to permit the corporation's retention of insider trading profits even though the trade by its employee indubitably contravenes the insider trading rules. The improbability of such legislative intent is likely to incline the courts toward construing the insider trading rules in like manner to how the Privy Council treated the *Securities Amendment Act* in *Meridian Global v Securities Commission*: the knowledge of the employee who is authorized to effect the transaction is to be attributed to the corporation.

To the present author, the notion that a corporation can only be liable for insider trading if its higher management is involved represents an unduly narrow reading of the insider trading rules. I would argue that the Singapore insider trading regime admits rules of attribution additional to *SFA* section 226(1), which purpose lies in delimiting the ambit of the constructive liability predicated by its interaction with the liability definition sections.[30] Insofar as *SFA* section 226(1) and the offence definition together link the knowledge in one division of the corporation with the acts performed by another division of the corporation, it is an outworking of the aggregation theory for constructing corporate criminality liability. In this light, *SFA* section 226(1) should not be seen as an exhaustive statutory specification of the attribution rules to be applied for corporations. It is there to circumscribe the

[30] *SFA*, ss. 218, 219.

ambit of the aggregation theory as it is employed in the Singapore insider trading regime.

IV. Disgorging the Unlawful Gains of a Corporation

There is, in principle, no reason why the corporation should be entitled to keep the gains from unlawful insider trading. Indeed, the corporation's gain is an unjust enrichment in every sense of the word. It is the fruit of an unlawful act. The perpetrator-employee is made to fork out the trading gains that the employer gets to keep.

If regulatory breach is triggered by vicarious liability of its employees, there will of course be no issue. Unfortunately, Commonwealth law precedent, in contrast to U.S. federal law on the same matter, has confined the operation of vicarious liability for actions of employees to strict liability offences. In matters of health and safety regulations, for example, all that the prosecution needs to prove is that a non-complying act—be it a non-misfeasance or misfeasance—was committed by the employees. In offences requiring *mens rea*, then, there is a need to attribute knowledge.

A. *Disgorgement through Private Enforcement Actions?*

Is there any rule of law that allows for disgorgement of the corporation's gains? Under *SFA* section 234(1), a civil action may be commenced by a contemporaneous trader against a person guilty of insider trading. The civil action that contemporaneous traders may take does not, however, entitle them to disgorgement of the insider trader's gains or losses avoided; rather the civil claim is premised on recovering the *losses* sustained by contemporaneous traders.[31] Indeed, the statute prescribes the method for assessing the contemporaneous trader's loss. It is the difference between the price at which the share traded at the time of the contravention and the price the share would have traded had the contravention not taken place.[32] Where an insider trader's actions do not affect the market price of the share in question, it is difficult to see how the contemporaneous trader's loss can be caused by the insider trader's unlawful action. Is there room for arguing that the price at which the share would have traded had the contravention not taken place is to be taken as the price with the inside information publicly disclosed? Under rule 10b-5 of (U.S.) *Securities Exchange Act 1934*,[33] the insider is under a duty to "abstain or disclose". In the event that the insider trades on the inside information without disclosure, a civil suit may be commenced to claim damages based on the price the securities would have traded were the information disclosed. This legal incident is a peculiarity of U.S. insider trading law stemming from rule 10b-5. Liability for insider trading under rule 10b-5 is premised on a "fraud" by a trading party. While a party trading in shares is not normally required to disclose the information, insiders stand on different grounds. As fiduciaries, they owe a duty to "abstain or disclose" to the beneficiaries of the fiduciary relationship, which in U.S. federal securities law extends beyond the corporation to the shareholders. To fulfill this duty, the fiduciary is obliged to

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[31] *SFA*, s. 234.
[32] *SFA*, s. 234(1)(b).
[33] 17 C.F.R. s. 240. 10b-5.

make due disclosure to the beneficiary. Were that obligation fulfilled, the beneficiary would have traded at a price that impounded the information in question. It is this "disclose or abstain" aspect of insider trading liability that permits damages to be calculated by reference to the share price that impounds the inside information.[34]

The Singapore insider trading rules, however, stand on different premises. The present insider trading regime is not in any way premised on the fiduciary theory. Rather it is more accurately described as one based on non-parity of information. The proscription against trading is triggered by the presence of two elements: first, a person's possessing information that is not publicly available[35]; and second, by his knowledge that the information is not generally available and that it might have a material effect upon the price or value of the securities if it was generally available.[36] The proscription is framed not in terms of "abstain or disclose", but in a straightforward proscription against trading.[37] A person in possession of information not publicly available must not trade. Period. Civil liability under *SFA* section 234 has to be assessed by reference to how the proscription is framed viz. what is the price of the share if the person in possession of non public information had not traded. Consequently, unless the trade by the person possessing the inside information affects the market price, it is difficult to see how the contemporaneous trader suffers any "loss" arising from insider trading.

Even if the civil liability to contemporaneous traders is disgorgement based, there are other potential impediments to a private civil action seeking disgorgement of the corporation's gains. At common law, it is axiomatic that an employer is vicariously liable for the torts committed by its employees. Breach of a statutory duty, on the other hand, employs a different set of rules. Whether such a breach entitles the protected party a right of civil compensation is a question of statutory construction. In recent years, the English and Australian courts have taken a highly restrictive approach to the implication of a civil right of action from the breach of a statutory duty.[38] The touchstone of statutory construction similarly informs the issue whether an employer should be vicariously liable for statutory breaches committed by its employees. Seeing that civil liability under the Singapore insider trading provisions is tagged to a

[34] *Elkind v Liggett & Myers Inc* 635 F 2d 156 (2d Cir, 1980), *State Teachers Retirement Board v Fluor Corp* 566 F Supp 945 (SDNY, 1983). Theoretically, if each plaintiff is to recover losses based on the difference between the price at which the share was transacted without disclosure and the price had there been disclosure, the cumulative damages that the defendants is made to pay might exceed the advantage obtained by reason of the insider trading. The Second Circuit in *Elkind v Liggett* placed a ceiling on the damages payable, limiting it to the defendant's gain or loss avoided viz. the measure of his unjust enrichment. The SEC, concerned that the disgorgement measure simpliciter served as an insufficient deterrent, pushed for the treble damages provision found in ITSA 1984: see Langevoort, "The Insider Trading Sanctions Act of 1984 and Its Effect on Existing Law" 37 Vand. L. Rev. 1273, 1276 (1984).

[35] *SFA*, s. 218(1)(a) (insider trading by connected persons); *SFA*, s. 219(1)(a) (insider trading by non-connected persons).

[36] *SFA*, s. 218(1)(b) (insider trading by connected persons); *SFA*, s. 219(1)(b) (insider trading by non-connected persons).

[37] *SFA*, s. 218(2)(a) (insider trading by connected persons); *SFA*, s. 219(2)(a) (insider trading by non-connected persons).

[38] *Lonrho Ltd v Shell Petroleum Co Ltd (No. 2)* [1982] AC 173; *Calveley v Chief Constable of Merseyside Police* [1989] 1 AC 1228; *Pickering v Liverpool Daily Post and Echo plc* [1991] 2 AC 370; *Hague v Deputy Governor of Parkhust Prison; Weldon v Home Office* [1991] 3 WLR 340. Margaret Fordham, "Breach of Statutory Duty—A Diminishing Tort" [1996] S.J.L.S. 362; S Deakin, A Johnston & B Markesinis, *Markesinis and Deakin's Tort Law* (Oxford: Clarendon Press, 2003) ch. 3.

person who has "acted in contravention of [the insider trading provisions]",[39] the statutory tort points to the primary offender as defendant. In the absence of clear legislative intention that secondary liability in the employer is intended, it is difficult to make the case that the employer is to be liable for the employee's commission of a statutory tort.

There is a third hurdle, one that stems from procedural barriers. The model of regulation in Singapore—and this is a model in common with the UK and Australia—has not in general relied on private enforcement. Private enforcement for public benefit, a model identified with the American legal system, stands in marked contrast to the Singapore and Commonwealth system which sees civil actions as principally compensatory in nature.[40] Not surprisingly, one does not observe the parameters necessary for sustaining a viable system of private enforcement in Singapore.

The problem of collective action afflicts the commencement of a lawsuit by contemporaneous traders against those who engaged in inside trades. It applies equally to traders who are victims of stock market manipulation. Even if the traders as a group suffer a significant loss, the small size of their individual holdings is likely to render it rational for them to be apathetic. If there are 5,000 investors suffering an average loss of $2,000 each, the cumulative loss will be $10 million. Yet, even if this is the recoverable sum, the lawsuit might not get organized, if only because the costs that attend arriving at a collective agreement to pursue a course of legal action is likely to be high for each investor. The monetary cost of filing a lawsuit is only one consideration. Bringing a class action requires negotiation on the choice of a lawyer, the sharing of costs, and decisions relating to the acceptability of a settlement proposal and the direction of the lawsuit. In addition, there are the opportunity costs that come with attending meetings. In proportion to the potential gains, the monetary costs and transaction costs are likely to significant. Indeed, the proportion is likely to rise as the individual holdings become smaller. This renders it unlikely that an action will be commenced. This is so *sans* an agent who willingly spends his time and effort to organize collective decision-making, which decision includes devising a workable scheme for sharing the costs of the action.

In the U.S., the problems of collective action are mitigated by the allowance for contingency fee arrangements, wherein the lawyer is permitted to take a percentage of a successful action, and to agree not to charge the clients legal costs should the action prove unsuccessful.[41] In Singapore, such an arrangement is unlawful.[42] The

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[39] *SFA*, s. 234(1).

[40] This is also reflected in the highly restrictive stance against punitive damages for torts: *Rookes v Barnard* [1964] AC 1129.

[41] US Supreme Court (federal law): *Taylor v Bemiss* 110 U.S. 42, 46 (1884); *Pennsylvania v Delaware Valley Citizens for Clean Air*, 483 U.S. 711 (1987). State law often adopt the same allowance: see for example *Pebbles v Miley* 439 So 2d 137, 142 (Ala 1983). This norm is mitigated by the *Private Securities Litigation Reform Act* of 1995 (Pub. L. No. 104-67, 109 Stat 737), which was enacted in response to alleged litigation abuses. See Statement of Conference Managers: *Private Securities Litigation Reform Act* of 1995, Conf Rep., H.R. Rep. No. 369, 104 Cong., 2d Session (Nov 28, 1995). Under *Securities Act* 1933 s. 27(c)(1), the court must (upon final adjudication) ascertain whether *Federal Rules of Civil Procedure* Rule 11 has been complied with i.e. that the actions and defenses are non-frivolous and made in good faith).

[42] *Legal Profession Act* (Cap. 161, 2001 Rev. Ed. Sing.), s. 107(1)(b): "… no solicitor shall—… enter into any agreement by which he is retained or employed to prosecute any suit or action or other contentious proceeding which stipulates for or contemplates payment only in the event of success in that suit, action

incentive for private enforcement is supplemented by the norm in U.S. litigation that each party bears his own legal costs, one to be contrasted to the Singapore system in which the loser is usually made to pay the legal costs incurred by the victor.[43] The phenomenon of the much maligned strike-suits in the U.S. should not blind one to the fact that the collective action problem is a very real one. Indeed, it is one that in a very serious way undercuts the formal provisions permitting victims of insider trading legal recourse. If the legal system is serious about affording investor-victims efficacious legal recourse, the collective action problem needs to be addressed.[44] A discussion of how such collective action problem can be addressed is outside the scope of this article. It suffices for the present to point out that institutional and other mechanisms should be put in place if the rights on paper are also to be effective in actuality.

B. *Forfeiture or Disgorgement under General Criminal Law?*

Is there provision under general criminal law for compelling the disgorgement of gains by the corporation through a power of forfeiture or confiscation? The power of forfeiture has historically been littered throughout diverse statutory proscriptions. A consolidation of sorts was effected by the *Corruption, Drug Trafficking and Other Serious Crimes (Confiscation of Benefits) Act*.[45] Under section 5 of the *Act*, a court may upon convicting a person of a "serious offence" issue a confiscation order against the defendant "in respect of benefits derived by him from criminal conduct if the court is satisfied that such benefits have been so derived." The *Act*, however, does not reach the gains in the hands of another that have arisen only because of the unlawful acts by the person convicted. In other words, the *Act* does not seek to "trace" the consequences of the criminal activity, except perhaps within the strict bounds of what constitutes the defendant's property. Even if it did, what constitutes

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or proceeding." Common law: see *Re a Solicitor* [1912] 1 KB 302. UK: *Solicitors' Practice Rules* 1990 r.8, The Bar's Code of Conduct former para 2.11, which was removed on 4 July 1998. The position in the UK was first mitigated by the Courts and Legal Services 1990 s. 58, which took effect in 1995. The *Act* empowered the Lord Chancellor to specify the kinds of cases that are susceptible to "conditional fee" agreements. Initially, they were limited to personal injury claims, claims made by a company in the course of liquidation and human rights litigation before the European Commission of Human Rights and European Court of Human Rights: S.I. 1995 No. 1674. It has since been extended to all civil proceedings: S.I. 1998 No. 1860 (excepting family proceedings.) See also *Access to Justice Act* 1999 which puts in place an amended regime by inserting a new Courts and Legal Services 1990 s. 58, and adding s. 58A and s. 58B.

[43] *Tullio v Maoro* [1994] 2 Sing. L.R. 489, CA citing *Elgindata (No. 2)* [1993] 1 All ER 232; *Ho Kon Kim v Lim Gek Kim (No. 2)* [2001] 4 Sing. L.R. 603. GP Selvam, ed., *Singapore Civil Procedure 2003* (Singapore: Sweet & Maxwell Asia, 2003) para. 59/3/1.

[44] The movement in the UK toward allowing contingency fee arrangement was first prompted by the Thatcher Government's policy of deregulation, which carried with it the aim of greater consumer choice and competition in the services industry. U.K., Lord Chancellor's Department, Green Paper, "Contingency Fees", Cm 571 (London: Her Majesty's Stationery Office, 1989). The greater liberality toward contingency fees arrangements which materialized in 1998 was prompted by the Blair (Labour) Government's concern to reduce the legal aid budget: U.K., Lord Chancellor's Department, "Access to Justice with Conditional Fees" (London: Her Majesty's Stationary Office, March 1998).

[45] Cap 65A, 2000 Rev. Ed. Sing.

a "serious offence" is exhaustively set out in the Second Schedule to the *Act*—and it does not include insider trading.[46]

C. *The Argument for a Rule requiring Disgorgement*

If corporate liability for employees' actions is predicated on a bright line rule like *respondeat superior* rather than the nuanced context dependent approach found in *Meridian Global v Securities Commission*, there will be little question that the corporation will be liable to disgorge its tainted gains. As this author has argued, *Meridian Global v Securities Commission* does *potentially* reach a case like that involving GIC; it is regrettable that the Regulator did not aggressively test the application of *Global Meridian v Securities Commission* in the local courts.

The result is a patently unacceptable one—the corporation gets to keep the gains. Importantly, these are gains which represent the fruits of unlawful insider trading by its employees. In the view of the present author, legislative clarification is warranted. At the minimum, an amendment is in order to render the corporation liable for disgorgement based on vicarious liability.

One policy reason favouring the identification doctrine over the vicarious liability doctrine lies in the fear that the corporation is exposed to unwarranted liability if it is to be strictly liable for the acts of its employees. Since strict liability accepts no defence that the employer has exercised due diligence in instituting internal controls against illegal activities, the identification doctrine confines liability to persons who might be said to personify the corporation's mind. This way, the illegal activities of rogue employees do not infect the corporation. As earlier argued, the identification doctrine is, however, under-inclusive. For one, its strict version as embodied in *Tesco v Nattrass*[47] does not reach employees' acts performed for the benefit of their employers.[48] The broader application of *Meridian Global v Securities Commission* results in functional vicarious liability.

Any fear of over-extensive liability is, however, unwarranted. Even if *Meridian Global v Securities Commission* is aggressive applied, treble damages forms the upper limit of the employer's liability. The civil penalty provisions—which find their inspiration in the *(U.S.) Insider Trading Sanctions Act* of 1984—do not predicate a dogmatic pursuit of treble damages. The U.S. Securities Exchange Commission indicated, in its submission to Congress on what became the *Insider Trading Sanctions Act 1984*,[49] that it would seek enforcement action against an employer who participates in the profits from insider trading; the SEC, however, recognized that the penalty sought is likely to be substantially less than the maximum allowed under the statute.[50] There is therefore no prospect of unlimited liability, since it

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[46] Seeing that insider trading is subject to a civil penalty up to three times the gains or loss avoided, it would be otiose.

[47] [1972] AC 153.

[48] A blameworthy state of mind must be found in corporate officials having plenary authority across a sphere of strategic corporate management: *Tesco v Nattrass* [1972] AC 153, 199.

[49] Pub. L. No. 98-376, § 1, 98 Stat. 1264.

[50] Insider Trading Sanctions and SEC Enforcement legislation: U.S., *Hearing on H.R. 559 Before the Subcommittee on Telecommunications, Consumer Protections and Finance of the House Committee on Energy and Commerce*, 98th Cong., 1st Session (Washington, D.C.: United States Government Printing Office, 1983) at 44.

is for the regulator to seek—and the court to order—the amount of civil penalty to be paid.

Be it as it may. If the policy stance taken in GIC is consistently applied in the future, the *lacuna* is an unacceptable one. On that premise, Parliament should at least make it clear that an employer is not entitled to retain the gains from unlawful insider trading by its employees. This, notwithstanding the fact that the corporation may have implemented all reasonable measures to ensure that its employees do not make unlawful use of information not publicly available. The uncoupling of the corporation's liability to disgorgement from its liability to civil penalty is justified on their different premises. The former rests on the imperative of reversing an unjust enrichment; it does not necessarily suggest that the corporation is blameworthy. By contrast, the latter will rest on some fault attributable to the corporation.

The creation of a distinct rule for disgorgement premised on vicarious liability sends important signals. It signals the readiness of the legislature to addressing the *lacuna* suggested by the GIC case. Importantly, it also accords with the principle of fair labeling propounded by Andrew Ashworth.[51] Insofar as the law has a declaratory or educative function, a distinction in the nature of the proceedings the Government takes against a defendant signals the latter's degree of blameworthiness. Importantly, it plays a role in reinforcing, in the case of insider trading, the normative standards of conduct expected of a corporation operating in the jurisdiction in question. The court and the regulator can of course signal the defendant's blameworthiness through the measure of damages awarded or sought. Insofar as the action proceeds as a "civil penalty", the proceeding carries punitive overtones. In a case where the corporation has taken all reasonable measures to guard against employee misconduct, a disgorgement action *simpliciter* merely suggests unjustified retention of gains. It does not necessarily suggest that the corporation has been remiss. There are, therefore, very sound reasons for inserting a statutory provision stipulating liability to disgorgement should an employer benefit from unlawful insider trading by its employee.

V. From Chinese Walls to a Robust Compliance Culture

Thus far, I have argued that that it is consistent with first, *Meridian Global v Securities Commission*, and second, the statutory scheme to attribute insider trading liability to the corporation when its employee so trades for its benefit. Such attribution performs first the role of allowing the Regulator to seek disgorgement of the gains obtained by the corporation. Second, it incentivizes the corporation to check on the activities of its agents. As the SEC memo indicated, the measure of penalty can be calibrated to reflect the blameworthiness of the defendant.[52]

The Singapore insider trading regime incorporates the aggregation theory of corporate liability. In essence the aggregation theory constructs organizational liability

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[51] Andrew Ashworth, *Principles of Criminal Law*, 2nd ed. (Oxford: Clarendon Press, 1995) 86. See also A Ashworth, "The Elasticity of Mens Rea" in C Tapper, ed., *Crime Proof and Punishment* (London: Butterworths, 1981); G Williams, "Convictions and Fair Labelling" [1983] Cambridge L.J. 85; J Horder, "Rethinking Non-Fatal Offences Against the Person" (1994) 14 Oxford J. Legal Stud. 335.

[52] *Supra* note 50.

by locating elements of the offence in the different arms of the corporation.[53] It is not necessary that there be any causative or other link between the different arms in which the elements are located. The manner in which corporate liability can be constituted under *SFA* section 226 is consistent with the aggregation theory. There is no need to show a causative link between the possession of inside information and its subsequent use. Under *SFA* section 220, it is "not necessary for the prosecution or plaintiff to prove that the accused person or defendant intended to use the information."[54] *SFA* section 220 therefore removes a potential stumbling block that may trip up the prosecution's case. An insider trading offence is made up of a few elements, broadly summarized as follows. First, the corporation must possess inside information knowing it to be inside information of a price sensitive nature.[55] Second, it trades while in possession of the inside information.[56] Consistent with the aggregation theory, it is not necessary that the person making the trade on behalf of the corporation possess the inside information. The corporation's liability for insider trading may be constituted even if there is no proven link between knowledge and the act of trading. Under *SFA* section 226(1)(a): "a corporation is taken to possess any information which an officer of the corporation possesses and which came into his possession in the course of the performance of duties as such an officer." Once the element of knowing possession is established, it suffices for insider trading liability that the prosecution (or plaintiff) proves that a trade was made on behalf of the corporation. As formulated under *SFA* section 218(2) and section 219(2),[57] it matters not whether or not the trader making the trade on behalf of the corporation knew of the information.

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[53] A controversial application of the aggregation theory involves aggregating individual bits of information held by different employees and imputing knowledge of the whole to the bank—even if the significance of the total package of information is not appreciated by any one individual within the corporation: *United States v Bank of New England* 821 F 2d 844 (1st Cir, 1987), cert. denied, 484 U.S. 843 (1987). The Bank of New England was prosecuted for "willfully" violating the *Currency Transaction Reporting Act,* 31 U.S.C.S. Sect 5311-11 (1982). Under the *Act*, a bank was required to file Currency Transaction Reports (CTRs) for any cash withdrawal exceeding USD10,000. A customer cashed a series of cheques, each less than USD10,000, but which cumulatively exceeded the amount. The trial judge instructed the jury to impute to the bank 'the knowledge of individual employees acting within their scope of employment.' 821 F 2d 844, 855 (1987). In effect, the bank was held liable for "negligently maintaining a poor communication network that prevented the consolidation of information held by its various employees." (p. 856) The defendants' argument that this did not satisfy the "willfulness" element in the *Act* was rejected by the appellate court.

[54] This is a legislative reversal of *Public Prosecutor v Ng Chee Kheong* [1999] 4 Sing. L.R. 56, [1999] SGHC 204, where Yong CJ, in a Magistrate's Appeal case, held that for a prosecution under the now repealed *Securities Industry Act* s. 103(1), the prosecution must prove that the defendant possessed an intention to use the undisclosed information in the trade, that he knew that such information was price-sensitive, and that it was generally unavailable.

[55] *SFA*, s. 218(1) (insider trading by connected persons); *SFA*, s. 219(1) (insider trading by non-connected persons).

[56] *SFA*, s. 218(2) (connected person), s. 219(2) (non-connected person).

[57] *SFA*, s. 218 governs the conduct of "connected persons" while s. 219 governs the conduct of non-connected persons. A connected person is defined in s. 218(5) to mean: an officer; a substantial shareholder (as defined in *Companies Act* Part IV Division 4); a person having access to information by reason of professional or business relationship and an officer of such a person. The difference between ss. 218 and 219 lies in the burden of proving that the person knew the information to be material and non-public. For connected persons, such knowledge is presumed: see s. 218(4). For non-connected persons, the burden is on the prosecution to prove the person knew the information to be material and non-public.

For a large financial institution, such an application of the aggregation theory is potentially crippling to its operations. A multi-service financial institution having a corporate finance division that receives information for the purpose of advising its clients would come into much confidential information. Its investment and trading arms, by executing trades on the market, would render it liable to insider trading liability. The only safe way for a large organization to do business is to embrace the safe-harbour given in *SFA* section 226(2) viz. the adoption of solid Chinese Walls. The conditions for accessing this safe-harbour are: (i) that the decision to enter the transaction was taken by some person other than the person possessing the information, (ii) that the corporation had in operation arrangements which ensure information held by the person possessing information was not passed to the decision-maker, and (iii) that the information was in fact not communicated to the decision-maker.[58]

The safe-harbour is made all the more important by the absence of a defence based on element (i) alone. The defendant-corporation cannot escape liability by proving there is no relationship between the division that possess knowledge of the inside information and the division that traded. Such a defence might have been possible if the offence is one requiring proof of an intention. Indeed, the High Court in *PP v Ng Chee Kheong* did find that such an element existed in the predecessor insider trading provision found in *Securities Industry Act* section 103(1). The effect of that decision has been nullified by *SFA* section 220. In moving the amendment to reverse the effect of *PP v Ng Chee Keong*, (then) DPM Lee Hsien Loong declared the decision erroneous and specifically stated there is no requirement for the prosecution to prove such an element.[59] As presently formulated, then, large corporations are more than strongly incentivized to adopt sound Chinese Walls. It is an imperative that they do so in order to avoid the prospect of insider trading liability.

If the incorporation of the aggregation theory within the Singapore insider trading regime is intended to lighten the burden of prosecuting the corporation, the Chinese Walls checks against its over-extension and its potentially crippling effect. This is a necessary carve-out. Given the economies of scale and synergies that come with building a multi-service financial firm, it is a phenomenon to be encouraged. Such economic efficiencies otherwise precluded by an unmitigated application of the aggregation theory is thus preserved by the Chinese Walls defence.

Yet the focus on Chinese Walls—albeit with the burden to prove that they are sufficiently sturdy to withstand negligent leakages—does not quite get to the heart of why one imposes criminal liability and civil penalties on corporations.

Insofar as one of the oft cited justifications for penal sanctions is deterrence, the corporation is equally susceptible to "sticks and carrots" for conditioning its behaviour. It is true that the corporation is a constructed entity, not sentient like individuals. Insofar as individuals have their interests tied to the fate of the corporation, they are likely to adjust the processes of the corporation to ensure that the organization as a whole is structured properly. Does this therefore mean that one should look

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[58] *SFA*, s. 226(2).

[59] Sing. *Parliamentary Debates*, vol. 73, col. 2137 and 2138 (5 October 2001) (Lee Hsien Loong). Deputy Prime Minister BG Lee Hsien Loong, introducing the *Securities and Futures Bill* at its Second Reading, spoke of the legislative history of *SIA* s. 103 and how *PP v Ng Chee Kheong* had introduced an additional element which was expressly disavowed by the former Minister of Finance when he introduced in 1986.

toward individuals? Here, the false premises of the methodological individualist are revealed. To attempt to locate the fault in individuals misses the empirical reality that the corporation is more than the sum of its parts. The hold of methodological individualism, which in some ways sustains the identification doctrine, seeks to locate blameworthiness in individuals, and from there, to attribute that blameworthiness to the corporation. The problem is: the harm may be occasioned by poor audits over its processes or just plain inadequate procedures to ensure compliance. To the present author, insufficient attention to compliance and the poor operationalization of compliance procedures constitute two of the key justifications for penal sanctions against the corporation. To these should be added the corporation's creation of unreasonable risks that result in harm, whether to people, the physical environment or the capital market. To the present author, then, the crimes having intentionality as a key element are a distraction; they bring up interesting conceptual questions. But they do not get to the heart of why we want to punish and sanction corporations. The nub of the issue is what for individuals would be behaviour conditioning, and for corporations, incentives to corporations for adopting sound compliance plans. Integral to the latter is the requirement that the corporation review the externalities it creates.

Penal sanctions have an expressive content. Indeed, this expressive content has an impact that is potentially of a different degree to that for an individual. Goodwill is an important asset to any business corporation. The infringement of a norm, albeit one imposed by the state, sends important signals about the corporation's compliance with the norms of the jurisdiction in which it operates. By levying a sanction and publicly broadcasting it, the corporation's customers are alerted to how they might have been taken advantage of. An investment banker whose corporate finance division leaks client-related information to its trading arm is likely to lose customers. For one, the maintenance of confidentiality critically determines the success of many deals. Secondly, a client who does not suffer any sense of umbrage at the use of his confidential information for his adviser's personal profit is a rare one. It is well and good if a regulatory system seeks to work co-operatively with the business corporation toward adopting safe work and health conditions. But if the corporation's history reveals a pattern of poor internal controls and if reputational capital is an important asset for the corporation, the failure to appropriate the expressive function of penal sanctions would be a regrettable one.

If there is little question that there are sound policy justifications for levying penal sanctions against corporations, the next question is how one should set the conditions for corporate criminal liability. The narrow identification doctrine, which attributes corporate liability only when a high managerial agent possesses a blameworthy state of mind, might be a suitable device for crimes of intentionality. Insofar as the definition of a crime requires proof of an intention—whether to kill or cause grevious hurt—the narrow identification doctrine aligns the blameworthiness of the corporation with those responsible for steering the company. Reliance solely on the identification doctrine for determining corporate liability would, however, be too narrow. Take the offence of causing death by rash or negligent act under the *Penal Code*[60] section 304A. If a corporation is taken to be rash or negligent only if the board or higher management possesses that blameworthy state of mind, the

[60] Cap 224, 1985 Rev. Ed. Sing.

corporation would not be liable if its safety operation are lax. It might be that the blameworthy state of mind cannot be located in any one person, perhaps because the job scopes are divided in such a way that control over the safety feature in question fell between the cracks. Rather, the negligence is to be located in the poor safety review mechanisms and the lack of a rigorous system of internal checks over existing safety procedures. As an organization, is it not blameworthy—if nothing else for its negligence in generating the risks which resulted in deaths? One would surely think so. Indeed, it would take a highly doctrinaire view of moral responsibility of individuals to take the counter position.

If poor review processes and safeguards are to be the parameters for attributing corporate criminal liability, then the nature of the corporate criminality can be framed accordingly. Australia has reconceptualized the nature of corporate liability to take into account blameworthiness on these grounds. The results of the radical rethink on corporate liability are found in *Criminal Code Act 1995*[61] Part 2.5. Under *Criminal Code Act 1995* section 12.3(1), where intention, knowledge or recklessness comprises the fault element in the physical element of any offence, the prosecution must show that the corporation authorized or permitted it, either expressly, tacitly or impliedly. Such authorization or permission may be shown by proving elements of the narrow identification doctrine.[62] Very significantly, it can also be shown by proving a blameworthy corporate culture:

> The means by which such an authorisation or permission may be established include …
>
> (c) proving that a corporate culture existed within the body corporate that *directed, encouraged, tolerated or led to non-compliance* (emphasis mine) with the relevant provision; or
>
> (d) proving that the body corporate failed to create and maintain a corporate culture that required compliance with the relevant provision.

A fair characterization of the difference between (c) and (d) is that the former involves some manner of positive contribution, while the latter involves a blameworthy omission. What, however, is meant by "corporate culture". This is defined in section 12.3(6) to mean "an attitude, policy, rule, *course of conduct or practice* existing within the body corporate generally or in the part of the body corporate in which the relevant activities takes place" (emphasis mine). Thus, the fact that the operations director has designed a set of compliance or safety procedures that look fine on paper does not mean that the corporation will not be criminally liable. The prosecution may, by establishing poor compliance procedures, show that the operationalisation of the plans were defective. That the safety or compliance procedures were in actuality routinely flouted or disregarded constitute a blameworthy "course of conduct or practice".[63]

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[61] Commonwealth of Australia, Act 12 of 1995.

[62] *Criminal Code Act 1995* (Aust), s. 12.3(2)(a) and (b).

[63] *Criminal Code Act 1995* (Aust), s. 12.3(4) sets out the factors relevant to determining the elements found in (2)(c) and (d):

(a) whether authority to commit an offence of the same or a similar character had been given by a high managerial agent of the body corporate; and

These general principles of corporate criminality, though generally applicable to offences contained in *the Corporations Act 2001* (Aust),[64] are expressly disapplied from *Corporations Act* (Aust) chapter 7,[65] which chapter deals with Financial Services and Markets.[66]

For the present author, what is unsettling is the incongruous state of the law on corporate liability for insider trading if the regulatory stance adopted in the GIC action is consistently applied. The notion that a corporation that profits from the insider trading of its employee is entitled to keep its gain is difficult to accept. Against the application of the aggregation theory by which the corporation may be liable even if there is no blameworthy insider trading, it is even more untenable.

A clarification effort may consist of making it clear that the corporation is strictly liable. Vicarious liability would place strong incentives on the corporation to adopt—and enforce—internal safeguards against insider dealing. The common law approach found in *Meridian Global v Securities Commission*, laudable as it is for stretching attribution rules beyond *Tesco v Nattrass*, is unsatisfactory from the perspective of certainty. Until the court decides, one can only guess at the interpretation that might be adopted. In regulation, sending the correct signals is important. A legislative amendment adopting a strict liability position indicates clearly to corporation that the burden of taking measures against insider trading lies with it.

To the present author, a balance can be struck between incentivizing sound internal controls against abusive market practices and the unfairness of corporate liability for acts of a rogue agent. Despite the corporation's sound design of internal controls and their rigorous enforcement, a corporate agent might yet manipulate the market, motivated perhaps by the generous bonus that would be triggered by his hitting the next benchmark. The corporation has done all it can. There is no useful purpose to be served by making it liable. In such a scenario, there is little objection to relieving the corporation of punitive liability. Indeed strict liability might, as Arlen and Bebchuk have argued, lead to a perverse incentive to under-police at its margins.[67] A carve-out for "due diligence in compliance" recommends itself. It incentivizes the reporting

(b) whether the employee, agent or officer of the body corporate who committed the offence believed on reasonable grounds, or entertained a reasonable expectation, that a high managerial agent of the body corporate would have authorised or permitted the commission of the offence.

[64] Commonwealth of Australia, Act 50 of 2001.

[65] *Corporations Act 2001* (Aust), s. 769A ("*CA 2001*").

[66] The Australian position on a regulator's right to seek disgorgement of a corporation's gains from its employee's insider trading might not be dissimilar to the position in Singapore. *CA 2001* s. 769B(1) provides for attribution to the corporation of conduct engaged in by a director, employee or agent within his scope of authority. While this section may be read to import vicarious liability to the corporation for acts of its agents, such a reading may be avoided in the insider trading context by construing s. 1042G as the rule of attribution. The offence formulation provision—s. 1043A—has, as one of its elements, the requirement that the corporation "possess" the inside information. Under s. 1042G, a corporation is taken to possess any information which an officer possesses. *CA 2001* s. 9 defines an officer to include any person "… who makes, or participates in making, decisions that affect the whole, or a substantial part, of the business of the corporation; … or who has the capacity to affect significantly the corporation's financial standing…" If s. 1042G is read as the statutorily prescribed rule of attribution, the corporation may not be liable if the information is held by a lower or even middle level manager. However, Australian Corporations Law has some additional provisions (like *CA* 2001 s. 1043L(6) and s 1043O(e)) which might be employed by the regulator against an "innocent" corporation in certain circumstances. (I am grateful to John Kluver for alerting me to these points under Australian law.)

[67] J Arlen & L Bebchuk, "Controlling Corporate Misconduct: An Analysis of Corporate Liability Regimes" 72 N.Y.U. L. Rev. 687 (1997). Further on perverse effects theory, see Khanna, "Corporate Criminal

of misconduct without the fear of strict criminal liability. Together with the proposal for no-fault disgorgement in Section IV above, it conveys the message that regulatory action will be calibrated according to its degree .

In this, it is useful to compare the Chinese Walls defence in Singapore and the defence for corporation operating in the U.S. market. In Singapore, the Chinese Walls defence is constituted by showing first, that there was no connection between the information held by the corporation and the trade, and second, by showing that there are "arrangements which ensure information held by the person possessing information was not passed to the decision-maker." [68] It does not speak of the other internal controls against insider trading: procedures for detecting unusual trades, review procedures etc.

In the U.S., an element of insider trading liability under rule 10b-5 is a requirement that the trade be shown to be "on the basis of" material non-public information. The corporation may avoid liability by showing two elements. First, that the trader was not aware of the information. Secondly, (and pertinently) that the corporation:

> … had implemented reasonable policies and procedures, taking into consideration the nature of the person's business, to ensure that individuals making investment decisions would not violate the laws prohibiting trading on the basis of material nonpublic information.[69]

The compliance measures contemplated by the defence go beyond information barriers. The use of a "blackout list" in suitable circumstances is also contemplated.[70]

The use of vicarious liability coupled with such a due diligence defence creates the right incentives for corporate behaviour. Earlier, a proposal was made for the creation of a distinct disgorgement rule that predicates the deprivation of an unjust enrichment arising from an unlawful activity regardless of fault. With such a rule in place, the rule that a corporation is *prima facie* liable to a civil penalty action should its employees engage in insider trading will prompt the corporation to institute internal measures for guarding against such illegality. Such vicarious liability incentivizes a corporation to monitor its operations. The due diligence defence—allowing a corporation to demonstrate that it has implemented policies and procedures that are reasonably sound in both conception and operation—is desirable. From a principles perspective, the taint of a civil penalty action should not be visited upon a corporation that has exercised due diligence in ensuring compliance with the law. Secondly, an unmitigated application of strict vicarious liability undercuts the incentive to detect and report misconduct. By assuring the corporation that it has a legal defence against a civil penalty action, the potential perverse effect of the corporation being lax in its detection and reporting is addressed.

Liability: What purpose does it serve?" 109 Harv. L. Rev. 1477 (1996); Parker, "Doctrine for Destruction: The Case for Corporate Criminal Liability" 17 Managerial and Decision Economics 381 (1996)

[68] *SFA*, s. 226(2).

[69] Rule 10b5-1(c)(2)(ii), (U.S.) *Securities Exchange Act 1934*.

[70] "These policies and procedures may include those that restrict any purchase sale, and causing any purchase or sale of any security as to which the person has material nonpublic information …": Rule 10b5-1(c)(2)(ii), (U.S.) *Securities Exchange Act 1934*.

VI. Conclusion

The current Singapore insider trading regime found in the *SFA* has updated the substantive definition of the insider trading proscriptions. It has also expanded the jurisdictional reach of the proscriptions to take into account the internationalized environment in which investment and advisory services are provided. Given the many items on the reform agenda, it is inevitable that some items were not expressly addressed by statute. The issue whether a corporation is liable under a civil penalty action to disgorge the unlawful insider trading gains obtained by its employee might be one of these.

I have argued that the absence of an express legislative provision addressing the specific point in question should not lend weight to the notion that the corporation is legally entitled to keep its gains. Seen in context and against how the corporate liability for insider trading is constructed, the attribution rule found in *SFA* section 226(1) should not be regarded as the only rules of attribution. The dicta of the Privy Council in *Meridian Global v Securities Commission* is instructive: one's interpretation of what rule of attribution to employ is to be informed by the content and purpose of the legislation. The rule of attribution that better prosecutes the legislative purpose is to be preferred over the rule of attribution that does so less effectively. There is a credible argument to be made that a corporation that holds the gains of insider trading made by its employees is liable to disgorge it under a civil penalty action.

Given the mixed message sent out by the GIC enforcement action, there should be a legislative initiative to create a distinct rule of law requiring no fault disgorgement. A disgorgement action under such a rule sends a different message to a civil penalty action; it does not suggest that a punitive action is being sought against the corporation. The mixed message that attends a civil penalty action is thereby avoided.

I have also argued that corporations can be better incentivized to monitor its operations and report misconduct. Channeling corporations toward the use of "Chinese Walls" is good. Making corporations vicariously liable but with a carve-out for instituting reasonably rigorous measures guarding against misuse of inside information is better. It provides greater incentives for complying with the law. The system ain't broke, but it can certainly be further improved.