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AN ANALYSIS OF THE COMMON LAW CAUSES  
OF ACTION FOR BREACH OF FIDUCIARY  
DUTY AND BREACH OF CONFIDENCE IN THE  
CONTEXT OF INSIDER TRADING

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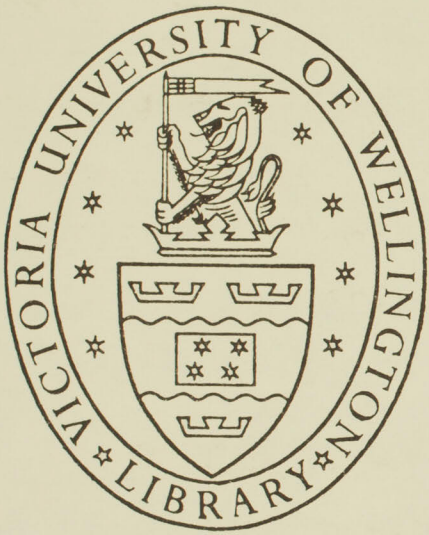
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## ABSTRACT

This paper will focus on the application of various constraints on insider trading which are derived from the principles of the common law and the doctrines of equity, within the context of New Zealand's securities markets. Accordingly, this discussion will involve an examination of those civil causes of action for insider trading which may be based upon a breach of fiduciary duty or a breach of confidence. These common law causes of action continue to have application and relevance in regard to insider trading which occurs in the securities of unlisted private or closely held companies in New Zealand by virtue of the fact that Part I of the Securities Amendment Act 1988 only regulates insider trading in the context of listed public companies. This enquiry will seek to unearth the various failings and inadequacies of those common law constraints which, it is assumed, led to the enactment of Part I of the Securities Amendment Act 1988. Following that, a brief examination will be conducted in regard to the manner by which Part I of the Securities Amendment Act 1988 will operate to proscribe certain insider trading practices in the securities of listed public companies. Finally, by way of conclusion this paper will analyse certain aspects of Part I of the Securities Amendment Act 1988 in order to determine whether or not the various problems which have been identified with the pre-existing common law restraints have been solved by the introduction of this remedial legislation. While it is conceded that the Companies Bill 1990 and various statutory enactments may be relevant in the context of insider trading, an administrative restriction upon the length of this paper has made it necessary to exclude those provisions from the scope of this enquiry. In order to provide the necessary background to this discussion, this paper will commence by considering what exactly is denoted by the phrase "insider trading." This discussion will then proceed with an examination of certain theoretical policy arguments both for and against the practice of insider trading which have been developed in other jurisdictions, particularly the United States. Such an investigation will be carried out prior to a discussion of substantive areas of law which may relate to insider trading, as these policy considerations will provide a valuable basis on which to consider the underlying purpose and effect of any such legal regulations or restrictions that may be imposed in the context of insider trading.

### Word Length

*The text of this paper (excluding contents page, footnotes, bibliography and annexures) comprises approximately 18,500 words.*



## PART I

### 1. INTRODUCTION

*“Nevertheless a certain class of dishonesty, dishonesty magnificent in its proportions, and climbing into high places, has become at the same time so rampant and so splendid that there seems to be reason for fearing that men and women will be taught to feel that dishonesty, if it can become splendid, will cease to be abominable. If dishonesty can live in a gorgeous place with pictures on all its walls, and gems in all its cupboards, with marble and ivory in all its corners, and can give Apician dinners, and get into Parliament, and deal in millions, then dishonesty is not disgraceful, and the man dishonest after such a fashion is not a low scoundrel.”*

- Anthony Trollope (1873)<sup>1</sup>

All of the jurisdictions to whom New Zealand has traditionally turned for a guiding hand on matters of law reform have enacted statutory prohibitions against the practice known as “insider trading”.<sup>2</sup> In the United Kingdom, the statute law creates a criminal offence.<sup>3</sup> In Australia<sup>4</sup> and the United States<sup>5</sup>, legislation creates both criminal and civil consequences whilst in Canada, the Federal Statute provides merely a civil remedy.<sup>6</sup> This consensus of international opinion indicates the standards expected in other securities markets.

The lack of any specific legislative proscription against insider trading in New Zealand prior to December 1988 prompted the *Wall Street Journal* to characterise New Zealand’s securities market as the “Last Wild West Show”, a reference to the relative ease with which profits could be made by indulging in dubious practices such as insider trading.<sup>7</sup> The Australian National Companies and Securities Commission also expressed concern about

<sup>1</sup> A. Trollope, *An Autobiography* (Williams and Norgate Ltd (ed)., London, 1946) 308. Here the English satirist Anthony Trollope was commenting upon the financial scene in London, England, in 1873. In his novel, *The Way We Live Now*, Trollope dealt with the theme of businessmen making dishonest fortunes by means of fraudulent dealing. This novel is viewed as an investigation into the ‘commercial profligacy of the age’ as it drew upon contemporary financial scandals, namely the celebrated ‘Bank of England Forgery’ affair of 1873 (in which four young Americans had bilked the Bank of England for £102,000 by forging signatures on bills of exchange) and upon questionable South American loans, especially that connected with the Honduras railway scandal of 1872 (the work of Charles ‘Joachim’ Lefeure, whose phoney railway laid no more than fifty miles of track before failing. See, N.J. Hall, *Trollope, A Biography* (Oxford University Press, Oxford, 1991) 384-385.

<sup>2</sup> Securities Commission, “Insider Trading: Report to the Minister of Justice” (Wellington, 1987) Vol.I, para 4.9.1.

<sup>3</sup> Company Securities (Insider Dealing) Act 1985.

<sup>4</sup> Corporations Act 1989 (Cwlth).

<sup>5</sup> Securities Exchange Act 1934 as amended by the Insider Trading Sanctions Act 1984 and Insider Trading and Security Frauds Enforcement Act 1988.

<sup>6</sup> Canadian Business Corporation Act 1973.

<sup>7</sup> *The Wall Street Journal*, New York, USA, 28 May 1987, 5.



the state of New Zealand law prior to 1988, suggesting that perhaps the practice of 'insider trading' is one of New Zealand's invisible trans-Tasman exports.<sup>8</sup> In a letter to the Chairman of the New Zealand Securities Commission, 21 January 1987, they commented that:

"On 12 January 1987 we sent you a copy of an advertisement in the 9 January issue of the *Australian Financial Review*. The advertisement offers insider information on 'New Zealand stocks' with profits of 100% to 1,000 %... (often overnight).

We are concerned that the offer may be spurious and thus a criminal offence under section 125 or 126 of the Securities Industry Legislation of Australia. I therefore seek your assistance in providing protection for Australian investors.

If the offer is genuine and any of the 'New Zealand stocks' on which insider information is being offered are listed on the Australian stock exchanges, then the Commission will also be concerned to protect Australian investors. In that regard our two Commissions will have to face such serious issues as whether to suspend Australian trading in the securities of New Zealand companies listed on the Australian stock exchanges until such time as the Commission is able to take steps to satisfy itself that investors in the Australian market are being protected from exploitation by insider trading emanating from New Zealand."<sup>9</sup>

In the face of such a diminution of New Zealand's reputation in international business circles, the then Minister of Justice released the New Zealand Securities Commission's report on Insider Trading in December 1987. In doing so, the Rt. Hon. Geoffrey Palmer stated that insider trading was a morally repugnant practice and that for the long term confidence of investors, New Zealand's securities markets could not continue to present the image of a last frontier for those wishing to manipulate the price of securities for their own financial gain<sup>10</sup>. The Securities Commission's report advised the Government to take effective action against such conduct by introducing a coherent set of legislative sanctions and remedies based on the US concept<sup>11</sup> known as "disclose or abstain":<sup>12</sup>

"An insider who has price-sensitive information that comes to him, or is generated by him, by reason of his position as an insider, should be prohibited from dealing or tipping until the information is published or is

<sup>8</sup> C. Patterson, "Insider Trading" [1988] NZLJ 70, 71.

<sup>9</sup> National Companies and Securities Commission of Australia - letter to Chairman of New Zealand Securities Commission, 21 January 1987; in C. Patterson, "Insider Trading," above n.8, 71.

<sup>10</sup> (1988) 25 NZPD 5280.

<sup>11</sup> See, e.g., *Re Cady, Roberts & Co.* 40 SEC 907 (1961); *SEC v Texas Gulf Sulphur* 401 F 2d 833 (1968).

<sup>12</sup> Securities Commission, "Insider Trading: Report to the Minister of Justice," above n.2, Vol. I, para 3.1.



otherwise reflected in market prices. While he is inhibited from disclosing, he should also be inhibited from dealing unless and until the market price has adjusted to reflect the information.”

These recommendations were accepted by Parliament and enacted in the form of Part I of the Securities Amendment Act 1988 (“the Act”) which came into force on 22 December 1988. This Act introduced for the first time in New Zealand an express statutory prohibition against insider trading in the securities of a listed “public issuer.”<sup>13</sup> The impetus for this enactment seems to have been founded upon the widespread belief that the law as it existed in New Zealand prior to 1988 did not provide effective coverage of the possible situations in which insider trading might occur.<sup>14</sup>

This paper represents a critical appraisal of the validity of that assumption, by focusing upon the application of various pre-existing constraints on insider trading which are derived from the principles of the common law and the doctrines of equity, within the context of New Zealand’s securities markets. Accordingly, this discussion will involve an examination of those civil causes of action for insider trading which may be based upon a breach of fiduciary duty or a breach of confidence. These common law causes of action continue to have application and relevance in regard to insider trading which occurs in the securities of unlisted private or closely held companies in New Zealand by virtue of the fact that Part I of the Securities Amendment Act 1988 only regulates insider trading in the context of listed public companies.<sup>15</sup> The fundamental purpose of this enquiry will be to unearth the various failings and inadequacies of those common law constraints which, it is assumed, led to New Zealand’s securities markets being characterised as the “Last Wild West Show.” Following that, a brief examination will be conducted in regard to the

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<sup>13</sup> See, below n.268. See, also P. Ratner & C. Quinn, *Insider Trading*, New Zealand Law Society Seminar, March 1990, 1.

<sup>14</sup> See, above n.7, n.8 and n.10. Prior to the introduction of the Securities Amendment Act 1988, the Chairman of the Securities Commission, Colin Patterson, asserted that there were four strong forces at work to prevent insider trading in New Zealand:

“*First*, we have the pressure of informed opinion and the strength of reputation which is, perhaps, the strongest inducement to honourable behaviour.

*Secondly*, we have codes of conduct such as the rules of the New Zealand Stock Exchange, and the opinions of organisations such as the Institute of Directors and the Listed Companies Association. *Thirdly*, we have rules of law, developed by judges from the principles of common law and the doctrines of equity, which insist that profits obtained in breach of duty cannot be kept.

*Fourthly*, we have some statute law on the subject, notably the provisions of the Companies Act 1955 requiring the disclosure by directors of their holdings and dealings in the shares of the company in which they hold office.” See, C. Patterson, “Insider Trading and the Director”; in J. Farrar (ed), *Contemporary Issues in Company Law* (CCH (NZ) Ltd., Auckland, 1987) 173.

<sup>15</sup> However, the Companies Bill 1990, which intends to provide coverage in relation to both public and private companies, proposes to cover similar ground to that covered under the Securities Amendment Act 1988 (which only applies to publicly listed companies, see below n.268). See, below n.16.



manner by which Part I of the Securities Amendment Act 1988 will operate to proscribe certain insider trading practices in the securities of listed public companies. Finally, by way of conclusion this paper will analyse certain aspects of Part I of the Securities Amendment Act 1988 in order to determine whether or not the various problems which have been identified with the pre-existing common law restraints have been solved by the introduction of this remedial legislation. While it is conceded that the Companies Bill 1990<sup>16</sup> and various statutory enactments<sup>17</sup> may be relevant in the context of insider

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16 The Companies Bill 1990 (introduced into Parliament on 5 September 1990) imposes general duties in relation to all actions of directors. These restate the common law duties of good faith and care and also clarify and reform the general duties of directors in relation to a company's confidential information, dealing in a company's shares and self interested transactions. The Companies Bill will be of relevance to the problem of insider trading as:

(i) The Companies Bill would apply to both public listed companies and private unlisted companies. Whereas the Securities Amendment Act 1988 only applies to public listed companies. See, Law Commission, "Report No.9: Company Law Reform and Restatement" (Wellington, 1989) para 538.

(ii) In the case of use of company information by directors (clause 123), disclosure of share dealings by directors (clause 124) and restrictions on share dealings by directors (clause 125); an employee receiving confidential information concerning the company, and nominating shareholders with whose directions and instructions a nominee director is required or accustomed to act in respect of their duties and powers as a director, are to be treated as directors for the purposes of clauses 123, 124 and 125.

(iii) Directors who are interested in a transaction or proposed transaction with the company are required to disclose such an interest on the interests register (clauses 117 and 118). Furthermore, a transaction entered into by the company may be avoided by the company within 3 months of the transaction being disclosed to all the shareholders (by means of the company's annual report or otherwise), if the company does not receive fair value under such a transaction (clause 119).

(iv) Directors are required to maintain in confidence the company's confidential information (clause 123).

(v) Directors of a company who deals in shares or other securities issued by the company, are required to disclose such dealings to the board of directors and enter the particulars of the transaction in the interests register (clause 124).

(vi) Under the Companies Bill, a director of a company who possesses confidential price-sensitive information in their capacity as a director, which is material to the assessment of the value of the shares or other securities issued by the company or related company, may only deal in such securities if the consideration they provided for the acquisition or disposal is "fair" in value, in light of that confidential price-sensitive information possessed by the director (clause 125).

17 The following statutory provisions may have relevance to insider trading:

(i) Section 195A of the Companies Act 1955 (which replaced the previous s.195 of the Companies Act 1955, as from 1 July 1988) requires the company to keep a register in which every officer of the company must disclose their interests in shares and debentures of that company and associated companies. This has relevance for the issue of detecting any untoward proceedings by directors and other company officers in securities transactions;

(ii) The New Zealand Stock Exchange Listing Requirements (issued in July 1989) imposes an obligation on companies listed on the New Zealand Stock Exchange (and their subsidiaries, officers and associates; see s.2.2) to disclose certain relevant information to the Exchange. By virtue of s.2.1 these requirements are declared to be a contract enforceable against each issuer for the benefit of every person who is or was a holder of quoted securities of that public issuer in the period in which the issuer was or is listed on the Exchange; and the Contracts (Privity) Act 1982 shall apply accordingly (subject to s.2.1.1).

(iii) Sections 250 and 266 of the Crimes Act will also apply such that, a person may not make a false statement which induces a person to buy or sell shares. However, this will not apply to anyone who makes no statement but merely trades on the basis of inside information (e.g., in the context of the stock exchange where transactions may be conducted in the absence of any face-to-face negotiations);



trading, an administrative restriction upon the length of this paper has made it necessary to exclude those provisions from the scope of this discussion.

In order to provide the necessary background to this discussion, this paper will commence by considering what exactly is denoted by the phrase "insider trading." This discussion will then proceed with an examination of certain theoretical policy arguments both for and against the practice of insider trading which have been developed in other jurisdictions, particularly the United States.<sup>18</sup> Such an investigation will be carried out prior to a discussion of substantive areas of law which may relate to insider trading, as these policy considerations will provide a valuable basis on which to consider the underlying purpose

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(iv) A company director, or other insider, who accepts payment in return for disclosing inside information commits an offence under Section 4 of the Secret Commissions Act 1910. Section 3 of that Act also makes it an offence for an outsider to offer such a payment to directors or other insiders;

(v) Section 209 of the Companies Act 1955 provides an opportunity for persons believing that "the affairs of the company have been or are being or are likely to be conducted in a manner that is, or any act or acts of the company have been or are likely to be, oppressive, unfairly discriminatory, or unfairly prejudicial," to make an application to the court for an order. The Court may "...make such order as it thinks fit, whether for-

- (a) Regulating the conduct of the company's affairs in future; or
- (b) Restricting or forbidding the carrying out of any proposed act; or
- (c) The purchase of the shares of any members of the company by other members of the company or by the company and, in the case of a purchase by the company, for the reduction accordingly of the company's capital; or
- (d) Directing the company to institute, prosecute, defend, or discontinue Court proceedings, or authorising a member or members of the company to institute, prosecute, defend, or discontinue Court proceedings in the name and on behalf of the company."

Whether s.209 could apply to the context of insider trading was recently tested by the New Zealand High Court in *Cotterall v Fidelity Life Assurance Company Ltd* (1987) 3 NZCLC ¶100-055. In this case a director and another major shareholder had learned that another company was interested in acquiring shares in their company at \$10 per share. The director then negotiated with another shareholder and purchased all of her shares at \$5.90 a share, without disclosing such inside information. The director subsequently sold the shares for \$10 and received a substantial profit. The plaintiff who had sold the shares at \$5.90 sought relief under s.209. The Court held that s.209 would not apply as it is only available to existing shareholders and not former shareholders. It is interesting to note that the factual picture presented by the *Cotterall* case was later described by the New Zealand Securities Commission as being, "as plain a case of insider trading as it is possible to conceive"; see Securities Commission, "Insider Trading: Report to the Minister of Justice," above n.2, Vol I, para 11.10.14.

(vi) Where pre-contractual negotiations for the sale and purchase of securities is conducted in a face-to-face type situation (i.e. a private company share sale scenario rather than the sale of a public company's shares through the stock exchange) and the insider trader has elicited the sale or purchase of those securities by means of a misrepresentation, the representee (i.e. the victim of such insider trading) may bring an action for damages under either s.6 of the Contractual Remedies Act 1979 (which applies the contractual measure for assessing damages) or s.9 of the Fair Trading Act 1986 (which applies the tortious measure for assessing damages). However, it must be pointed out that non-disclosure of material information in pre-contractual negotiations will only amount to a misrepresentation in very limited circumstances. See, J.F. Burrows, J.N. Finn, S. Todd, *Cheshire and Fifoot's Law of Contract* (7 (NZ) ed., Butterworths, Wellington, 1988) 288-293.

18

See, e.g. H.G. Manne, *Insider Trading and the Stock Market* (Collier-MacMillan Ltd, New York, 1966).



and effect of any such legal regulations or restrictions that may be imposed in the context of insider trading.

## (1) WHAT IS INSIDER TRADING ?

To understand the nature of insider trading it is important to appreciate the value of information in the financial markets. Information is what the market relies on to determine the price of a particular commodity which is the subject of that market. In insider trading cases this will primarily be the market for company securities.<sup>19</sup> According to the "efficient capital markets hypothesis,"<sup>20</sup> all available information about a company's financial prospects is fully and virtually instantaneously reflected in the market price of the company's securities. In an efficient developed market, therefore, investors can be

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<sup>19</sup> Insider trading is a term that can apply to the misuse of price sensitive information concerning company assets and company performance without necessarily relating to a company's securities. However, in New Zealand section 2 of the the Securities Amendment Act 1988 has limited the meaning of "insider trading" to the trading of securities, such that:

"Inside Information" in relation to a public issuer, means information which-

(a) Is not publicly available; and

(b) Would, or would be likely to, affect materially the price of the securities of the public issuer if it was publicly available.

<sup>20</sup> The use of information is central to the efficient working of the capital market. In this context the concept of efficiency relates to the prices and values associated with all securities. An efficient capital market is said to be one in which prices are accurate signals for allocating financial capital to physical assets, such as buildings, plant and equipment. This means in turn, that the returns or rewards on securities offered in capital markets will reflect a general level in the market adjusted for the risk associated with each security. That return on individual securities is best conceived as a normal return. This does not mean that actual returns do not vary around that normal return; only that any departures are random without persistent bias, positive or negative, around the norm. This concept is what is meant by the "efficient capital markets hypothesis." See, E.F. Fama, "Efficient Capital Markets: A Review of Theory and Emperical Work" (1970) 25 *Journal of Finance* 383. According to the "strong form" of market efficiency the market price fully reflects all available information, including unpublished information. Thus, insiders cannot consistently out-perform the market because prices already reflect inside information. This assertion obviates the need to regulate insider trading since if prices fully reflect all available information, non-insiders who deal at the market price will enjoy the equivalent of complete knowledge which includes the unpublished information known to the insider. According to "strong form efficiency," inside information only confers an advantage on an insider when that insider knows that no-one else has the information. As where the information is known to others and another insider trades ahead of the insider in question, the market price will already have begun to impound the information. On this analysis, when the market price fully reflects all available information, but an insider believes it does not, the insider's performance will be inferior to that of unsophisticated investors who trade on the assumption of "strong form efficiency." The insider's purchases will increase the price beyond that justified by the information and the insider will pay more than the security is worth. Except for that insider's mistaken buying pressure, the price will fall to that dictated by the information. Hence, "strong form efficiency" should be encouraged because rather than placing other investors at a disadvantage, insider trading contributes to market efficiency and benefits non-insiders by increasing the flow of valuable information to the market. See, W. Hogan, "Insider Trading," (1988) 6 *Company and Securities Law Journal* 39, 40-41; J. Suter, *Insider Dealing in Britain* (Butterworths, London, 1989) 23-25.



confident that the market price accurately reflects the company's prospects and this in turn ensures the efficient allocation of capital within that market.<sup>21</sup>

It is apparent to even the most casual observer that the market will respond to the release of financial information and alter the market price of company securities accordingly, good news moving the price up, bad news moving it down. A party indulging in the practice known as "insider trading" (or insider dealing) designs to trade in a company's securities while they are in possession of such price sensitive information which has not yet been released to the market, and therefore has not yet had an effect on the market price of these securities. For example, where the share price of company X is presently \$5 and a certain party gains possession of price sensitive information relating to an oil find by that company which will push its share price to \$10, that party will aim to deal in these shares at \$5, \$6 or \$7, indeed any price lower than the market price these shares will reach on the information being made public. On the other hand, if the shares stand at \$10 and that party learns that the oil well has run dry, then their aim is to sell their shares in the market at \$10 before the news is released and the share price falls back to some figure below that.

Information may become reflected in prices in various ways. There may be a specific statement or disclosure to the market. That is appropriate for some kinds of information, such as profits, losses, and dividends. But it is by no means appropriate in all cases. For example, where a company obtains a lucrative contract, it may not be appropriate to publish any information pertaining to it. Nevertheless, the effect of the contract will, in due course, become reflected in security prices as a response to the increased profitability of the company, without any specific disclosure necessarily being made as to the existence or terms of the contract.

It is a difficult question to decide whether any particular item of information has affected prices or is likely to affect them. It may be noted that some information proclaims its price-sensitivity from its nature. Typically, this includes information of a possible or pending takeover, capital reconstruction or major new undertaking. Another important element is lapse of time, especially in relation to information about a trend, whether favourable or unfavourable, affecting the company. For example, there may be a general decline in the construction industry apparent to all observers which may have a profound effect on a particular company which is not for the time being accurately reflected by the price of that company's securities. This information as to the effect of such a trend on that particular company may be price-sensitive and known only to insiders.

<sup>21</sup> See, R.J. Gilson & R.H. Kraakman, "The Mechanisms of Market Efficiency" 70 Va L Rev 549, 554 (1984).



The operation of the securities market in New Zealand has been said to rest upon two basic principles:<sup>22</sup>

- (a) Disclosure of all material information; and
- (b) Orderly procedures for transacting business, whether by subscription and allotment or sale and purchase.

Insider trading is essentially a problem of non-disclosure;—“a person whose position provides him with access to information that indicates a disparity between the value of a corporation’s securities and the price at which they may be acquired or disposed of acts on the information before it becomes available to those with whom he trades in order to obtain for himself without risk, the benefit of his early knowledge. It can occur, and has, in the shares of both closely held, private companies and widely held, public companies”<sup>23</sup> listed on the stock exchange.<sup>24</sup>

“Insiders” (i.e., parties in possession of unreleased price-sensitive information) are usually persons<sup>25</sup> connected with the company whose securities are being traded (e.g. a director<sup>26</sup>), but it can also include recipients<sup>27</sup> of information from the aforementioned party (i.e. a tippee). However the classic form of insider trading usually involves a direct transaction in which a director or company officer purchases shares in their company, possibly through an agent so that they may conceal their identity.<sup>28</sup>

<sup>22</sup> J. Farrar & M. Russell, *Company Law and Securities Regulation in New Zealand* (Butterworths, Wellington, 1985) 345.

<sup>23</sup> P. Anisman, *Insider Trading Legislation for Australia: An Outline of the Issues and Alternatives* (Australian Government Publishing Service, Canberra, 1986) 2.

<sup>24</sup> See, e.g., *Coleman v Myers* [1977] 2 NZLR 225, discussed below at n.137; *SEC v Dirks* 103 S.Ct 3255 (1983), discussed below at n.163.

<sup>25</sup> Securities Amendment Act 1988 s.2: “Person” includes a corporation sole, a company or other body corporate (whether incorporated in New Zealand or elsewhere), an unincorporated body of persons, a public body, and a Government Department.

<sup>26</sup> See, e.g., Securities Amendment Act 1988 s.3(1)(b).

<sup>27</sup> See, e.g., Securities Amendment Act 1988 s.3(1)(c) and (e).

<sup>28</sup> See, e.g., *Strong v Repide* 213 US 410 (1909). In that case the plaintiff had sold shares in a company to a person who, unknown to her, was the agent of a director in the company. The director was aware at the time of purchase of the shares of an impending sale of that company's land to the Phillipine Government. Indeed, the director was acting as the chief negotiator in the transaction, which was duly completed after the plaintiff had sold her shares to the agent of the director, and which subsequently produced a substantial profit for that director.



Professor Warren Hogan of the University of Sydney's Department of Economics has identified two possible approaches to the definition of insider trading.<sup>29</sup> The first approach reflects the notion of property rights in information, so that insider trading is defined as:<sup>30</sup>

"... the use of information, not publicly available, by a participant in a securities transaction whose access to that information is derived directly or indirectly from a fiduciary relationship and giving the participant and associates a financial advantage over others. The advantage may be secured from trading in the securities of the company in which the fiduciary relationship is established, or in other companies whose market values may be influenced if confidential information held by the initial company were acted upon."

According to this definition the owners have a property interest in the information held by the company so that those persons breaching a fiduciary relationship might gain at the expense of the owners, namely shareholders. However, the use of insider information does not cause a 'loss of wealth' for all shareholders.<sup>31</sup> Only those shareholders who sold at the time when trading was being conducted on the basis of inside information might be said to have 'lost wealth'; an interpretation resting upon an assumption that the security in question has subsequently risen in price after the transaction. However, when the prospect is for a fall in the price of the relevant security, the only loss of wealth resulting from insider trading is experienced by those buying shares in the company prior to the information becoming public.

The second approach reflects a principle of equality of access to information about securities, whereby all participants, actual and potential, are given the same opportunity to gain information on any one security traded in a market. This approach sets aside the property concept, as information is not perceived as the property of the company as an individual legal entity, or as contributing to the wealth of its owners (i.e. the shareholders). Under this approach insider trading may be defined as:<sup>32</sup>

"... the use of information, not publicly available by any participant in a securities transaction to the financial advantage of that participant and

<sup>29</sup> W. Hogan, "Insider Trading," above n.20, 39.

<sup>30</sup> W. Hogan, "Insider Trading," above n.20, 39-40.

<sup>31</sup> D.W. Carlton and D.R. Fischel, "The Regulation of Insider Trading," 35 Stan. L. Rev. 857, 868 (1983).

<sup>32</sup> W. Hogan, "Insider Trading," above n.20, 40.



associates over other participants. The breadth of this definition implies restraining use of any confidential information from whatever the source and however it was devised."

A comparison between these two suggested approaches shows the difference between them. The 'property approach' is about using information, developed within fiduciary relationships of a company, to financial advantage. The 'equal access' approach requires that the same information about securities should be available to all participants, actual and potential, in the market. The former acknowledges the connection between information and the wealth of the shareholders, whereas the latter denies its existence or, at the very least, its primacy for the workings of securities markets.

It will be seen that both of these jurisprudential approaches to the problem of defining insider trading are reflected within the present constraints upon insider trading in New Zealand's securities markets. This should become apparent after an examination of both, pre-existing remedies for insider trading and the additional remedies provided under Part I of the Securities Amendment Act 1988.<sup>33</sup>

<sup>33</sup> See, below n.81, n.179, n.266, n.271.



## PART II

### 2. THEORETICAL CONSIDERATIONS PERTAINING TO THE LEGAL REGULATION OF INSIDER TRADING

The initial question of whether insider trading should be regulated has given rise to considerable debate. The following discussion of theoretical considerations relating to insider trading will provide a valuable insight into the underlying purpose and effect of any such regulation upon insider trading. It is certainly not universally agreed that insider dealing is reprehensible, for while some commentators would view it as the unacceptable face of capitalism<sup>34</sup>, others see nothing wrong with it and indeed even think it should be encouraged. This latter view was first advanced in Professor Manne's 1966 publication, *Insider Trading and the Stock Market*<sup>35</sup>, which asserted that the practice is, in the economic sense, positively beneficial and ought not to be prohibited. Since then the debate has raged between those who would support Professor Manne's position or variations thereof, and consider the problem in terms of economic efficiency alone and those who, relying on notions of fairness, market integrity and morality, would argue for prohibition.<sup>36</sup> This debate is worth considering here, for the lack of consensus as to the merits and wisdom of constraining this practice has important implications in terms of whether the various remedies and methods of enforcement to be discussed in this paper, are of an appropriate nature to be applied in this area.

<sup>34</sup> D. Sugarman, "The Regulation of Insider Dealing"; in B. Rider (ed), *The Regulation of the British Securities Industry* (Oyez Publishing Ltd, London, 1979) 62.

<sup>35</sup> H.G. Manne, *Insider Trading and the Stock Market* (Collier-MacMillan Ltd, New York, 1966).

<sup>36</sup> The literature on this debate is voluminous and only the more important contributions are noted here. The starting point must be H.G. Manne's 1966 text, hereafter cited as Manne (1966), above n.35, which provoked a number of responses; see, J. Hetherington, "Insider Trading and the Logic of the Law" *Wis. L. Rev.* 720 (1967); R. Schotland, "Unsafe at any Price, A Reply to Manne, Insider Trading and the Stock Market," 53 *Va. L.Rev.* 1425 (1967); M. Mendelson, "The Economics of Insider Trading Reconsidered," 117 *U.Pa. L.Rev.* 470 (1969). Manne's response to these criticisms can be found in, "Insider Trading and the Law Professors," 23 *Vand. L. Rev.* 547 (1970), hereafter cited as H.G. Manne (1970). Other important contributions to the debate include; W. H. Painter, "Inside Information, Growing Pains for the Development of a Federal Corporation Law under Rule 10b-5," 65 *Colum. L.Rev.* 1361 (1965); C. Stone, "Fashioning a Lid for Pandora's Box," *Securities L.Rev* 205 (1970); V. Brudney, "Insiders, Outsiders and Informational Advantages," 93 *Harv. L. Rev.* 322 (1979); M. Dooley, "Enforcement of Insider Trading Restrictions," 66 *Va. L. Rev.* 1 (1980); K. Scott, "Insider Trading, Rule 10b-5, Disclosure and Corporate Privacy," 9 *J. Leg. Studies* 801 (1980); D.W. Carlton & D.R. Fischel, "The Regulation of Insider Trading," 35 *Stan. L. Rev.* 857 (1983).



*"The insiders' gain is not made at the expense of anyone".<sup>37</sup>*

An initial difficulty in terms of justifying any such constraints is that it is not easy to identify an individual victim of the insider; indeed it is frequently asserted that this is a victimless crime.<sup>38</sup> This may not be the case if the insider trading has occurred in a face-to-face transaction where it may be possible to establish some misrepresentation or some deliberate inducement to the other party (hereafter referred to as an outsider) to deal, on the part of the insider. However, most insider trading takes place on impersonal, anonymous, stock exchanges where it is impossible to establish any relationship between the insider and the outsider other than the coincidental one of having both been in the market at the same time. Individuals who deal in such impersonal markets have decided to do so voluntarily, without any inducement from the insider, quite independently of anything which the insider does, and in full knowledge of the price at which they are dealing.<sup>39</sup> Such individuals cannot say that any loss suffered by them is caused by the insider trading.<sup>40</sup> Their loss has been caused by the initial non-disclosure of the information in question by the relevant corporation and the subsequent market readjustment on disclosure.<sup>41</sup> This loss will occur regardless of whether insiders have dealt or not, for in any event the outsider would still have dealt in the market and would have sustained the same losses.<sup>42</sup> As an investor's decision to sell or to purchase is unaffected by whether the insider is also secretly buying or selling in the open market. If the insider neither trades nor discloses material non-public information, one can nevertheless expect the investor to pursue their trading plan. To be sure, sellers are naturally disadvantaged by the non-disclosure of good news, just as buyers are disadvantaged by the non-disclosure of bad news.<sup>43</sup>

The outsider's mistake has been in independently reaching a decision to deal on the basis of information which was not wholly up to date, but then share ownership involves risk and one of the risks is that someone else in the market is better informed than yourself.<sup>44</sup> In

37 H.G.Manne (1966), above n.35, 61.

38 H.G.Manne (1966), above n.35, 61.

39 See, M. Dooley, above n.36, 33.

40 See, J. Hetherington, above n.36, 723-725.

41 See, C. Stone, above n. 36, 211.

42 See, J. Hetherington, above n. 36, 733. An outsider may perhaps be regarded as the 'victim' of an insider if it could be shown that the non-disclosure of price sensitive information has been deliberately planned by the insider in order to facilitate his own dealing; however, many insiders are not in a position to dictate the timing of disclosure.

43 J.D. Cox, "An Economic Perspective of Insider Trading Regulation and Enforcement in New Zealand" (1990) *Canta. L. R.* 268, 269.

44 See, W. Painter, above n.36, 1386: "... part of the penalty which you must pay, perhaps for engaging in the rough and tumble of financial life." See also, K. Scott, above n.36, 808: "... the game is, after all, voluntary." In any event, in the present day securities markets in New Zealand investors are predominantly institutional investors who are well able to look after themselves; see



any event, Professor Manne argues that, far from having been disadvantaged from trading in a market where insiders are active, the outsider will have benefited from their activities, which will have moved the price of the securities in the right direction, thus ensuring that the outsider gets a better bargain than would otherwise have been the case.<sup>45</sup> Thus, not only may we lack credible plaintiffs as far as insider trading is concerned, we have supposed "victims" who have actually "benefited" from the activity.

### *Market Egalitarianism*

However, even though it is not possible to show a direct causal link<sup>46</sup> between the activities of the insider, the decision of the outsider to deal, and the loss incurred, it might still be possible to regard the outsider as a victim in the sense that he is a victim of an informational advantage possessed by other people in the market, of which he is ignorant, and which he could not have obtained. This, it is argued, is contrary to the idea of market egalitarianism which requires that all investors trading on impersonal exchanges should have relatively equal access to information.<sup>47</sup> The aim of securities regulation is to ensure, as far as practically possible, that the market operates freely on the basis of equality between buyer and seller. Of course, it is accepted that it is not always possible to put people on a completely equal footing, for there will always be informational advantages based on superior experience and foresight.<sup>48</sup> In a sense, therefore, inside information is always present but, it is argued, it should be possible to remove informational advantages achieved unfairly through access to information which cannot be obtained by others and which in all probability is being used by the insider in breach of some fiduciary or other duty.<sup>49</sup>

Opponents of regulation see this goal of market egalitarianism as unrealistic for, they argue, it could not be achieved other than through the immediate disclosure of all information, to ensure that all investors in the market place are informed and dealing on an equal basis. In

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J. Farrar & M. Russell, "The Impact of Institutional Investment on Company Law" (1984) 5 Co. Law 107.

45 See, H.G. Manne (1966) above n.35, 77-110. However, the outsider still does not get the price they would have got had the information been disclosed.

46 The absence of a causal link and an identifiable victim does not necessarily mean that the practice should not be regulated, although it may indicate that remedies based on a rationale of compensation for an identifiable injury may not be appropriate. See, C. Stone, above n.36, 212.

47 See, *SEC v Texas Gulf Sulphur*, 401 F 2d 833, 848 (1968); "... Rule [10b-5] is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information" (Emphasis added). See also, L. Loss, "The Fiduciary Concept as Applied to Trading by Corporate Insiders in the United States" (1970) 33 MLR 36.

48 See, K. Scott, above n. 36, 805.

49 See, V. Brudney, above n.36.



practice, however, not even the quickest, most prompt, disclosure would ensure this result. All it would do is create another category of insider ("near insiders" as they are sometimes called), made up of the professionals in the market; i.e., merchant bankers, brokers, analysts, institutional investors etc, who are in a position to respond at once to any new information.<sup>50</sup> They would profit along with the insiders while the remainder of the market being unable to respond immediately, would continue to be at a disadvantage.

### *Investor Confidence*

Despite the fact that market egalitarianism is perhaps an unattainable objective, the most fundamental goal in regulating the securities market is surely the encouragement of efficiency<sup>51</sup> in that market and the maintenance of investor confidence.<sup>52</sup> It is important that nothing be permitted to impair investors confidence in the market as "a clean place" in which to do business.<sup>53</sup> The danger is that if investors perceive themselves to be at a disadvantage, if they are concerned that they may be harmed by insider trading, or if they are unhappy about being in a market where some of the players have a substantial informational advantage over them, then they may withdraw from the market and so decrease its liquidity.<sup>54</sup> This loss of confidence may be particularly felt by the company in whose securities the insider trading occurred, for while it may be difficult to see any direct injury to the company as a consequence of insider trading<sup>55</sup> there may be indirect injury to

50 See, D. W. Carlton & D. R. Fischel, above n.36, 880.

51 The term 'efficiency' may be used in three senses; allocational, external and internal. An allocationally efficient market is one which allocates capital to users in such a way that those who can make the best use of capital are favoured by the market in terms of being allocated more capital than those who make a poorer use of capital. In an externally efficient market, prices fully reflect available information. Internal efficiency is concerned with whether transaction costs are so high as to discourage dealing by outsiders, who keep the market externally efficient, and whether those not required to bear transaction costs make excessive returns. though necessary to allocational efficiency, external efficiency is not synonymous with allocational efficiency since allocational efficiency also requires internal efficiency. The distinction between external and internal efficiency is more fully considered in; R.R West, "Two Kinds of Market Efficiency," (1975) 31 Fin. Analysis J. 30.

52 This has been a primary concern of the New Zealand Securities Commission; see, Securities Commission, "Insider Trading: Report to the Minister of Justice," above n.2, Vol.I, para 4.4.1.

53 In stipulating "investor confidence" as one of the objectives of the securities markets, the British Government's 1985 White Paper on Investor Protection stated that such a market: "... must inspire confidence in issuers and investors by ensuring that the financial services sector is, and is seen to be, a 'clean' place to do business." See, L.C.B. Gower, "A New Framework for Investor Protection" (1985) Cmnd 9432, HMSO, London, 21.

54 See, D.W. Carlton & D.R. Fischel, above n.36, 866, on the importance of market liquidity. The catastrophic consequences of a loss of investor confidence in the markets, however caused, are clearly shown by the stock market crash in October 1987. Anything which might contribute to such a loss of confidence by investors must therefore be prevented.

55 Although direct injury to the company can occur in some cases as where, for example, the insider trader alerts the public to an ore find by a company, thereby forcing up the price of surrounding land before the company has an opportunity to acquire it; see e.g., *SEC v Texas Gulf Sulphur* 401 F 2d 833 (1968).



its reputation for integrity and probity, thereby damaging its standing in capital markets.<sup>56</sup> Insider trading may, therefore, make capital raising more expensive for a company.<sup>57</sup> Thus it would follow that in order, to avoid such a result and to ensure that efficiency and confidence is maintained, it will be necessary to constrain insider trading. This will remove any incentive for the insider to delay the disclosure of information to the market, thereby enhancing the flow of information which will in turn ensure that investors can be satisfied that the pricing of the securities by the market is an accurate basis upon which to reach their investment decisions.<sup>58</sup>

Professor Manne would deny, however, that insiders have any incentive to delay the disclosure of information, beyond delaying it just long enough for them to trade. He argues that it is in their interest to have it disclosed as soon as possible after they have dealt, thus ensuring their immediate profit.<sup>59</sup> In any event he noted that insider traders are rarely people the people with the ability to determine the timing of the disclosure.<sup>60</sup> In his opinion, therefore, prohibition is not needed to ensure a flow of information to the market.

### *Market Efficiency*

Indeed, those against regulation would argue that it is the prohibition and not the practice of insider dealing which inhibits the flow of information to the market place. It does this in a number of ways. Firstly insiders who have information do not trade upon it. Thus, the prohibition may actually create an incentive for insider trading as it causes the insider to suppress such information which in turn makes the information valuable. Secondly, individuals who may or may not be within the ambit of any such prohibition do not trade, because of doubts as to their position, given the typically uncertain application and scope of such legislation. Thirdly, such a prohibition deprives individuals of the incentive to acquire valuable information, for they are denied the opportunity to sell the acquired information to others or to profit directly by trading themselves.<sup>61</sup> Fourthly, prohibition forces speculators out of the market and they play an economically important role in stabilising prices; as speculators tend to buy when the price is low and sell when it is high, thereby forcing the price of the securities within a narrower range.<sup>62</sup> Insiders are

<sup>56</sup> Such possible damage was accepted in *Diamond v Oreamuno* 248 NE 2d 910, 912 (1969); but see contra, *Brophy v Cities Service Co* 70 A (2d) (1948); *Freeman v Decio* 584 F 2d 186 (1978).

<sup>57</sup> See, M. Mendelson, above n.36, 477.

<sup>58</sup> See, M. Mendelson, above n.36, 473-476; R. Schotland, above n.36, 1448.

<sup>59</sup> See, H.G. Manne (1966), above n.35, 104-105; D.W. Carlton & D.R. Fischel, above n.36, 879.

<sup>60</sup> See, H.G. Manne (1966), above n.35, 104-105; D.W. Carlton & D.R. Fischel, above n.36, 879.

<sup>61</sup> See, D.W. Carlton & D.R. Fischel, above n.36, 885.

<sup>62</sup> See, H.K. Wu, "An Economist Looks at Section 16 of the Securities Exchange Act 1934," 68 Colum. L. Rev. 260 266 (1968).



speculators par excellence and forcing them out of the market in this way only increases instability within the market by denying insiders the ability to gradually ease prices towards the correct price.<sup>63</sup>

This view of insider trading as a mechanism which, far from resulting in the withholding of information and the endangering of the efficient operation of the market actually increases investor confidence in the pricing mechanism of the market is one of Professor Manne's main arguments in favour of the practice.<sup>64</sup> Insider trading in his view moves prices in the right direction towards the level correctly reflecting all the real facts about the company, thus ensuring that capital resources will be properly allocated. Not all commentators are convinced, however, for while insider trading may move prices in the right direction it does so derivatively through price and trade decoding as the market deduces the presence of such information from the trading activity. This can only occur slowly and sporadically and is dependent upon such factors as the ability of other people to identify the fact of insider trading taking place in particular securities from the surrounding "noise" of other trading in the market.<sup>65</sup> Indeed, as Gilson & Kraakman noted, if one really believed that insider trading does have such a beneficial effect on market pricing, then the best way of achieving this is to provide for immediate disclosure of the fact that insiders are dealing so that instead of such a slow derivative process, there would be a much quicker reaction by the market.<sup>66</sup>

### *Self-Regulation by Companies*

It is equally difficult to assert that insider trading diminishes investor confidence in those particular companies where it is known or suspected to occur, so making it more difficult and expensive for them to raise capital. Carlton & Fischel make the point that if insider trading did harm companies in this way, then there would be an incentive for them to show the markets that they have taken steps internally to prevent insider trading in order to give themselves a competitive edge over companies which do not take such steps.<sup>67</sup> In the absence of any evidence that companies take such steps, they argue, it is clear that companies do not regard themselves as harmed in the markets. To the limited extent that companies in New Zealand have taken such steps, they have done so as a response to such requirements as ss.195 and 195A of the Companies Act 1955, the Insider Trading

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<sup>63</sup> See, J. Hetherington, above n.36, 277.

<sup>64</sup> H.G. Manne (1966), above n.35, 77-110. See also, D.W. Carlton & D.R. Fischel, above n. 36, 868.

<sup>65</sup> See, R. Schotland, above n.36, 1443-1449; R.J. Gilson & R.H. Kraakman, above n.21, 572-579.

<sup>66</sup> R.J. Gilson & R.H. Kraakman, above n.21, 632.

<sup>67</sup> D.W. Carlton & D.R. Fischel, above n.36, 863-866.



(Approved Procedure for Company Officers) Notice 1991,<sup>68</sup> the *New Zealand Stock Exchange Guidelines for Securities Transactions by Directors* (March 1982) and the so-called "Chinese Wall" exemptions for insider trading liability under the Securities Amendment Act 1988,<sup>69</sup> but not it seems, as a consequence of any perception that the absence of such provisions has harmed them in the market.

### *Commercial Morality*

The net result is that the economic arguments do suggest that insider trading is not so obviously detrimental that it needs to be constrained or prohibited. This does not mean, however, that there is no justification for constraint, for as Schotland observed:

"Even if we found that unfettered insider trading would bring an economic gain, we might still forgo that gain in order to secure a stock market and intracorporate relationships that satisfy such non-economic goals as fairness, just rewards and integrity."<sup>70</sup>

Jennings put the point more succinctly when he noted that:

"After all we do not let Paul rob Peter merely because he may be able to put the stolen property to a better economic use."<sup>71</sup>

Such a reliance upon moral imperatives with pleadings of unfairness, theft and dishonesty, Manne suggests, is a consequence of frustration at the inability to find a justifiable basis for regulation.<sup>72</sup> However, it is submitted that these general notions of fairness and the belief that the behaviour is by its very nature dishonest, is a true reflection of the law's long standing concern with the enforcement of fiduciary duties, the abuse of confidence and unjust enrichment.<sup>73</sup>

68 Made pursuant to s.8(1)(c) of the Securities Amendment Act 1988. See, below n.284.

69 See, Securities Amendment Act 1988 ss.10, 12(2) and 14. See, below n.284.

70 R. Schotland, above n.36, 1439.

71 R.W. Jennings, "Book Review (Manne (1966))," 55 Calif. L. Rev. 1229, 1234 (1967).

72 H.G. Manne (1970) above n.36, 548. Professor Loss notes that such a criticism of the moral or public opinion factor, which relegates it to a proposition of "it's just not right," is a grievous defect of strictly economic arguments against insider trading. He observes that; "[t]his overlooks the fact that it is important for the markets, as it is for the courts, not merely to do equity but to appear to do equity. Why should the public enter the markets if the rules of the game make it perfectly legitimate for insiders (and their friends and business associates) to play with marked cards?". See L. Loss, *Fundamentals of Securities Regulation* (Little Brown & Co. Ltd, Boston, 1983) supp. 1986, 608.

73 See, K. Scott, above n.36, 807.



### *Entrepreneurial Compensation*

In the face of profiting by insiders in positions of trust and confidence, the opponents of regulation would argue that profiting by such individuals should still be permitted because it is, in their view, an effective and valuable method of rewarding entrepreneurial skills, as ordinary methods of compensation are inflexible, insufficiently wide ranging and inadequate.<sup>74</sup> Indeed Carlton & Fischel go so far as to say that the unique advantage of insider trading is that it may present a solution to the dilemma of contract negotiation costs, for it allows a company officer to alter their compensation package in the light of new knowledge, thereby avoiding the costs to the company of continual renegotiation.<sup>75</sup>

This view of insider trading as an efficient compensation scheme has been criticised on a number of grounds.<sup>76</sup> First, it is in fact a very inefficient way to compensate entrepreneurial talent as it depends to some extent on fortuitous occurrences which enable insider trading to be carried out successfully (e.g., a takeover bid which has actually materialised). The haphazard nature of the reward means that it may not equate with the insiders' contribution to the company but rather, the fact that they are able to access such price sensitive information, the extent of their financial resources and the number of shares those resources will enable them to deal in.<sup>77</sup> Moreover, it is difficult to see why entrepreneurial talent which has already been brought and paid for by the corporation should be entitled to additional payments.<sup>78</sup> Furthermore, insider trading creates perverse incentives by encouraging company officers to invest in risky projects which are likely to have the greatest impact on share prices if successful while protecting them from the losses which such investments may also create by letting them insider trade on bad as well as good news, before it is released to the market.<sup>79</sup>

This discussion of the theoretical assertions relating to insider trading serves to highlight the apparent tension between considerations of efficiency within the market and equitable concerns relating to ethical standards and the perceived relationship between insider trading and public confidence in the securities markets. The debate rages on with no clear winners on either side. Such uncertainty as to whether or not insider trading should be constrained

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74 H.G. Manne (1966), above n.35, 131-158.

75 D.W. Carlton & D.R. Fischel, above n.36, 871.

76 D.W. Carlton & D.R. Fischel, above n.36, 862 and 868. See also, H.G. Manne (1966), above n.35, 147-188.

77 See, M. Mendelson, above n.36, 481-487; K. Scott, above n.36, 808.

78 See, J. Hetherington, above n.36, 727-730.

79 See, R. Schotland, above n.36, 1543.



or prohibited is in turn reflected by the sluggish response of New Zealand's legislature to regulate such practices in the recent past.<sup>80</sup>

## A. COMMON LAW REMEDIES FOR INSIDER TRADING

### 1. FIDUCIARY DUTIES AND INSIDER TRADING

The so-called fiduciary duties imposed upon agents of the company refers to the body of laws invented and elaborated by the Court of Chancery in the eighteenth and nineteenth centuries to ensure that persons holding assets or exercising functions in a representative capacity for the benefit of other persons (i.e. the "beneficiary") will act in good faith to further the interests of those they represent. The duties of good faith and loyalty which this fiduciary relationship imposes are virtually identical with those of trustees, and in a legal context the description of a fiduciary as a "trustee" will have validity.<sup>81</sup> It is now generally agreed that the word "fiduciary" goes beyond itself to identify a single class of relationships, and that fiduciary duties be reduced to a single set of rules and principles which apply to all such relationships.<sup>82</sup> Therefore, before considering liability for breach of fiduciary duty, we must first determine whether different types of insider traders would be regarded as fiduciaries and in whom they are fiduciaries. Secondly, it will be necessary to consider the particular duty or duties relevant to imposing liability for insider trading, which would apply to them.

### 2. INSIDERS AS FIDUCIARIES OF THE COMPANY

There is a well established principle of equity that a director is in a fiduciary relationship (i.e. a relationship of trust<sup>83</sup>) with the company.<sup>84</sup> It is equally clear that company officers, at least those officers occupying positions of responsibility,<sup>85</sup> owe the same duties to the company as directors. Also in a fiduciary relationship vis-à-vis the company

<sup>80</sup> L.C. Gower, *Gower's Principles of Modern Companies Law*, 14th ed., 1993, 172-173, para. 1.1.1.1. See also G. Palmer & M. Palmer, *Company Law and Securities Regulation in New Zealand*, para. 2.1.22, where it is observed that the directors' position has been widely by analogy to that of a trustee. However, the law relating to the duties of directors is the subject of a different rule played by statute. See also G. Palmer & M. Palmer, *Company Law and Securities Regulation in New Zealand*, para. 2.1.22, where it is observed that the directors' position has been widely by analogy to that of a trustee. However, the law relating to the duties of directors is the subject of a different rule played by statute. See also G. Palmer & M. Palmer, *Company Law and Securities Regulation in New Zealand*, para. 2.1.22, where it is observed that the directors' position has been widely by analogy to that of a trustee. However, the law relating to the duties of directors is the subject of a different rule played by statute.

<sup>81</sup> It should be observed that proposals for the reporting of substantial shareholdings and interests in shares of listed companies within New Zealand which were detailed in, Securities Commission, "Nominee Shareholdings in Public Companies" (Wellington, 1982), were never implemented by the New Zealand Government.



## PART III

### 3. COMMON LAW REMEDIES FOR INSIDER TRADING

#### (1) FIDUCIARY DUTIES AND INSIDER TRADING

The so-called fiduciary duties imposed upon agents of the company refers to the body of duties invented and elaborated by the Court of Chancery in the eighteenth and nineteenth centuries to ensure that persons holding assets or exercising functions in a representative capacity for the benefit of other persons (i.e. the 'beneficiary'), will act in good faith to protect the interests of those they represent. The duties of good faith and loyalty which this fiduciary relationship imposes are virtually identical with those of trustees, and to a limited extent the description of a fiduciary as a 'trustee' still has validity.<sup>81</sup> It is now generally agreed that the word 'fiduciary' does not of itself identify a single class of relationships, nor can fiduciary duties be reduced to a single set of rules and principles which apply to all such relationships.<sup>82</sup> Therefore, before considering liability for breach of fiduciary duty we must first determine whether different types of insider traders would be regarded as fiduciaries and to whom they are fiduciaries. Secondly, it will be necessary to consider the particular duty or duties relevant to imposing liability for insider trading, which would apply to them.

#### (a) INSIDERS AS FIDUCIARIES OF THE COMPANY

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<sup>81</sup> L.C.B. Gower, *Gower's Principles of Modern Company Law* (4 ed., Stevens Ltd, London, 1979) 572. See also, J. Farrar & M. Russell, *Company Law and Securities Regulation in New Zealand*, above n.22, 224, where it is observed that the director's position has been said to be analagous to that of a trustee. However, this description has severe limitations. The chief of these is the different role played by trustees *vis-a-vis* the taking of risks. The law of trusts does not grant a wide discretion to trustees, as their normal function is to preserve the trust capital at all costs. By contrast, directors as fiducaries necessarily take risks, and the Courts have always been reluctant to interfere with their business judgement.

<sup>82</sup> See, P.D. Finn, *Fiduciary Obligations* (Law Book Co., Sydney, 1977) 2.

<sup>83</sup> See, *Great Eastern Railway Co v Turner* (1882) LR Ch 149, Lord Selborne at 152; *Selangor United Rubber Estates Ltd v Craddock (No. 3)* [1968] 2 All ER 1073, 1091-1094.

<sup>84</sup> See J. Farrar & M. Russell, *Company Law and Securities Regulation in New Zealand*, above n.22, 224.

<sup>85</sup> See, *Canadian Aero Services Ltd v O'Malley* [1974] 40 DLR (3d), Laskin J. at 381; L.C.B. Gower, *Gower's Principles of Modern Company Law*, above n.81, 574; P.D. Finn, *Fiduciary Obligations*, above n.82, 201.



would be those professional advisers, such as bankers, brokers and lawyers, who undertake to act for or on behalf of the company in some particular matter or matters.<sup>86</sup> These three categories, (directors, officers and professional advisers), are relatively clear cut, but beyond that the position is somewhat blurred. Whether employees of the company would be regarded as fiduciaries for these purposes is debatable and will depend on the facts of the case<sup>87</sup>, always bearing in mind that the categories of fiduciaries are not closed.<sup>88</sup> In any event, company employees will owe a general duty of good faith or fidelity which may be sufficiently wide to impose liability for insider trading.<sup>89</sup>

It is unlikely that parties in a business relationship with the company, such as a major supplier or creditor would be regarded as being in a fiduciary relationship with the company,<sup>90</sup> even though that relationship may offer opportunities to acquire unpublished price-sensitive information about the company. It also seems that no fiduciary duties would be owed to the company by the employees of its professional advisers.<sup>91</sup> Thus, it is clear that not all of the parties who may indulge in insider trading will be held to account as fiduciaries to the company, in whose shares they have traded.<sup>92</sup>

86 See, P. D. Finn, *Fiduciary Obligations*, above n.82, 201.; L.S Sealy, "Fiduciary Relationships" (1962) CLJ 69, 76; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378; *English v Dedham Vale Properties Ltd* [1978] 1 All ER 382.

87 The decision of *Reading v A-G* (1951) AC 507, seems to suggest that courts may find employees in such a fiduciary relationship if they wish; see R. Goff & G. Jones, *The Law of Restitution* (3 ed., Sweet & Maxwell Ltd, London, 1986) 633. An example of an American court finding a company employee liable for insider trading at common law on a fiduciary basis is *Brophy v Cities Service Co.* 70 A (2d) 5 (1949).

88 See, *Tate v Williamson* (1866) LR 2 Ch App 44; *New Zealand Netherlands Society v Kuys* [1973] 2 NZLR 163; *Boston Deep Sea Fishing v Ansell* (1888) 39 Ch D339.

89 See, P.D. Finn, above n.82, 266; *Faccenda Chicken Ltd v Fowler* [1986] 1 All ER 617; *Wessex Dairies Ltd v Smith* [1935] 2 KB 80. In practice the company employee's obligations regarding the use of confidential information is probably the most appropriate basis for liability.

90 The courts' reluctance to treat this category of "insiders" as fiduciaries stems from the fact that parties in such business relationships are acting in their own interests, and not on behalf of the company. See, L. Lehane, "Fiduciaries in a Commercial Context"; in P.D. Finn (ed), *Essays in Equity* (Law Book Co Ltd, Sydney, 1985) 95; R. Goff & G. Jones, supra n.87, 633.

91 Although, P.D. Finn, above n.82, argues at 203 that this is not to say that it would not be possible to create fiduciary relationships in that situation, where the employee is to substantially perform their employer's undertaking and is aware that what they are doing is for the company's benefit. This limitation on the scope of fiduciary duties is illustrated by the famous American case *US v Chiarella* 445 US 222 (1980), where an employee of a printing firm had decoded takeover documents which his employer was printing on behalf of a company. Having identified the target companies from the documents the employee purchased shares in these companies ahead of public announcements of the takeover bids. The United States Supreme Court held that the employee was not in a fiduciary relationship with the target companies in whose shares he dealt, as he was not an insider of these companies. Neither was he in a fiduciary relationship with the victims he had purchased shares from as he had no prior dealings with them, he was not their agent nor was he a person in whom they had placed their trust and confidence. However it must be pointed out that the court did not consider whether the defendant had broken any duty to his employer or to the company which engaged his employer, for the issue had not been put to the jury.

92 This is not to suggest that those not covered will escape liability under common law, for they may well be subject to other constraints such as breach of confidence.



### *Profit Making By Fiduciaries*

"I can resist anything but temptation" said Oscar Wilde.<sup>93</sup> Most human beings seem equally equipped to face the world. Those persons who are in a fiduciary relationship with a company are likely to be presented with more temptations than most, for their relationship with a company may give them access to valuable economic information and, while they are required to serve the company's interests, they will often encounter clear opportunities to enrich themselves. However, one of the most important duties a fiduciary owes to the company is that they will not place themselves in a position where their duty to the company and their own interests conflict or may conflict.<sup>94</sup> Thus, fiduciaries are required to put the interests of the company before their own.<sup>95</sup> In the context of insider trading, a fiduciary who pursues their own interests by purchasing or selling shares in the company would not appear to be in conflict with the interests of the company, as companies in New Zealand are unable to purchase their own shares.<sup>96</sup> However, notwithstanding this logical difficulty, "the building blocks are at hand"<sup>97</sup> as one particular aspect of the conflict of interest' duty which is of greatest relevance in the insider trading context is the rule of equity that a person who is in a fiduciary relationship with the company is not entitled to profit from that position.<sup>98</sup> This "no-profit" rule has been rigorously applied by the courts, as illustrated by the leading decisions of *Regal (Hastings) Ltd v Gulliver*<sup>99</sup>,

93 *Lady Windermere's Fan*, Act I; see, H.M. Hyde (ed), *Oscar Wilde, The Complete Plays* (Methuen Ltd, London, 1988) 38.

94 *Aberdeen Railway Co Ltd v Blaikie Brothers* (1854) 1 Macq 642, 471-472; *Bray v Ford* (1896) AC 44, 51; *Boulting v ACTA* [1963] 1 All ER 716, 728; *New Zealand Netherlands Society v Kuys* [1973] 1 WLR 1126, 1129.

95 See, *Bray v Ford* (1896) AC 44, per Lord Herschell at 51-52; "It is an inflexible rule of a Court of Equity that a person in a fiduciary position ... is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger in such circumstances, of the person holding a fiduciary position being swayed by interest, rather than by duty, and thus prejudicing those whom he was bound to protect."

96 See, *Trevor v Whitworth* (1887) 12 App Cas 409.

97 L. Loss, "The Fiduciary Concept as applied to Corporate 'Insiders' in the United States" (1970) 33 MLR 34, 34.

98 See, *Bray v Ford* (1896) AC 44, Lord Herschell at 51; *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378; *New Zealand Netherlands Society v Kuys* [1973] 2 NZLR 163, Lord Wilberforce at 166.

99 [1942] 1 All ER 378. The directors of *Regal (Hastings) Ltd* (hereinafter to be referred to as the company) wished to extend the company's operation by the acquisition of two cinemas in addition to those already owned. Thereby, a subsidiary company was set up with the share capital in it being subscribed for by *Regal* itself, four of its directors, the company's solicitor and certain third parties introduced by the company chairman. These individual shareholders agreed to subscribe for the shares after *Regal* was unable to raise more than £2,000 of the £5,000 share capital required for the subsidiary. Eventually the business was taken over by means of a sale of the shares in *Regal* and the subsidiary. The net result was that the shareholders in the subsidiary made a profit of almost £3 per share on their holdings. The new owners of *Regal* promptly sued to recover these



*Boardman v Phipps*<sup>100</sup> and *Industrial Development Consultants Ltd v Cooley*.<sup>101</sup> In particular, it is seen to be irrelevant that profits sought by the fiduciary could not have been obtained by the company. The fiduciary will be held strictly liable to account for any profits gained by virtue of their relationship with the company.<sup>102</sup>

It seems clear that fiduciaries would therefore be liable to account to the company for personal profits gained from share purchases, where their position as a fiduciary has enabled them to exploit unpublished price sensitive information.<sup>103</sup> However, the position is not so clear when a fiduciary has used such information in selling their existing shareholdings, thereby avoiding a loss on the release of some adverse news. At first glance this situation does not appear to fall foul of the no-profit rule as there is not a profit in the usual sense of the word.<sup>104</sup> However, since the essence of the no-profit rule is to prevent a fiduciary making gains from their position within the company, it is arguable, therefore, that the concept of a profit should be interpreted in a wide sense so as to include the use of a fiduciary position to avoid a loss that would otherwise be suffered.

It may be argued that the policy which underlies the 'conflict of interest' duty from which the 'no-profit rule' is derived, is the deterrence of possible prejudice or injury to the company.<sup>105</sup> As previously noted<sup>106</sup> it is difficult to identify any particular loss or injury<sup>107</sup> suffered by the company as a result of insider trading, except in those cases where a

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profits. The House of Lords found that the directors had obtained their profits by reason and in the course of the execution of their office. The directors were thus liable to account to the company. It appeared to make no difference that the directors had acted bonafide throughout, and that the company could not have exploited the opportunity to acquire the shares of its intended subsidiary since it did not have the necessary cash assets.

100 [1967] 2 AC 46. A solicitor who acted for a family trust and one of the beneficiaries had used confidential information about a company, which they had obtained while representing the interests of the trust, to purchase shares in the company at an undervalue and subsequently recovered substantial profits on them. They were held liable to account to the family trust despite the fact that they had acted honestly throughout, that the trust had not been harmed but had actually benefitted from the transactions in question, and that the trust could not itself have brought the shares.

101 [1972] 2 All ER 162. In this case a managing director had privately entered into a business contract, which he gained knowledge of by virtue of his position as a director. The court held that the director was liable to account to the company for the benefits derived under this contract, despite the fact that the company itself could not have gained the contract in question.

102 Supra n.100 and n.102.

103 It might also be noted that directors cannot escape liability to account to the company for such profits, by means of resignation from the board either before or after the profit is made. See, *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162.

104 See, P.D. Finn, above n.82, at 127 for a discussion on the question of imposing liability in respect of savings made rather than profits gained.

105 See, *Bray v Ford* (1896) AC 44, per Lord Herschell 51-52.

106 See, above n.37.

107 One possible source of corporate injury was identified in *Diamond v Oreamuno* 248 NE 2d 910 (1969) where Chief Judge Fuld observed at 912 that: "despite the lack of any specific allegation of damage, it may well be inferred that the defendants' actions might have caused some harm to the



fiduciary has diverted a 'corporate opportunity' for themselves.<sup>108</sup> Thus, the use of such a fiduciary duty to constrain the practice of insider trading in the absence of any particular injury to the company arguably results in a distortion of the fundamental policy which underlies this duty.

### *Ratification*

It is clear that the company in a general meeting of shareholders, at least if it acts unanimously, can waive a fiduciary's liability to account for a breach of the 'no-profit rule'.<sup>109</sup> However, where they purport to ratify such a breach by a simple majority in a general meeting, the answer is less clear cut. In the *Regal* decision<sup>110</sup>, the House of Lords assumed, without much discussion, that the directors as controlling shareholders could have protected themselves against any liability to account had they obtained the prior or subsequent approval of the general meeting<sup>111</sup>. There is some difficulty however, in reconciling this view with the decision in *Cook v Deeks*<sup>112</sup>, where it was held by the Privy Council that fiduciaries could not make a present of corporate assets for themselves, by exercising their voting control of the general meeting to ratify a diversion of profits away from the company and into their own pockets.<sup>113</sup>

These two cases are usually distinguished on the basis that *Regal* would permit the ratification of *bona fide*, incidental, profit making as opposed to the *malafide* expropriation

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enterprise. Although the corporation may have little concern with the day-to-day transactions in its shares, it has a great interest in maintaining a reputation of integrity, an image of probity, for its management and insuring the continued public acceptance and marketability of its stock. When officers and directors abuse their position in order to gain personal profits, 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."

108 See, J. Farrar & M. Russell, *Company Law and Securities Regulation in New Zealand*, above n.22, 247; see also, *Regal (Hastings) Ltd v Gulliver* [1942] 1 All ER 378; *Cook v Deeks* [1916] 1 AC 554; *Industrial Development Consultants Ltd v Cooley* [1972] 2 All ER 162.

109 *New Zealand Netherlands Society v Kuys* [1973] 2 NZLR 163; J. Farrar & M. Russell, above n.22, 249.

110 [1942] 1 All ER 378, Lord Russell at 389.

111 Permitting such ratification would tie in with the view supported by Carlton & Fischel, who argue that insider trading is purely an internal matter to be regulated contractually between the directors and the shareholders. See, D.W. Carlton & D.R. Fischel, "The Regulation of Insider Trading," above n.36, 857.

112 [1916] 1 AC 554. In this case three out of four directors of a railway company diverted a contract in which the company was interested to another company owned by the directors. These three directors used their voting control of the general meeting to secure the passing of a resolution declaring that the company had no interest in the contract. The Privy Council refused to permit the general meeting to ratify such conduct, finding that the contract in question was entered into in such circumstances that it belonged in equity to the company and ought to have been dealt with as an asset of the company. The directors had acquired it for themselves while acting ostensibly for the company, therefore, they held the contract on trust for the company. Thus, the directors could not retain the benefit of the contract.

113 [1916] 1 AC 554, Lord Buckmaster L.C. at 564.



of corporate assets which *Cook v Deeks* represents.<sup>114</sup> If that is the true distinction, into which category would insider trading fall? It is submitted that insider trading by a fiduciary is unlikely to be regarded as a *Regal* type *bonafide* incidental, profit making situation. It is more likely, in light of present day attitudes to such conduct,<sup>115</sup> to be regarded as a misappropriation of company assets (in the form of unreleased price-sensitive information) as in *Cook v Deeks*<sup>116</sup>. Thus, such conduct may not be ratifiable by a simple majority in a general meeting, for the "majority cannot directly or indirectly appropriate to themselves money, property or advantages which belong to the company, or in which the other shareholders are entitled to participate."<sup>117</sup> Such a breach could therefore only be ratified by the company in a general meeting if a majority of shareholders who are independent of the wrongdoing fiduciary voted to waive that fiduciary's liability to account.<sup>118</sup>

However, if the matter is found to be capable of ratification by a simple majority as in the *Regal* decision, then a wrongdoing fiduciary can vote as a shareholder to ratify their own misconduct.<sup>119</sup> Unless expressly stated in articles of the company ratification is not required to be carried out by a disinterested majority independent of the wrongdoing fiduciary. It is submitted that such a requirement would be undesirable as the resulting resolution would only reflect the interests of disinterested shareholders. Such a process would obscure the proper focus of enquiry, which is the interests of the company as a general body.<sup>120</sup> In any event, the interests of disinterested shareholders may be

<sup>114</sup> See, L.S. Sealy, above n.86, 262. See also, L.C.B. Gower, above n.81, who notes at 617 that providing a satisfactory answer to the distinction between these two cases is difficult and perhaps impossible. One distinguishing feature which might be noted is that in *Cook v Deeks* the majority in general meeting was comprised of the very individuals who had diverted the contract to themselves whereas in *Regal* there is some suggestion that Lord Russell had in mind ratification by a majority in general meeting which was independent of the wrongdoers. An independent ratification requirement however must be doubted, for company law has never required wrongdoing directors to abstain from exercising their votes as shareholders to ratify their breaches of duty, see *Northwestern Transportation Co Ltd v Beatty* (1887) 12 App Cas 589; *Burland v Earle* [1902] AC 83, Lord Davey at 94.

<sup>115</sup> The evidence supporting this claim as to present day attitudes in New Zealand towards the conduct of insider trading is, perhaps unavoidably, largely anecdotal.

<sup>116</sup> This approach requires that information be accepted as property in the sense of being a corporate asset. There is some support for this view in *Boardman v Phipps* [1967] 2 AC 46, where Lord Cohen at 103, while accepting information was not property in the strictest sense of the word, still regarded it as an asset of the trust which trustees could not appropriate for themselves. Both Lord Hodson at 103 and Lord Guest at 115, accepted that confidential information could be regarded as the property of the trust. However, Lord Upjohn at 127 was unwilling to accept that information could be treated as property. See, R. Goff & G. Jones, above n.87, 653.

<sup>117</sup> *Burland v Earle* [1902] AC 83, Lord Davey at 93; *Estmanco (Kilner House) Ltd v GLC* [1982] 1 All ER 437.

<sup>118</sup> Above n.114.

<sup>119</sup> *North Western Transportation Co Ltd v Beatty* (1887) 12 App Cas 589; *Burland v Earle* (1902) AC 83, Lord Davey at 94. See also, J. Farrar & M. Russell, above n.22, 264.

<sup>120</sup> See, Law Commission, "Report No.9, Company Law Reform and Restatement" (Wellington, 1989), para 535.



adequately protected by s.209 of the Companies Act 1955<sup>121</sup>, as the exercise of defacto voting control over a general meeting by interested shareholders so as to ratify their own wrongdoing, could amount to 'unfairly prejudicial' conduct.<sup>122</sup>

### *Liability to the Company*

It must be emphasised that the fiduciary relationship here is between the company whose unpublished price sensitive information is used or disclosed and the individual fiduciary. Therefore, where the profit making by fiduciaries is not ratifiable (or if while ratifiable, it has not yet been ratified), then an action for breach of fiduciary duty would lie in the hands of the company, and not with any individual victim of the insider trading (i.e., a shareholder<sup>123</sup>). As to the nature of the liability imposed, the basic position is that any fiduciary who profits from their position of trust will hold that profit on constructive trust for the company.<sup>124</sup>

### *The Rule in Foss v Harbottle* <sup>125</sup>

If the company decides not to initiate proceedings against a fiduciary who has received a profit by means of insider trading, the question arises as to whether a derivative action on behalf of the company for breach of duty would be available to a shareholder invoking the "fraud on the minority" exception to the rule in *Foss v Harbottle*.<sup>126</sup> It is submitted that such a breach of duty would satisfy the initial requirement of this exception that, the action sought to be brought is one that cannot be ratified by a simple majority of the company in a general meeting,<sup>127</sup> for reasons previously stated.<sup>128</sup> The shareholder is also required to show that the wrongdoers are in control of the company and are thus preventing such an action being brought. This may be problematic, as the company's decision not to proceed against a fiduciary who has profited from their position of trust by means of insider trading

121 See, J. Farrar & M. Russell, above n.22, 264.

122 *Cook v Deeks* 1916] 1 AC 554, per Lord Buckmaster L. C. at 564-565: "Even supposing it be not ultra vires of a company to make a present to its directors, it appears quite certain that directors holding a majority of votes would not be permitted to make a present to themselves. This would be to allow a majority to oppress the minority ..."

123 The issue of whether an insider trader may owe fiduciary duties to the shareholders of a company will be considered further below. See, below n.132.

124 See, R. Goff & G. Jones, above n.87, 656.

125 (1843) 2 Hare 461.

126 (1843) 2 Hare 461. See, J. Farrar & M. Russell, above n.22, 262.

127 If the breach is capable of being ratified, then a derivative action will not lie, since there is no objection to fiduciary's using their votes to exculpate themselves in such circumstances; see, *Northwestern Transportation Co. Ltd v Beatty* (1887) 12 App Cas 589. However, ratifying one's own wrongdoing may amount to unfairly prejudicial conduct within s. 209 of the Companies Act 1955; see, J. Farrar & M. Russell, above n.22, 264.

128 Above n.118.



may not always be a reflection of the wrongdoers ability to control the general meeting but, rather, a decision by the company that such proceedings would result in adverse publicity for the company, which would damage its standing in the financial market's and thus would not be in the best interests of the company.

Even if a derivative action could be brought, individual shareholders have little incentive to pursue such a course, particularly in light of the fact that any benefit gained would be held on behalf of the company and would not advantage the individual shareholder.<sup>129</sup> Indeed, to the extent that the fiduciary engaging in insider trading is also a shareholder, then some of the retrieved profit would actually find its way back to them.<sup>130</sup> The incentive to bring a "derivative action" against the fiduciary who is in breach would be greatest for any shareholder who has sold some<sup>131</sup> of their shares at the same time as the fiduciary purchased shares in the market; but even such a shareholder as this is unlikely to favour such an action which retrieves what they perceive to be their loss and delivers it to the company.

#### (b) DIRECTORS AS FIDUCIARIES OF THE SHAREHOLDERS

This brings us to the question of whether a shareholding victim of a director<sup>132</sup> engaging in insider trading has any cause of action against such a director. Does a director owe any fiduciary duties to shareholders?

The orthodox approach is that set out in *Percival v Wright*<sup>133</sup>, such that directors do not owe any fiduciary duties to individual shareholders. This case therefore represents a major obstacle to any attempt by shareholders to seek civil remedies against directors.<sup>134</sup> However, it has long been accepted that there may be limited circumstances or "special

129 The plaintiffs would therefore only benefit indirectly; i.e., through the fact of their shareholding in the company.

130 How much they would retrieve would, of course, depend on the size of their shareholding.

131 If they have sold their entire shareholding they would lack *locus standi* to bring such a derivative action.

132 It is submitted that there is little likelihood of any fiduciary relationship being established between shareholders and such insiders as company officers or professional advisers who may not be in sufficient proximity to the shareholders to give rise to a fiduciary relationship.

133 [1902] 2 Ch 421. This case involved an action to set aside a sale of shares in a limited company, on the ground that the purchasers, being directors, ought to have disclosed to the vendor shareholders certain pending negotiations for the sale of the company's undertaking. The court found, on the facts, that the directors did not owe any duty of disclosure to the shareholders and could purchase their shares without disclosing the fact of the negotiations. Swinfen Eady J. stated at 426 that the contrary view would place directors in a most invidious position, as they could not buy or sell shares without disclosing negotiations, a premature disclosure of which might well be against the interests of the company.

134 The *Percival v Wright* approach has recently been followed by the Supreme Court of Western Australia in *Divine Holdings Pty Ltd v Paracel Pty Ltd* [1980] 4 ACLR 928.



facts",<sup>135</sup> which could result in the creation of an independent fiduciary relationship between a director and an individual shareholder. This occurred in *Allen v Hyatt*<sup>136</sup>, where directors of the company put themselves in a fiduciary relationship with some of the shareholders when they undertook to sell those individuals' shares in an agency capacity. Even without such a specific appointment directors may, in particular circumstances, find themselves within a special relationship with the shareholders which requires disclosure of all material facts, as was accepted by the New Zealand Court of Appeal in the influential case of *Coleman v Myers*.<sup>137</sup> The special facts in this case which caused the directors to owe a fiduciary duty of disclosure to shareholders<sup>138</sup> were found to be:<sup>139</sup>

"... the family character of the company; the position of the father and son in the company and the family; their high degree of inside knowledge; and the way they went about the takeover and the persuasion of the shareholders".

The courts have also been prepared to regard the context of a takeover as providing the necessary "special circumstances" for fixing fiduciary duties upon directors towards individual shareholders. For example, in *Gething v Kilner*<sup>140</sup> Brightman J considered that where a take-over bid had been made, the directors of the offeree company were under a duty to their own shareholders to be honest and not to mislead such shareholders into accepting an inadequate price for their holdings. Thus, directors of an offeree company who purchase shares from existing shareholders while in possession of such price-sensitive information concerning a take-over bid may well owe a fiduciary duty to disclose such material information to the vendor shareholders.

135 This concept is somewhat akin to the "special facts doctrine" accepted long ago in the United States as the common law forerunner to their extensive statutory scheme for insider trading. The "special facts doctrine" as expounded by the United States Supreme Court in *Strong v Repide* 213 US 419 (1909) extended the duties of directors to imply a fiduciary obligation towards shareholders where special facts existed (i.e., where a director purchased shares from a shareholder without informing them of an impending sale of the company's assets which would affect the value of the shares).

136 [1914] 30 TLR 444.

137 [1977] 2 NZLR 225. This case involved the take-over at an undervalue of a family company by a company formed by one of the respondent directors of the family company. The respondents held the positions of chairman and managing director of the family company. Essentially it was alleged that the respondents had obtained control of the family company by buying out the other shareholders from whom the true value of the company's assets had been concealed.

138 The directors were held to owe a fiduciary duty to these shareholders to disclose material matters, as to which they knew or had reason to believe that these shareholders would not be adequately informed of.

139 [1977] 2 NZLR 225, per Cooke J. at 330.

140 [1972] 1 All ER 1166.



From these cases it is clear that the courts will not automatically impose a fiduciary duty of disclosure upon directors when they enter into transactions with the company's shareholders. However, the courts will consider imposing such a duty where there are face-to-face negotiations between the parties which gives rise to a relationship between the parties in which the shareholder obviously relies on the director to disclose all material information.<sup>141</sup> This will undoubtedly be of considerable significance in closely held private companies where there is likely to be face-to-face share dealings between a director and a shareholder. However, such a duty may be unsuitable in the context of a publicly listed company where most of the trading will occur on an impersonal level through the stock exchange,<sup>142</sup> where neither the shareholder or the director can identify the person on the 'other side' of the transaction. Indeed, as Langevoort points out,<sup>143</sup> neither party knows nor cares who their buyers or sellers are, there is no bargaining similar to that in face-to-face transactions, and furthermore, given the essential independence of the buyer and seller's decisions to deal, causation and injury are difficult to trace. Thus, such a duty is unlikely to have any impact in the context of stock exchange dealings where none of the special circumstances<sup>144</sup> relied upon in *Coleman v Myers* are likely to be present. Mr Justice Mahon expressly recognised this obstacle in the *Coleman* case and concluded that in the context of transactions conducted anonymously through the stock exchange the regulation of directors liability to shareholders for insider trading must be left to the legislature.<sup>145</sup>

141 C. Patterson, "Insider Trading and the Director," in J. Farrar (ed), *Contemporary Issues in Company Law* (C.C.H. NZ Ltd, Auckland, 1987) 178.

142 However, there does not appear to be any reason why the 'special circumstances' approach should not apply to share transactions between directors and shareholders of all companies, including those listed on the Stock Exchange, when the transaction is preceded by direct communication between the parties. There are as yet no New Zealand cases where the Court has applied the fiduciary duty in this way; see, C. Patterson, above n.141, 179. See also, *Coleman v Myers* [1977] 2 NZLR 225, Mahon J. at 278.

143 D. C. Langevoort, "Insider Trading and the Fiduciary Principle: A Post-*Chiarella* Restatement", 70 Calif L.Rev 1, 7 (1982).

144 Above n.139.

145 [1977] 2 NZLR 225, per Mahon J. 278: "The application of the rule so assumed to exist must necessarily be confined to private companies and to such transactions in public company shares, listed or otherwise, where the identity of the shareholder is known to the director at the time of the sale ... [I]n the case of stock exchange purchases and sales the regulation of insider trading must be left to the legislature." As shall be seen this statement was a prophesy of things to come, as Part I of the Securities Amendment Act 1988 which was introduced to deal with the problem of insider trading in New Zealand's securities markets, will only apply to public issuers of securities listed on a stock exchange (i.e. publicly listed companies). See, below n.268.



(c) DIRECTORS AS FIDUCIARIES TO PERSONS OUTSIDE THE COMPANY

Given the difficulties outlined above in establishing some fiduciary relationship between a director and an existing shareholder, it is submitted that no such liability will exist between a director and a party who is not an existing shareholder. The imposition of a fiduciary duty depends on a pre-existing relationship between the fiduciary and the principal. Thus, a director who engages in insider trading by selling their shareholding in advance of disappointing results to a purchaser who isn't an existing shareholder, will not be found liable to account to such a purchaser on the basis of any fiduciary relationship. Consequently, directors in possession of price-sensitive information may trade with persons outside the company with relative impunity.<sup>146</sup>

It is, therefore, anomalous that where a shareholder can establish that a fiduciary duty of disclosure is owed to them by directors under the "special facts" approach discussed in the previous section,<sup>147</sup> they will have redress against a director engaging in insider trading, but that no relief at all is available where fortuitously the person with whom the director deals is a complete outsider. However, in the United States where r.10b-5 of the Securities Exchange Act 1934 applies, the courts have interpreted that provision as imposing upon the insider "[a]n affirmative duty to disclose material facts known to them by virtue of their position"<sup>148</sup> to both existing shareholders and complete outsiders. This was demonstrated in the *Re Cady, Roberts & Co.* decision where the SEC refused to limit the application of r.10b-5 to existing shareholders noting that such an approach was too narrow and ignored the plight of the buying public.<sup>149</sup>

146 However, such directors may well be subject to other constraints. See, above n.16 and n.17.

147 See, above n.135.

148 *Re Cady, Roberts & Co.* 40 SEC 907, 911 (1961).

149 40 SEC 907, 911-912 (1961). In this case an employee of a brokerage firm was also a director of a public company. At a director's meeting of that public company, the employee learned that the company was about to announce a reduction in its dividend. The employee/director passed this information on to another partner in the brokerage firm. Before this information became publicly available, the partner sold shares in that public company out of a number of his customers' accounts. The SEC held in this case that there had been a breach of r.10b-5 of the Securities Exchange Act 1934. It stated that corporate insiders have a duty to disclose material facts known to them by virtue of their position, and which are not known to the persons they are dealing with, and which, if known would affect their investment decision. The SEC also noted at 911 that where the disclosure was inappropriate the transaction should be foregone by the insider.



(d) TIPPEE LIABILITY TO THE COMPANY AS A CONSTRUCTIVE TRUSTEE

In general terms an insider who communicates unpublished price-sensitive information to any other person has engaged in the act of "tipping," hence the recipient of that inside information is denoted by the term "tippee."<sup>150</sup> Tipping by insiders is an integral element in many insider trading schemes.<sup>151</sup> This raises a question as to whether any civil liability can attach to a tippee participating in such a scheme which involves a breach of fiduciary duty by the insider who discloses price-sensitive information to the tippee, so as to enable the tippee to trade on the basis of that inside information. Given that it is difficult, as noted above,<sup>152</sup> for anyone other than the company to found any liability on a breach of fiduciary duty, we will concentrate here on the possibility of the company recovering any insider trading profits made by a tippee.

The liability of the tippee will depend on whether third parties who participate in a fiduciary's breach of trust may be liable to account to the company as constructive trustees.<sup>153</sup> The classic statement of the circumstances in which a constructive trust may be imposed upon a "stranger" (i.e., the tippee who is outside the relevant fiduciary - principal relationship) is to be found in the judgement of Lord Selborne in *Barnes v Addy*:<sup>154</sup>

"[S]trangers are not to be made constructive trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees."

Lord Selborne's judgement is the source from which subsequent judgements have developed two separate categories whereby a constructive trust may be imposed upon a third party.<sup>155</sup> These two categories are;

<sup>150</sup> See, P. Mitchell, *Insider Dealing and Directors' Duties* (2 ed., Butterworths, London, 1989) 239-240.

<sup>151</sup> See, e.g., *Re Cady, Roberts & Co.* 40 SEC 907 (1961), as discussed above at n.149.

<sup>152</sup> Above n.146.

<sup>153</sup> See, C. Harpum, "The Stranger as Constructive Trustee" (1986) 102 LQR 114, 118-119 on the nature of a third party's liability as a constructive trustee. Generally the third party is required to account for any improper gain or to make good any loss suffered as a result of their actions.

<sup>154</sup> (1874) 9 LR. Ch.App 224, Lord Selborne at 251-252.

<sup>155</sup> *Selangor United Rubber Estates Ltd v Craddock (No. 3)* [1968] 2 All ER 1073; *Karak Rubber Co Ltd v Burden* [1972] 1 All ER 1210; *Belmont Finance Corp Ltd v Williams Furniture Ltd (No. 2)* [1980] 1 All ER 393; *International Sales & Agencies Ltd v Marcus* [1982] 3 All ER 551; *Lipkin*



- (1) Where the third party has knowingly received trust property, disposed of in breach of trust; and
- (2) Where the third party has knowingly assisted in a dishonest and fraudulent design of the trustee.

Thus, the key requirement in order to impose liability under these two categories is 'knowing' participation by the third party in a breach of trust. However, difficulties have arisen over the degree of knowledge which must be established under each category and the position has been clouded by the often conflicting formulations in the cases as to the appropriate standard to be applied.<sup>156</sup> It is therefore difficult to state the position with complete certainty and that caveat must be borne in mind when considering the relevant authorities.

#### (i) A Tippee Who Knowingly Receives Trust Property

The first category, that of third parties who receive company assets disposed of in breach of trust, brings us back to the issue discussed earlier;<sup>157</sup> can unpublished price-sensitive information be classified as 'corporate property'? Assuming that information can be classified as property in this way, tippees who receive unpublished price sensitive information would, according to the generally accepted view, be liable as constructive trustees to account for any gain made from such information, if they received the property with actual knowledge of the fiduciary's breach of trust or in circumstances in which they ought to have known of the breach.<sup>158</sup> It would seem that such a degree of knowledge could be established where, for example, the tippee is a participant in an insider trading scheme, where the individuals concerned act as either a tipper or a tippee, and where all such individuals are fully aware that the information is being wrongfully disclosed.<sup>159</sup> On the other hand, it is doubtful if the requisite degree of knowledge could be established where the tippee received the information in the course of a casual social conversation;

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*Gorman v Karpnale Ltd* (1987) BCLC 159. See generally, C. Harpum, above n.153; A.J. Oakley, *Constructive Trusts* (2 ed., Sweet & Maxwell, London, 1987) 85-111; G. Moffatt and M. Chesterman, *Trust Law: Text and Materials* (Weidenfeld and Nicholson Ltd, London, 1988) 606-607.

<sup>156</sup> See, G. Moffatt and M. Chesterman, above n.155, 609-613.

<sup>157</sup> Above n.114.

<sup>158</sup> *Belmont Finance Corp Ltd v Williams Furniture Ltd (No. 2)* [1980] 1 All ER 393; *International Sales & Agencies Ltd v Marcus* [1982] 3 All ER 551; *Lipkin Gorman v Karpnale Ltd* (1987) BCLC 159.

<sup>159</sup> It seems safe to assume that insider trading schemes would involve persons who are familiar with the workings of the securities market and thus would not be unaware of the nature and sources of such price-sensitive information which is being tipped to them.



although this would be subject to such factors as the degree of knowledge possessed by the tippee of matters such as the insider's position within the company concerned.

An illustration of the tippee problem is provided by the *Regal (Hastings) Ltd v Gulliver* decision,<sup>160</sup> discussed above,<sup>161</sup> where the chairman of the company did not purchase any of the shares himself and his involvement was limited to that of finding third parties to purchase shares in the subsidiary company. Thus, the chairman was not liable to account to the company because he had not profited from his position, and the third party purchasers (i.e. tippee's) were not party to the action presumably because, on the facts, they did not possess the requisite degree of knowledge to found any liability upon constructive trust. As a rule, however, where the insider does not profit himself, the third party could still be liable for the knowing receipt of corporate property, if the requisite level of knowledge can be established. Indeed, where the insider does not profit but has consciously broken their duty to the company by disclosing the information, then it has been suggested that the director should be liable to account to the company for the tippee's gain.<sup>162</sup> On the other hand where, as in *Regal*, the insider innocently discloses information in breach of trust, which a third party innocently uses, then it is submitted that it would be unlikely that liability would be imposed under the doctrine of constructive trust. This type of innocent disclosure by the fiduciary with no consequential liability for the innocent tippee was the basis for the well known United States decision, *SEC v Dirks*.<sup>163</sup> In this case the defendant, Dirks, was a financial analyst who received information from a former officer (Secrist) of a company (Equity Funding of America) that the assets of that company were vastly overstated as a result of fraudulent corporate practices. Secrist disclosed this information to Dirks because he wanted Dirks to investigate the fraud and disclose it publicly. In the course of carrying out his investigation Dirks discussed the information he obtained with his own clients, some of whom promptly sold their holdings in Equity Funding. In due course the authorities investigated Equity Funding and found the allegations to be true, and the company subsequently went into receivership. Obviously Dirks' clients had avoided a substantial loss by acting on the information "tipped" to them by Dirks. The SEC<sup>164</sup> took the view that Dirks, as a tippee, had been subject to a "disclose or abstain" obligation as a consequence of his being tipped by the

160 [1942] 1 All ER 378.

161 See, above n.99.

162 See, R. Goff & G. Jones, *The Law of Resitution*, above n.87, 653 who suggests that the insider should be liable for the gains which they have enabled the third party to make by their breach of fiduciary duty. This has happened in *SEC v Texas Gulf Sulphur Co* 401 F 2d 833 (1968) where the non-trading insiders were liable for their tippees gains under Rule 10b-5 (which was promulgated under §.10b of the Securities Exchange Act 1934).

163 103 S.Ct 3255 ; 77 L. Ed., 2d 913 (1983).

164 The Securities & Exchange Commission.



insider (Secrist) and duly prosecuted him for his conduct. The Supreme court disagreed, as they applied the now standard fiduciary-type approach set out in *US v Chiarella*,<sup>165</sup> that liability is premised upon a duty to disclose arising from a relationship of trust and confidence between the parties to the transaction, and accepted that he had not been under any duty to "disclose or abstain." A tippee's duty to disclose or abstain arose when there had been a breach of duty by the insider and the tippee knew or ought to have known of it. Therefore, whether the insider's tip constituted a breach of the insider's fiduciary duty is the first issue which must be decided, for not all disclosures of unpublished price sensitive information are inconsistent with the duty insiders owe to shareholders.<sup>166</sup> In the circumstances of this case there had been no breach by Secrist; he had not passed on the information to benefit personally, directly or indirectly.<sup>167</sup> He received no monetary benefit nor did he do it to make a gift of the information to Dirks. Instead he was clearly motivated by a desire to expose the fraud. As there was no breach by Secrist, Dirks could not be a participant in any breach of fiduciary duty by such an insider.<sup>168</sup>

It is obvious that imposing liability on the tippee's tippee, who may be referred to as the 'sub-tippee', is even more difficult. A sub-tippee may be quite unaware of the original source of the information, and may even possess certain doubts as to its accuracy, thus in practice it may be very difficult to establish that a sub-tippee necessarily knew that such information has been given in breach of duty. It is unlikely therefore that civil liability on this basis, can extend in practice to the sub-tippee.

#### (ii) A Tippee Who Has Knowingly Assisted in the Dishonest and Fraudulent Design of the Trustee

The second category to be considered is that which allows liability to be imposed on the basis of knowing assistance by third parties in the dishonest and fraudulent design of the insider.<sup>169</sup> Here too, there is considerable doubt over the degree of knowing involvement which is required, with the generally accepted view being that liability will arise where the

<sup>165</sup> 445 US 222 (1980).

<sup>166</sup> A legitimate disclosure would, for example, cover disclosure in the ordinary course of business (i.e., disclosure of information to professional advisers). If such a disclosure is legitimate then the person receiving it (tippee) is not receiving it in breach of any trust.

<sup>167</sup> See, 77 L. Ed, 2d 913, 927-928 (1983).

<sup>168</sup> See, 77 L. Ed, 2d 913, 927-928 (1983).

<sup>169</sup> The liability here will be a personal liability to account as no trust property will have been received; see, H. Hanbury & R. Maudsley, *Modern Equity* (13 ed., Stevens & Sons Ltd, London, 1989) 289; J. Nathan & O. Marshall, *Cases and Commentary on the Law of Trusts* (7 ed., Stevens & Sons Ltd, London, 1980) 413.



third parties actually knew of the breach of duty or wilfully shut their eyes to it.<sup>170</sup> This category, which is not dependent upon the receipt of property, is useful because it avoids the difficulties already encountered in treating information as property. However, it poses hurdles of its own in terms of the degree of knowledge required and the degree of wrongdoing required of the fiduciary. It is necessary, for example, to establish that the assistance was assistance in a dishonest and fraudulent design which, in this context, requires something more than mere misfeasance or breach of trust.<sup>171</sup> It must be fraudulent and dishonest in the plain understanding of those words.<sup>172</sup> It is submitted that in practice it is unlikely to prove difficult to establish such a dishonest and fraudulent design in most insider trading scenarios, although *Regal (Hastings) Ltd v Gulliver*<sup>173</sup> is an example of when it could not be established, for the court in this case found that the directors had acted bona fide throughout the disputed dealings.

As to the degree of assistance by a third party that is required, this will be of interest to individuals such as bankers and stockbrokers who often play an important role in any insider trading scheme by virtue of the services they supply within the securities market. Would a stockbroker who executed transactions for an insider trader be liable, where they are aware of the client's position of trust at the time of the trading and where they have subsequently become aware of the coincidence of such trading ahead of the release of price sensitive information? It is submitted that the answer is surely that they would not be liable, for they have simply facilitated an ordinary commercial transaction and had no grounds at that point in time for thinking that there was anything untoward. However, would the position be different if the same scenario had occurred on a number of occasions? What if the stockbroker continued to execute such transactions, because it was

<sup>170</sup> See, *Belmont Finance Corporation Ltd v Williams Furniture Ltd (No. 1)* [1979] All ER 118, where all the judges in the English Court of Appeal disagreed with the view supported by *Selangor United Rubber Estates Ltd v Cradock (No. 3)* [1968] 2 All ER 1073, and *Karak Rubber Co Ltd v Burden (No. 2)* [1972] 1 All ER 1210, which favoured the imposition of liability where the parties ought to have been aware of the breach of duty. On this point, see C. Harpum, "The Stranger as a Constructive Trustee" (1986) 102 LQR 114, at 152-154; R. Goff & G. Jones, *The Law of Restitution*, above n.87, at 718. Support for the *Selangor* and *Karak* approach can more recently be found in *Baden Deluau and Lecuit v Societe Generale etc* (1983) BCLC 325. However, the consensus among the commentators seems to be in favour of the *Belmont* case approach, see H. Hanbury & R. Maudsley, above n.169, at 292.

<sup>171</sup> Dishonest and fraudulent are regarded as having the same meaning for these purposes; see *Belmont Finance Corporation Ltd v Williams Furniture Ltd (No. 1)* [1979] 1 All ER 118, Buckley L.J. at 130. In *Baden Deluau and Lecuit v Societe Generale* (1983) BCLC 325, Gibson J. stated at 409 that the dishonest design was the taking of a risk to the prejudice of another's rights, which risk is known to be one which there is no right to take. A wider interpretation of the phrase (that it was sufficient if the design assisted was of a morally reprehensible character) that was suggested by Ungoed Thomas, J. in *Selangor United Rubber Estates Ltd v Cradock (No. 3)* [1968] 2 All ER 1073, at 1105, was rejected in *Belmont Finance Corporation Ltd v Williams Furniture Ltd (No. 1)* [1979] 1 All ER 118. See, C. Harpum, above n.170, 416.

<sup>172</sup> *Belmont Finance Corporation Ltd v Williams Furniture Ltd (No. 1)* [1979] 1 All ER 118, 130.

<sup>173</sup> (1942) 1 All ER 378.



good business for them, after they might have already become suspicious? Could they be said to be wilfully blind to the insider's breach of trust, thereby giving rise to a liability to account? Certainly the imposition of liability in an appropriate case on such a third party would have a beneficial effect by enhancing the degree of self-regulation of insider trading as brokers and other such third parties acted to protect their own positions. It is submitted, however, that it is by no means clear that liability would arise, for establishing the degree of knowledge required and the active involvement of the stockbroker in the dishonest design may present insurmountable difficulties.<sup>174</sup> Another possibility is the situation where the stockbroker engages in copycat trading; i.e., where the stockbroker follows, on his own account, the trading of a client, the client being an individual engaged in insider trading. It is submitted that as there is neither receipt of corporate property disposed of in breach of trust, nor knowing assistance in a dishonest design, it would therefore seem that no liability on the basis of constructive trust would arise.

#### (e) AN OVERVIEW OF FIDUCIARY DUTIES AND INSIDER TRADING

By way of conclusion, it may be observed that the fiduciary duty approach will only stretch so far; and it begins to look frayed when used to impose liability on anyone not clearly in an immediate fiduciary relationship with the company. Another example of its limitations can be seen in *United States v Carpenter*<sup>175</sup>, a case involving a journalist employed by the *Wall Street Journal* who told friends of the stocks which he was going to mention in his influential column, thus enabling them to trade in those stocks ahead of the market. Obviously the journalist was not in any fiduciary relationship with those persons who were the supposed victims of that insider trading and so this case is difficult to place within a fiduciary framework. However, criminal convictions were secured against the defendant under section 10b of the Securities Exchange Act of 1934 on the basis that he had misappropriated this price-sensitive information from his employer, the *Wall Street Journal*, which therefore imposed an obligation upon him to disclose such information or abstain from trading. This switch from considering the wrong to the persons with whom they traded to considering the wrong to the persons from whom they obtained the information is interesting, for it is the jurisprudential route which is of use for the purposes of civil liability in an action for breach of confidence, to which we now turn.

<sup>174</sup> Given that the emphasis in this category is on the third parties' involvement in the dishonest design of the fiduciary, it is unlikely (but not impossible) that a broker would be found liable without, for example, them having actually been a member of the insider trading ring.

<sup>175</sup> 108 S.Ct 316 ; 98 L. Ed 2d 275 (1987).



## (2) BREACH OF CONFIDENCE AND INSIDER TRADING

The notion of a confidence may be described as the relation of intimacy or trust between two parties, one of whom (the confider) has imparted private or secret matters to another (the confidant). As noted earlier,<sup>176</sup> the law protects the company by enabling it to require persons working under service contracts to observe confidentiality by virtue of their fidelity covenant, expressed<sup>177</sup> or implied<sup>178</sup>. But a broader principle of equity is said to transcend this purely contractual relationship, "that he who has received information in confidence shall not take unfair advantage of it".<sup>179</sup> Thereby, under this equitable doctrine, confidences are enforceable through the action of "breach of confidence".<sup>180</sup> This restriction on the use of information divulged in confidence may afford a basis for protecting inside information, for "if a defendant is proved to have used confidential information, directly or indirectly obtained from a plaintiff, without the consent, express or implied of the plaintiff, he will be guilty of an infringement of the plaintiff's rights".<sup>181</sup>

While breach of confidence actions mainly concern trade secrets and intangible industrial property, the protection of price-sensitive information, whether or not amounting to 'corporate property', is technically within this jurisdiction, certainly where it concerns the relationship between a company and its servants (e.g. directors). As we shall see, this equitable jurisdiction may be of sufficient width to encompass an action by a confider in respect of the unauthorised use or disclosure of unpublished price sensitive information. Indeed it is the very width of this jurisdiction, which may make it a valuable form of action

<sup>176</sup> Above n.89.

<sup>177</sup> When a person, under the terms of an express contract, agrees to communicate specific information to another and/or permits that other to have access to material which may be a source of information, that person can stipulate in the contract that the information communicated or acquired shall be kept secret and confidential, that it can only be used by the recipient for the purposes designated in the agreement and that it can be further communicated only to the extent provided in the agreement. A confidential relationship may thus be fully constituted by express contractual terms. Capable of covering a wide range of inside information, such stipulations are common in contracts of employment, consultancy agreements, licences for the use of industrial information and agreements giving access to financial information for the purposes of raising finance or obtaining credit. See, *A B Consolidated v Europe Strength Food Co* [1978] 2 NZLR 515, 520; P.D. Finn, *Fiduciary Obligations*, above n.82, 184; J.A. Suter, *The Regulation of Insider Dealing in Britain* (Butterworths, London, 1989) 185.

<sup>178</sup> In a contract of employment a term as to confidentiality may be implied. See, *New Zealand Needle Manufacturers Ltd v Taylor* [1975] 2 NZLR 33, 41; *Wilson Malt Extract Co Ltd v Wilson* [1919] NZLR 659; *A B Consolidated v Europe Strength Food Co* [1978] 2 NZLR 515.

<sup>179</sup> *Seager v Copydex* [1967] 2 All ER 415, Lord Denning at 417; *Schering Chemicals Ltd v Falkman Ltd* [1981] 2 All ER 321; *A B Consolidated v Europe Strength Food Co* [1978] 2 NZLR 515, 520-521.

<sup>180</sup> See, F. Gurry, *Breach of Confidence* (Clarendon Press, Oxford, 1984) 3.

<sup>181</sup> *Saltman Engineering Co. Ltd v Campbell Engineering Co. Ltd* [1963] 3 All ER 413, Lord Greene MR at 414. See also, *Seager v Copydex Ltd* [1967] 2 All ER 415; *Conveyer Co of Australia Pty Ltd v Cameron Bros Engineering Co.* [1973] 2 NZLR 38, 41-42.



in the insider trading context. Despite the fact that in the *Dunford & Elliott* decision,<sup>182</sup> which is the only reported example of an action for breach of confidence being employed in an insider trading type scenario, the Court declined to grant the relief sought, the analysis of this case which is carried out below<sup>183</sup> would suggest that, on a different set of facts, misuse of inside information may be actionable as a breach of confidence.

The essence of the cause of action in all cases is the unauthorised use or disclosure of confidential information which is imparted in such circumstances as to import an obligation of confidence.<sup>184</sup> What must now be considered, is whether or not these requirements would be difficult to fulfil in the context of insider trading.

### (a) THE QUALITY OF CONFIDENTIALITY

A key requirement is that the information possesses the requisite degree of confidentiality to merit protection. It must not be something which is "public property and public knowledge".<sup>185</sup> Where, however, the information is in part public and in part private then the confidant's position remains tainted by his knowledge of the private information, such that they must not act on any such information until all of the information has been published to the public.<sup>186</sup> As price-sensitive information of the nature with which we are concerned is unpublished, it would logically be assumed that such information would not be considered as being in the public domain and thus clearly satisfies this requirement.

However, a problem which exists in the insider trading context is that company's often have the need to consult various advisers, which in all probability necessitates the disclosure of such information to these parties. As a result a number of people within the company and outside of it may be aware of this information. Such a limited disclosure to

182 [1977] 1 Lloyd's Rep 505.

183 See, below n.188.

184 In *Coco v A. N. Clark (Engineers) Ltd* (1969) RPC 41, Megarry J stated at 47 that to enforce a duty of confidence it was necessary for the plaintiff to prove three elements:

- (a) the information had the necessary quality of confidence;
- (b) it must have been imparted in circumstances importing an obligation of confidence; and
- (c) there must have been an unauthorised use to the detriment of the plaintiff.

See also, *Seager v Copydex* [1967] 2 All ER 415; *Saltman Engineering Co Ltd v Campbell Engineering Ltd* [1963] 3 All ER 413; *Terrapin Ltd v Builders' Supply Co (Hayes) Ltd* [1960] RPC 128. The *Coco* case approach has been followed by the New Zealand Court of Appeal in *A B Consolidated v Europe Strength Co* [1978] 2 NZLR 515, at 520.

185 *Saltman Engineering Co Ltd v Campbell Engineering Ltd* [1963] 3 All ER 413; Lord Greene M. R. at 415. See also, *Thomas Marshall (Exports) Ltd v Guinle* [1979] 1 Ch 227, 248; *Conveyer Co of Australia Pty Ltd v Cameron Bros Engineering Co.* [1973] 2 NZLR 38, 42; *A B Consolidated v Europe Strength Food Co* [1978] 2 NZLR 515, 521.

186 See, *Schering Chemicals Ltd v Falkman* [1981] 2 All ER 321; *Seager v Copydex Ltd* [1967] 2 All ER 415; *Terrapin v Builders' Supply Co (Hayes) Ltd* [1960] RPC 128.



these advisers for a limited purpose does not necessarily mean that the information has been put into the public domain by the company so as to deprive it of the necessary element of confidentiality.<sup>187</sup> However, there is obviously a dividing line to be drawn, such that the company must take care not to disclose the information to such a degree that the courts would regard it as having lost that confidentiality, as in *Dunford & Elliott Ltd v Johnson & Firth Brown Ltd*.<sup>188</sup> In this case, the plaintiffs, a company that was engaged in steelmaking, sustained very severe trading losses of about £1 million annually in the previous two years, and therefore decided to make a rights issue to their shareholders to the amount of £3 million. The combined institutional shareholders of this company owned 43 per cent of the issued shares. At a meeting between the plaintiff company and the institutional shareholders it was suggested that the institutional shareholders (the "consortium") should underwrite this rights issue since very few ordinary shareholders were expected to take up the rights issue. The plaintiff company's financial advisers prepared a report of the company's financial prospects for the next financial year and disclosed it to the consortium under a stipulation of confidence. The consortium considered that £3million would not be sufficient to save the plaintiff company and that at least another £1 million was needed. So it was decided by the consortium alone that the defendants, a rival steelmaking company, and another company should be invited to come in and each underwrite £500,000. The consortium thought that if the defendants were invited to underwrite £500,000 each they ought to see the confidential information contained within the financial report. The defendants were given the information, which was, of course, not available to shareholders other than the consortium, but the defendants subsequently declined to underwrite the plaintiff company. However, the defendants later made a press announcement stating that they were making an offer to the shareholders in the plaintiff company to purchase their shares. Under the terms of this offer the defendants would pay 35p per share, whereas the current market price was 17p a share. The plaintiff company issued a writ claiming an injunction to forbid the defendant's use of the confidential information contained within the financial report, so as to restrain this takeover bid. The English Court of Appeal focused upon the fact that confidential financial information concerning the company had been disclosed to a group of shareholders holding 43 per cent of the equity capital (but not to other shareholders) as well as other prospective underwriters of a rights issue by that company. Therefore, in the circumstances of this

<sup>187</sup> In the decision of *Franchi v Franchi* [1967] RPC 149, Cross J. noted at 153 that whether an item of information is still confidential after being disclosed to a certain class of persons "must be a question of degree depending on the particular case, but if relative secrecy remains, the plaintiff can still succeed." See, J.A. Suter, *The Regulation of Insider Dealing in Britain*, above n.20, 188-189.

<sup>188</sup> [1977] 1 Lloyd's Rep 505. Although the English Court of Appeal declined to grant the relief sought, an analysis of this case would appear to suggest that, on a different set of facts, misuse of inside information could be a breach of confidence.



case the Court reasoned that such a widespread use of the information "drives a hole into the blanket of confidence",<sup>189</sup> so as to deprive it of a confidential quality which it would have otherwise possessed.

As to the substance of the information, there is no requirement that it be of momentous importance in order to possess the requisite degree of confidentiality. All types of unpublished price sensitive information could be classified as confidential, whether the information relates to internally generated information such as annual figures, profit forecasts, or possible take-over plans, or whether it is information obtained in negotiations with other companies concerning joint ventures, possible agreed mergers etc. The information must be specific, in the sense that it must not be general information inevitably acquired by an employee in the ordinary course of their employment as part of their stock of knowledge, for an employer cannot attempt to constrain an employee when they leave their employment from using such knowledge.<sup>190</sup> An employee can, however, be prevented from using a specific item of confidential information, and since this element of specificity is inherent in the nature of unpublished price-sensitive information<sup>191</sup>, this requirement should be satisfied. The only other limit to the type of information which might be confidential appears to be that it must not be mere "tittle tattle"<sup>192</sup>, but since it is unlikely in any event that information which is price-sensitive would be regarded as tittle tattle, this restriction will be of little consequence in the insider trading context.

## (b) THE OBLIGATION OF CONFIDENCE

Having ascertained that the information does possess the requisite quality of confidence, the next issue is to decide whether it has been imparted in circumstances importing an obligation of confidence. The confider must have disclosed the information for a limited purpose and any use or disclosure of it by the confidant for any other purpose will be prohibited by the obligation of confidence, provided that the confidant knew or ought to have known that the information was being imparted for a limited purpose.<sup>193</sup> Disclosure by the confider in this context includes verbal or written disclosure to the confidant.<sup>194</sup>

<sup>189</sup> [1977] 1 Lloyd's Rep 505, Lord Denning M. R. at 509. See J.A. Suter, *The Regulation of Insider Dealing in Britain*, above n.20, 192-193.

<sup>190</sup> *Herbert Morris v Saxelby* [1916] 1 AC 688; *Faccenda Chicken Ltd v Fowler* [1986] 1 All ER 617.

<sup>191</sup> Unpublished price sensitive information by its nature relates to a specific item of confidential information i.e., a financial report. Such information can of course be specific even though it only relates to a contemplated transaction, such as a possible takeover bid.

<sup>192</sup> *Coco v A. N. Clark (Engineers) Ltd* [1969] RPC 41, Megarry J. at 48; *A B Consolidated v Europe Strength Food Co* [1978] 2 NZLR 515, 521.

<sup>193</sup> *Morris v Moat* (1851) 9 Hare 241; *Lamb v Evans* (1892) 3 Ch 462; *Terrapin Ltd v Builders' Supply Co (Hayes) Ltd* [1960] RPC 128; *Saltman Engineering Co Ltd v Campbell Engineering*



The key then is to establish disclosure in circumstances where the confidant knew or ought to have known that the unpublished price sensitive information was being imparted for a limited purpose. In determining whether the defendant actually knew of the obligation, the courts will obviously be greatly assisted by any express contractual term spelling out the requirement of confidentiality, and many employment contracts entered into by directors will include such a provision.<sup>195</sup> Similarly, many agreements between companies and their professional advisers will specifically impose an obligation of confidentiality.<sup>196</sup> An interesting example of such a requirement of confidentiality is provided in the *Dunford & Elliott* decision.<sup>197</sup> In this case, the plaintiff company's financial advisers produced a report on the plaintiff's financial prospects and disclosed it to the institutional shareholders (the "consortium") under a stipulation that the information was confidential and was not to be used in any way to influence investment decisions. The English Court of Appeal found that in view of the presence of such a stipulation, this information had thereby been imparted in circumstances which imported an obligation of confidence.<sup>198</sup>

Even in the absence of a direct contractual obligation between the parties it may be possible to establish from the evidence that the confidant knew of the obligation of confidence, as in *Schering Chemicals Ltd v Falkman Ltd*.<sup>199</sup> In this case the court thought it obvious from the facts that the defendant actually knew of the requirement of confidentiality even if it was not established that it had been expressly stated to him and even though he was not in a contractual relationship with the plaintiffs.<sup>200</sup> Cases involving actual knowledge of an obligation of confidentiality are usually quite straightforward, the difficulties arise when it is asserted that the confidant ought to have known of such an obligation.

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- Ltd* [1963] 3 All ER 413; *Schering Chemicals Ltd v Falkman Ltd* [1981] 2 All ER 321; *A B Consolidated v Europe Strength Food* [1978] 2 NZLR 515, 522-523.
- 194 *Terrapin Ltd v Builders' Supply Co (Hayes) Ltd* [1960] RPC 128; *Seager v Copydex Ltd* [1967] 2 All ER 415.
- 195 See, for example, *Thomas Marshall (Exports) Ltd v Guinle* [1979] 1 Ch. 227, where the defendant was appointed managing director of the plaintiff company under a contract of employment which included an express term stating that he was not to engage in any other business without the company's consent while he was employed as managing director; and that during and after his employment he was not "to disclose" confidential information in relation to the affairs, customers or trade secrets of the company. After ceasing to be managing director he was neither "to use or disclose" confidential information about the suppliers and customers of the company. See also, *A B Consolidated Food v Europe Strength Co* [1978] 2 NZLR 515, 520.
- 196 See, for example, *Dunford & Elliot Ltd v Johnson & Firth Brown Ltd* [1977] 1 Lloyd's Rep 505.
- 197 [1977] 1 Lloyd's Rep 505.
- 198 [1977] 1 Lloyd's Rep 505, 509. See, above n.188
- 199 [1981] 2 All ER 321. See, below n.221.
- 200 [1981] 2 All ER 321, Shaw L.J. at 336; Templeman L.J. at 342. See, below n.221. See also, *Reid & Sigrist Ltd v Moss & Mechanism Ltd* [1932] 49 RPC 461, involving a chief draughtsman, where the court took the view that this was so important a position that it was obvious to anyone in such a position that they must observe the confidentiality of the information that they obtained.



In determining whether the confidant ought to have known, the courts are helped by the reasonable man approach that was put forward by Megarry J. in *Coco v A. N. Clark (Engineers) Ltd*:<sup>201</sup>

“It seems to me that if the circumstances are such that a reasonable man standing in the shoes of the recipient of the information would have realised that upon reasonable grounds the information was being given to him in confidence, then this should suffice to impose upon him the equitable obligation of confidence. In particular where information of commercial or industrial value is given on a business-like basis and with some avowed common object in mind ... I would regard the recipient as carrying a heavy burden if he seeks to repel a contention that he was bound by an obligation of confidence.”

Applying this “reasonable man” approach to the standard insider trading scenario it seems clear that many of the people in receipt of unpublished price-sensitive information do indeed receive it on this basis and cannot deny an obligation of confidence.

### *Company Directors and Officers*

Consider the most obvious insiders, the company’s own directors and officers. They may well have actual knowledge of the obligation of confidence but even if they have not, the courts should have no hesitation in finding that they ought to have known, as such an obligation arises naturally from these positions.<sup>202</sup> Indeed in *Baker v Gibbons Pennycuick V.C.* accepted that the prohibition on the unauthorised use or disclosure of

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201 [1969] RPC 41, Megarry J. at 47. The plaintiff in this case designed a moped engine and sought the co-operation of the defendants in its manufacture. After the plaintiff disclosed to the defendants all the details of his design and proposals for its manufacture, the parties fell out and the defendants decided to manufacture their own engine. When the defendants brought out their own design which closely resembled the plaintiffs, he brought a motion for an interlocutory injunction to restrain the defendants from misusing information communicated to them in confidence solely for the purpose of the joint venture. The defendants denied that any confidential information had been supplied to them, or used by them in the engine they had manufactured.

202 See, *Cranleigh Precision Engineering Ltd v Bryant* [1966] RPC 81, where Roskill J. observed at 98 that the absence of an express term in the managing directors contract of employment does not prevent an obligation of confidence being implied by the court: “... I have not lost sight of the fact that the heads of agreement unlike the draft service agreement which Bryant refused to sign, contained no express obligation not to divulge confidential information, but this makes no difference, for, were it necessary, I would not hesitate to imply into the contract of employment between Bryant and the plaintiffs the relevant obligation. It is both reasonable and necessary to do so.” See also, *Conveyer Co of Australia Pty Ltd v Cameron Bros Engineering Co* [1973] 2 NZLR 38, 41.



confidential information applied with "particular force" as between a director and their company, given the fiduciary nature of the position which they occupy.<sup>203</sup>

### *Professional Advisers and Outside Consultants*

The same applies where a company discloses such information to professional advisers and outside consultants. They are covered by an obligation of confidence for in all these instances, the information is disclosed for a limited purpose which the confidant ought to have realised is the only legitimate purpose for which they may use that information. Thus, bankers<sup>204</sup>, brokers<sup>205</sup>, lawyers<sup>206</sup>, accountants<sup>207</sup>, sub-contractors<sup>208</sup>, and outside consultants<sup>209</sup> have all attracted obligations of confidence. This is also the case where unpublished price-sensitive information is disclosed to another company with a view to a joint venture which later falls through.<sup>210</sup> The position of other advisers, such as advertising agencies and public relations firms, has yet to be confronted in the courts but there is no reason why they too would not be affected by an obligation of confidence in the appropriate circumstances. Certainly an advertising agency briefed about an imminent take-over bid would have obtained information in circumstances which warrant an obligation of confidentiality. That this is so is reinforced by Shaw L.J. in *Schering Chemicals Ltd v Falkman Ltd*, who noted that:<sup>211</sup>

203 [1972] 2 All ER 759, 764-765. The defendant company in this case carried on the business of marketing a specialised item of building insulation. For that purpose it employed 16 selling agents who each covered a specific area in the United Kingdom. The plaintiff after joining the company, became a director. He was later removed from office and thereafter set up a competing business. In proceedings instituted by the plaintiff against the company and two of its directors, the company made a counterclaim and applied for an interlocutory injunction to restrain the plaintiff from soliciting agents of the company to terminate their employment and to join the plaintiff's competing business. This claim was based on an equitable obligation under the general law (as opposed to an express or implied contractual term) not to use confidential information. It was contended by the company that, where a person, particularly the director of a company, had obtained confidential information they could not use it to the prejudice of the person who had given it and that the names and addresses of the agents was confidential information obtained from the company without which it would have been impossible for the plaintiff to solicit the company's agents. See also, the observation of Roskill J. at 91 in *Cranleigh Precision Engineering Ltd v Bryant* [1966] RPC 81.

204 *Tournier v National Provincial and Union Bank of England* [1924] 1 KB 461.

205 See, *Brown v IRC* [1965] AC 244.

206 *Parry-Jones v Law Society* [1968] 1 Ch 1; *Lord Ashburton v Pape* [1913] 2 Ch 469.

207 *Parry-Jones v Law Society* [1968] 1 Ch 1, Lord Denning at 7, Lord Diplock at 9.

208 *Saltman Engineering Co Ltd v Campbell Engineering Ltd* [1963] 3 All ER 413.

209 *Schering Chemicals Ltd v Falkman Ltd* [1981] 2 All ER 321. See, below n.221.

210 *Seager v Copydex Ltd* [1967] 2 All ER 415.

211 [1981] 2 All ER 321, 337. See, below n.221. See, also *Dunford & Elliott Ltd v Johnson & Firth Brown Ltd* [1977] 1 Lloyd's Rep 505, per Lord Denning M.R. at 509: "As between men of business, when one gives information to another on a stipulation or understanding that the information is to be regarded as confidential - and not passed on by the recipient to others - such a stipulation or understanding will usually be enforced by the law."



“... the communication in a commercial context of information which at the time is regarded by the giver and recognised by the recipient as confidential, and the nature of which has a material connection with the commercial interests of the party confiding that information, imposes on the recipient a fiduciary obligation to maintain that confidence thereafter unless the giver consents to relax it.”

### *Employer and Employee*

A further possibility is the unauthorised use or disclosure of confidential information by an employee of the company or an employee of the professional advisers, outside consultants, etc, in whom the company has confided. Confidential communications between employer and employee are firmly rooted in the law of contract.<sup>212</sup> Here the starting point is that all employees (as agents of their employers) owe their employers a duty of fidelity, one aspect of which is an obligation to respect the confidentiality of information obtained in the course of their employment.<sup>213</sup> Use of such information for the employee's own purposes is a breach of that duty.<sup>214</sup> Thus, any employee of the company will be in breach of an obligation owed to the company (just as any breach by an employee of a professional adviser would be a breach of the duty owed to the professional adviser) where the information is used by the employee for the purposes of insider trading. Although the authorities are not absolutely clear on the point, it seems that this obligation of fidelity and with it the obligation of confidence will arise in the case of all employees, whatever the position held by them.<sup>215</sup> The only qualification to this general obligation arises in cases where the employer has been very casual about the confidentiality of the information which they are now seeking to prevent a former employee from using. In *United Indigo Chemical Co Ltd v Robinson*, for example, the court refused relief where the plaintiffs had never pointed out to the employee that the information was confidential, nor had they placed any constraints on access to that information on their workforce.<sup>216</sup>

212 See, P. Mitchell, *Insider Dealing and Director's Duties* (2nd ed, Butterworths, London, 1989) 28.

213 However, while the duty of faithful service ceases with the ending of the contract of employment, the duty to respect the confidentiality of information does not. See, P. Mitchell, above n.212, 28..

214 See, *Lamb v Evans* (1893) 1 Ch 218; *Amber Size and Chemical Co Ltd v Menzel* [1913] 2 Ch 239; *Wessex Dairies Ltd v Smith* [1935] 2 KB 80; *Thomas Marshall (Exporters) Ltd v Guinle* [1979] 1 Ch 227; *Faccenda Chicken Ltd v Fowler* [1986] 1 All ER 617.

215 See, F. Gurry, *Breach of Confidence*, above n.180, 180.

216 [1932] 49 RPC 178. In this case the defendant was formerly employed as works manager by the plaintiff company which manufactured chemicals. After the defendant left the plaintiff's service, he established a business as a manufacturer of chemicals and dyes, and marketed a product which the plaintiff's claimed was manufactured with the use of secret processes learnt during the course of his employment with them. The Court refused to grant an injunction restraining the defendant from using the knowledge he had acquired during his employment by reason of the fact that, the



Finally, it should be reiterated that in an action for breach of confidence founded upon the equitable ground a confidant can only be liable for misuse of information where such information is proven to be confidential.<sup>217</sup> Where an action is brought against a former employee, this requirement of confidentiality is reinforced by "the principle that the courts will refuse to prevent a man earning his living by using the knowledge, skill and expertise he has acquired as his own and will refuse to treat its use as an actionable breach of confidence."<sup>218</sup> A distinction must be drawn, therefore, between the employee's ordinary stock of knowledge about securities markets, which they are free to use after the termination of their employment, and the employer's confidential information, which the employee is bound not to use for his own purposes after he has left his employer's service.<sup>219</sup>

### *An Action By The Company Against Employees of Confidants*

A further contingency which must be given consideration, is whether the company itself has a cause of action against an offending employee of anyone in whom the company has confided, such as a professional adviser. Clearly an action could not be based on any duty of fidelity, because the company is not the individual's employer. However, despite this absence of a contractual relationship between the parties an action may still be brought on the basis of the general equitable jurisdiction.<sup>220</sup> In *Schering Chemicals Ltd v Falkman Ltd*<sup>221</sup> the plaintiff company (Schering) attempted to restrain the defendants from broadcasting a television documentary said to have been compiled using confidential information imparted by the plaintiffs in confidence to the defendants. Schering had been facing adverse publicity concerning a drug which it produced and to counter that publicity it had employed the defendant company of television training specialists (Falkman) to advise its directors and executives on how to present the company's case when being interviewed

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defendant had not been told at any stage that what he learnt during his service was to be regarded as confidential, and he had acquired the knowledge honestly and in circumstances in which the knowledge was freely available to all of his fellow workers without any constraints imposed by the management. See also, F. Gurry, *Breach of Confidence*, above n.180, 181.

217 See, above n.190.

218 *Ansell Rubber Co. Pty Ltd v Allied Rubber Industries Pty Ltd* [1972] RPC 811, Gowans J. at 818. See, also *Faccenda Chicken Ltd v Fowler* [1986] 1 All ER 617, 625-626.

219 See F. Gurry, *Breach of Confidence*, above n.180, 199.

220 This was clearly established in *Saltman Engineering Ltd v Campbell Engineering Ltd* [1963] 3 All ER 413, where there was no contractual relationship between the plaintiff and the defendants, who had obtained the plaintiff's designs with a view to manufacturing certain products for them, but who then purported to use the designs for themselves. The court found that an obligation of confidence was established in these circumstances despite the absence of any contractual relationship between the parties.

221 [1981] 2 All ER 321.



by the media. Falkman in turn obtained the services of the second defendant, Elstein, a broadcaster, to assist in the project. Elstein subsequently sought to make a documentary about the company using much of the information obtained from the training course. On the facts, the English Court of Appeal found that an obligation of confidence existed between Schering and Elstein directly, despite the absence of any contract, on the basis that the information was confidential and had been obtained by Elstein in circumstances where it was obvious to him that the information had been disclosed for the limited purposes of the training course only. In the appropriate circumstances therefore not only professional advisers but also outside consultants brought in by them and indeed their own employees may each be subject to a direct obligation of confidence to the original confider company.<sup>222</sup>

### *An Action By The Company Against A Third Party Tippee'*

In addition to treating people such as Elstein with no direct relationship to the confider as confidants, liability can also be extended to third party recipients, who obtain the information, directly or indirectly, from the confidant in breach of that confidant's obligation of confidence. Such a third party recipient in insider trading terminology is of course categorised as a 'tippee'. The liability of such third party recipients was also considered in *Schering*<sup>223</sup> where the third defendant, Thames Television, in addition to the defendants Falkman and Elstein, was restrained from broadcasting the program in breach of confidence, on the basis that having chosen to employ Elstein in making the film with full knowledge of how he came to be in possession of the information about the company, they were thereby in no better a position than Elstein himself. In the words of Templeman L.J.<sup>224</sup> "[t]he confidentiality which attaches to Elstein attaches likewise to Thames Television." It has long been established that any third party who receives confidential information with actual knowledge<sup>225</sup> that they are receiving it in breach of confidence will be restrained from using it.<sup>226</sup> However, the learned commentator Francis Gurry suggests that this will also be the case where the third party ought to have known of the breach.<sup>227</sup>

<sup>222</sup> See, F. Gurry, *Breach of Confidence*, above n.180, 286-287.

<sup>223</sup> [1981] 2 All ER 321.

<sup>224</sup> [1981] 2 All ER 321, 346.

<sup>225</sup> It is probable that wilful abstention from enquiries which if made would give the third party knowledge of the breach will suffice. See *London & Provincial Sporting News Agency Ltd v Levey* (1928) Macg. Cop.Cas. 340; discussed in F. Gurry, *Breach of Confidence*, above n.180, 272-273.

<sup>226</sup> *Morrison v Moat* (1851) 9 Hare 241; *Ashburton v Pape* [1913] 2 Ch 469; *Argyll v Argyll* [1967] Ch 302; *Fraser v Thames Television* [1984] QB 44. See, also, *Infometrics Business Services Ltd v Broadcasting Corporation of New Zealand*, Unreported, 7 September 1987, High Court, Wellington Registry CP363/87, where Eichelbaum J. stated at 4 that notice to a third party recipient of the "surreptitious" obtaining of ... information" by the confidant was sufficient to



### (c) BREACH OF DUTY

Where an obligation of confidentiality has been established, the confidant will be liable for any use or disclosure of that confidential information for any purpose other than that for which it was confided.<sup>228</sup> This would clearly preclude the use or disclosure of unpublished price-sensitive information for the purpose of insider trading. It has been suggested in the past that it was necessary to establish that the authorised use or disclosure resulted in detriment to the confider,<sup>229</sup> but that requirement seems to have lapsed, although it may have a bearing on the appropriate remedy.<sup>230</sup> This eliminates the difficulties which might arise where a company wishes to sue for breach of confidence because as we have seen, the company is not always directly affected adversely by insider trading.<sup>231</sup> There is also no requirement that the unauthorised use or disclosure be intentional so that a cause of action may lie even if the defendant has subconsciously used or disclosed the information.<sup>232</sup> Thus unthinking disclosure, as where a director unwittingly lets slip some unpublished price sensitive information in the course of casual conversation, may found a cause of action against the director if all the other necessary elements can be established.

In the event of breach, any action must be brought by the confider as the person who is entitled to have the confidence respected.<sup>233</sup> Thereby, a cause of action against a confidant indulging in insider trading on the basis of confidential information obtained by virtue of their position, again rests in the hands of the company rather than in the hands of any individual victim of the insider trading.

### (d) REMEDIES FOR BREACH OF DUTY

The remedies available for breach of confidence are damages, an account of profits, an injunction and the delivery up or destruction of the item in question. As far as insider trading is concerned, obviously delivery up or destruction is irrelevant and so, generally,

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support an action by the confider for breach of confidence against the third party recipient of such confidential information, where the original confidant was in breach of an obligation of confidence.

227 F. Gurry, *Breach of Confidence*, above n.180, 274.

228 *Saltman Engineering Co Ltd v Campbell Engineering Ltd* [1963] 2 All ER 413, Lord Greene M.R. at 414.

229 *Coco v A. N. Clark (Engineers) Ltd* [1969] RPC 41, 48. See, F. Gurry, *Breach of Confidence*, above n.170, 407-408.

230 F. Gurry, above n.180, 407-408.

231 Above n.37.

232 See, *Seager v Copydex Ltd* [1967] 2 All ER 415, 418-419.

233 *Fraser v Evans* [1969] 1 QB 349.



would be injunctive relief, given that persons engaging in insider trading are most unlikely to advertise their intentions in advance.<sup>234</sup> The key remedies, therefore, will be the pecuniary ones of damages and the equitable remedy of an account of profits; the plaintiff must choose between these remedies.<sup>235</sup> In practice a plaintiff will almost invariably elect to claim damages because of the difficulties associated with an action for account.<sup>236</sup>

### *An Account Of Profits*

The purpose of the equitable remedy of an account of profits is to compel the defendant to surrender those profits which were improperly made.<sup>237</sup> On its face such a remedy would appear to be suitable in the context of insider trading so that persons engaging in this activity will be required to account for their ill-gotten gains. However, a problem often encountered in the setting of abuse of confidential information, is the calculation of profits, for the defendant can only be required to account for those profits which are attributable to such a breach of duty.<sup>238</sup> In an insider trading situation it is theoretically difficult to identify the percentage of any profits gained<sup>239</sup> which can be ascribed to the misuse of confidential information as such profits will have been achieved by the mixture of the insider trader's personal knowledge of market conditions with the confidential price sensitive information. The difficulties with such a calculation are compounded by the fact that there will undoubtedly be other factors at work in the securities market at the time when the insider trading took place which may also have contributed in a certain degree to the

<sup>234</sup> However, in the context of a takeover injunctive relief may be appropriate in order to restrain the takeover bid of an insider. See for example, *Dunford & Elliot Ltd v Johnson & Firth Brown Ltd*, above n.188.

<sup>235</sup> *Peter Pan Manufacturing Corporation v Coresets Silhouette* [1963] RPC 45, Pennycuik J. at 58; *VanCamp Chocolates Ltd v Auslebrooks Ltd* [1984] 1 NZLR 354, 361; *Ansell Rubber Co. Pty Ltd v Allied Rubber Industries Pty. Ltd* [1972] RPC 811, Gowans J. at 828. See, F. Gurry, *Breach of Confidence*, above n.180, 417-418.

<sup>236</sup> An action for account has generally been regarded as an unsatisfactory and cumbersome procedure because of the practical difficulties associated with the calculation of the defendant's wrongful profits. See, for example, *Siddell v Vickers* [1892] 9 RPC 152, where Lindley L.J. stated at 162: "The plaintiff therefore was perfectly within his right in electing, as he did in this case, to have an account of profits; but I do not know any form of account which is more difficult to work out, or may be more difficult to work out than an account of profits." While Lindley L.J.'s criticism was dealing with the procedure in a partnership context his views are of general application. See also, F. Gurry, *Breach of Confidence*, above n.180, 418-419; A.S. Burrows, *Remedies for Torts and Breach of Contract* (Butterworths, London, 1987) 263-269.

<sup>237</sup> Slade J. reaffirmed this central principle in the following classic statement in *My Kinda Town Ltd v Soll* [1982] FSR 147, at 156: "The purpose of ordering an account of profits in favour of a successful plaintiff ... is not to inflict punishment on the defendant. It is to prevent an unjust enrichment of the defendant by compelling him to surrender those parts of the profits, actually made by him which were improperly made and nothing beyond this." See, A.S. Burrows, above n.236, 266.

<sup>238</sup> See, A.S. Burrows, above n.236, 266.

<sup>239</sup> As pointed out earlier, there is some doubt as to whether an insider who has used price sensitive information in selling their existing shareholdings, thereby avoiding a loss that would otherwise be suffered, can be said to have made a profit. See, above n.104.



wrongdoer's profits.<sup>240</sup> A solution to this problem may however be at hand if the courts elect to adopt the approach outlined by Pennycuick J. in *Peter Pan Manufacturing Ltd v Corsets Silhouette Ltd*.<sup>241</sup> Under this approach, a person must account for all of the profits which they have made from a certain activity, where such profits could not have been achieved at all without the misuse of confidential information. Obviously this would require a finding that profits gained by means of insider trading may properly be viewed as being of such a nature that they would not have come into existence without the use of confidential inside information.

### *Damages*

As for an action for damages, here too, there are difficulties in the context of insider trading. Where the obligation of confidence is based on contract, either express or implied, then damages will be available as a normal contractual remedy. Thus damages are awarded with the object of placing the plaintiff (confider) in the position in which they would have been had the contract been performed by the confidant.<sup>242</sup> However, if the obligation is an equitable one damages are to be recovered on a tortious basis, so that the plaintiff (confider) is to be placed in the position they would have been if the breach of confidence had not been committed.<sup>243</sup> Furthermore, if the obligation is an equitable one then damages may be available in lieu of or in addition to an injunction.<sup>244</sup>

In either case the purpose of the damages is to compensate the plaintiff for the loss caused to them by the breach.<sup>245</sup> This can be something of a problem as far as insider trading is concerned, for the plaintiff is most likely to be a company suing a confidant or a professional adviser suing an errant employee, neither of whom is likely to have suffered any loss other than some intangible and perhaps unquantifiable loss of reputation or standing. Of course there may be direct damage to the company if the insider trading has

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240 For example, where there is a bull market for those shares, it may be difficult to determine what percentage of the profit is attributable to the state of the market and what percentage is attributable to the misuse of confidential information.

241 [1963] 3 All ER 402. This was a case involving the misuse of confidential information relating to the manufacture of a particular kind of brassiere. Here the defendant was held liable for all of the profits it had made through the sale of such articles. As Pennycuick J put it at 413, this was because "the manufacture of the article in question of itself involved the use of confidential information and Silhouette [the defendant] could not have manufactured that article at all without the use of the confidential information". The New Zealand Court of Appeal adopted this formula in *A B Consolidated Food Co v Europe Strength Co* [1978] 2 NZLR 515.

242 F. Gurry, *Breach of Confidence*, above n.180, 364.

243 *Seager v Copydex Ltd (no.2)* [1969] 1 WLR 809, 813 and 815. See, also F. Gurry, *Breach of Confidence*, above n.180, 364-365.

244 F. Gurry, *Breach of Confidence*, above n.180, 364-365.

245 F. Gurry, *Breach of Confidence*, above n.180, 364.



taken place in the shares of a take-over target which results in an increase to the company's cost for acquiring that target. But here too it is very difficult to quantify the loss suffered by the company, for there may be many other factors at work in the market which, along with the insider trading, contribute to the increase in the target's share price.

However a possible solution may lie in the English Court of Appeal's approach to the assessment of damages for breach of confidence under the equitable jurisdiction in *Seager v Copydex Ltd (No. 2)*.<sup>246</sup> The court in this case held that damages were to be assessed at the "market value" of the information which the defendants had misused.<sup>247</sup> This approach has been criticised by Gurry as being inconsistent with the basic purpose of damages which is to compensate the plaintiff for the actual loss they have suffered.<sup>248</sup> In any event the English Court of Appeal in *Dowson & Mason Ltd v Potter*<sup>249</sup> has now stressed that *Seager v Copydex Ltd (No. 2)* does not lay down a general principle but simply reflects the fact that in the circumstances of that particular case, the loss to that individual plaintiff was indeed the market value of the information, which they would have sold since they did not intend to exploit this information themselves. Therefore the principle that damages should compensate the plaintiff for their actual loss remains the essential approach in assessing damages, with all the difficulties which that entails in the insider trading context.

<sup>246</sup> [1969] 1 WLR 809. In this case the defendant company was negotiating for the marketing rights of a patented carpet grip, which the plaintiff firm had invented, and was now willing to sell to the defendant company. During an interview with the defendant company's assistant general manager and sales manager the plaintiff tried to interest them in an alternative device which they had invented called an "Invisigrip", which the plaintiff had not yet patented. The information was given in confidence. The defendant company were not at the time interested in the alternative device. Subsequently, negotiations regarding marketing the patented grip having broken down, the defendant company applied for a patent in respect of a carpet grip very similar to the alternative device (the "Invisigrip"), citing the assistant general manager as the inventor. The English Court of Appeal having found that the defendant company had made use, albeit honestly, of information which they received in confidence from the plaintiff, and which was not available to the public, held that the plaintiff was entitled to damages for breach of confidence, the damages to be assessed on the basis of reasonable compensation for the use of the confidential information.

<sup>247</sup> [1969] 1 WLR 809, per Lord Denning MR at 256, per Salmon L.J. and Winn L.J. concurring at 257.

<sup>248</sup> F. Gurry, *Breach of Confidence*, above n.180, at 444, "It is an assessment more in keeping with a *quantum meruit* award or award for reasonable recompense for services rendered". See, G. Jones, "Restitution of Benefits obtained in Breach of Another's Confidence" (1970) 86 LQR 463, where it is suggested at 488-491 that such an assessment based on *quantum meruit* could be usefully employed in breach of confidence cases.

<sup>249</sup> [1986] 2 All ER 418, Sir Edward Eveleigh at 422; Stocker L.J. at 424; Slade L.J. at 424-425.



### (3) CONCLUSION ON COMMON LAW REMEDIES FOR INSIDER TRADING

The common law relating to fiduciary duties is clearly inadequate to deal with the problem of insider trading because as we have observed,<sup>250</sup> many persons who may have the opportunity to engage in insider trading will not be liable to account under existing equitable rules as they are not in sufficient proximity to the company or its shareholders to give rise to a fiduciary relationship. This problem is partly mitigated by the law relating to an action for breach of confidence based upon the general equitable jurisdiction which may operate to extend civil liability for insider trading to those persons who are not in an immediate fiduciary or contractual relationship with the company, but who nevertheless may be privy to price-sensitive information by virtue of the privileged or restricted position which they occupy (e.g. a director of an entirely separate company who has been negotiating with the confiding company in question with regard to a possible joint venture or merger between these two entities).

However, even where such an action for breach of fiduciary duty or breach of confidence may lie against those persons indulging in insider trading, a further obstacle to relief is created by virtue of the fact that the company is virtually the sole beneficiary of fiduciary obligations imposed upon insiders,<sup>251</sup> while in the context of a breach of confidence, any action must also be brought by the company, as the company will be the confiding party who is entitled to have the confidence respected.<sup>252</sup> Thereby, an action for breach of fiduciary duty or breach of confidence will almost always rest in the hands of the company rather than the individual "victim" (i.e., a former or existing shareholder) of such insider trading. The result of this is that proceedings are unlikely to be taken against directors or other persons who have engaged in insider trading, where the defendant retains defacto control over the company (as in the *Regal* case<sup>253</sup>), especially as it seems that the courts have no power to prevent defendants who are shareholders from voting at the general meeting.<sup>254</sup> For normally the decision to commence proceedings is taken by the board of directors as a business judgement incidental to their management of the company,<sup>255</sup> however, it is well settled that if the directors do not commence proceedings (as may be the case if they are the potential defendants) the power to bring an action reverts to the general

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250 Above n.92.

251 See, above n.134.

252 See, above n.233.

253 *Supra*, n.110.

254 *Mason v Harris* (1879) 11 Ch D 97.

255 See, *Shaw & Sons (Salford) Ltd v Shaw* [1935] 2 KB 113.



meeting.<sup>256</sup> There is also very little incentive for an individual shareholder who is the victim of any such insider trading to pursue a derivative action for breach of confidence or fiduciary obligation on behalf of the company against an insider, as any financial relief that may be recovered would be granted to the company rather than the shareholder.<sup>257</sup> The likelihood of proceedings by the company is further reduced in that a company may well be reluctant to take proceedings against a director or other fiduciaries closely associated with the company where such an action might "cast a cloud on the corporation's name, injure stockholder relations and undermine public regard for the corporation's securities".<sup>258</sup>

From the foregoing it is apparent that although civil liability for insider trading on the basis of breach of confidence and breach of fiduciary duty may technically be very broad, enforcement difficulties have devalued such proceedings to the extent that the risk of any such action against an insider may be minimal. Thus, legislative intervention in the form of Part I of the Securities Amendment Act 1988 was required in order to provide an effective remedy and deterrent for the practice of insider trading.

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256 See, *Pender v Lushington* (1877) 6 Ch D 70.

257 See, above n.129.

258 *Diamond v Oreamuno* 248 NE 2d 910, 912 (1969).



## PART IV

### 4. AN OVERVIEW OF PART I OF THE SECURITIES AMENDMENT ACT 1988

Part I of the Securities Amendment Act 1988 (the Act) which came into force on 22 December 1988 introduced for the first time in New Zealand an express prohibition against insider trading without resort to the need to establish the existence of fiduciary or other duties. The insider trading provisions contained within Part I of the Act have been designed to give statutory effect to that concept known to securities markets as "disclose or abstain". In the words of the New Zealand Securities Commission in its Report to the Minister of Justice on Insider Trading.<sup>259</sup>

"The basis of the principles [sic] is adopted from the concept known as 'disclose or abstain'. An insider who has price-sensitive information that comes to him, or is generated by him, by reason of his position as an insider, should be prohibited from dealing or tipping until the information is published or is otherwise reflected in market prices. While he is inhibited from disclosing, he should also be inhibited from dealing unless and until the market price has adjusted to reflect the information."

When Part I of this Act is taken together with Part II of that same Act (generally referred to as the "Nominee Disclosure Provisions"), the provisions of the Securities Act 1978, the Securities Regulations 1983, the Securities Commission's proposals for takeover legislation,<sup>260</sup> the Report of the Ministerial Committee of Inquiry into the sharemarket (generally referred to as the "Russell Committee Report")<sup>261</sup> and the subsequent Report of the Sharemarket Inquiry Establishment Unit,<sup>262</sup> the policy underlying New Zealand's securities<sup>263</sup> legislation becomes clear; namely to encourage investment in New Zealand's securities markets by promoting public disclosure of all relevant information in a timely manner.<sup>264</sup> The merits of such an approach are debatable in the sense that one may dispute the wisdom of such a policy and the benefits (if any) to be observed by legislating

259 Securities Commission, "Insider Trading: Report to the Minister of Justice", above n. 2, Vol. I, para 3.1.

260 Securities Commission, "Company Takeovers: Report to the Minister of Justice" (Wellington, 1988).

261 Ministerial Committee of Enquiry, "Report of the Committee of Enquiry into the Sharemarket" (Wellington, 1988).

262 Sharemarket Inquiry Establishment Unit, "Report of the Sharemarket Inquiry Establishment Unit" (Wellington, 1989).

263 The term "security" is defined in section 2(1) of the Securities Act 1978.

264 P. Ratner & C. Quinn, "Insider Trading", above n. 13, 1.



“fairness” in the marketplace.<sup>265</sup> “Fairness”, after all is a concept which like beauty is in the eye of the beholder. However, following the introduction of the Securities Act in 1978 the New Zealand legislature has repeatedly indicated that in the crucial arena of the market in which capital is raised by entities who engage in the activity of offering securities to the public for subscription, it is important to promote the idea that New Zealand’s securities markets are inherently fair in nature. “Fairness” in this context means that the same information about securities, that are subscribed for or traded by the investing public, should be available to all participants, actual and potential, in the market.<sup>266</sup>

The main provisions of the Act dealing with insider trading are contained in sections 7 to 14. In essence those provisions prohibit an insider from dealing or tipping<sup>267</sup> in securities of a public company in which the insider has inside information.

The statutory definitions of the terms “inside information” and “insider” are central to the application of the Act. “Inside information” is defined as information, in relation to a public issuer, which is not publicly available, and which would, or would be likely to, affect the price of the securities if it were publicly available.<sup>268</sup> That definition makes it clear that this proscription against insider trading only relates to public issuers. A “public issuer” is defined as a company or person that is, or that was at any time, a party to a listing agreement with a stock exchange.<sup>269</sup> A “stock exchange” means the New Zealand Stock Exchange and includes a stock exchange registered under the Sharebrokers Act 1908.<sup>270</sup> Hence, the insider trading provisions of the Act will only apply to trading, tipping and tippee trading in connection with companies that are or which have at any time been listed on the New Zealand Stock Exchange, so that unlisted private or closely held companies will be excluded from the scope of Part I of the Act.

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265 See, above n.72.

266 See, e.g., Securities Commission, “Proposed Recommendations for Security Regulations” (Wellington, 1980), para 3.3.6.

267 Under sections 9(1) and 13(1) of the Securities Amendment Act 1988 an insider will be liable for “tipping” in circumstances where they have advised or encouraged another person to deal in the securities of a public issuer or alternatively where they have communicated information or caused information to be disclosed to a person knowing or believing that person or another person will, or is likely to, deal in the securities of a public issuer.

268 Securities Amendment Act 1988 s. 2. For a more detailed analysis of this statutory definition of “inside information”, see; E. Abernathy, P. Castle, J. Farrar, H. Strauss (eds), *Andersons Company and Securities Law* (Brooker & Friend Ltd, Wellington, 1991) Vol III, 11-104 - 11-105; P. Ratner & C. Quinn, *Insider Trading*, above n.13, 8-13; Securities Commission, “Insider Trading: Report to the Minister of Justice”, above n.2, Vol I, paras 6.1-6.5.

269 Securities Amendment Act 1988 s.2.

270 Securities Amendment Act 1988 s.2.



In regard to those persons who may be categories as insiders for the purposes of establishing liability under the Act, the definition of an "insider" is extensive and is contained within section 3(1) of the Act which provides:

"(1) For the purposes of Part I of this Act, "insider" in relation to a public issuer, means -

(a) The public issuer:

(b) A person who, by reason of being a principal officer, or an employee, or company secretary of, or a substantial security holder in, the public issuer, has inside information about the public issuer or another public issuer:

(c) A person who receives inside information from a person described in paragraph (a) or paragraph (b) of this subsection about the public issuer or another public issuer:

(d) A person who, by reason of being a principal officer, or an employee, or company secretary of, or a substantial security holder in, a person described in paragraph (c) of this subsection, has that inside information:

(e) A person who receives inside information in confidence from a person described in paragraph (c) or paragraph (d) of this subsection about the public issuer or another public issuer:

(f) A person who, by reason of being a principal officer, or an employee, or company secretary of, or a substantial security holder in, a person described in paragraph (e) of this subsection, has that inside information.

The definition of an "insider" is crucial to the application of the Act, as Part I of the Act will not be breached unless the information emanates from a person<sup>271</sup> connected with the public issuer in the manner prescribed by section 3(1). The key point to note in regard to

<sup>271</sup> Securities Amendment Act 1988 s.2: "'Person' includes a corporation sole, a company, or other body corporate (whether incorporated in New Zealand or elsewhere), an unincorporated body of persons, a public body, and a Government department."



the definition of an "insider" is that with the exception of the public issuer itself, to be an insider a person must possess inside information and have acquired it either:

- (1) By reason of their relationship with the issuer; or
- (2) In confidence from an insider.

Therefore, the definition of an "insider" incorporates a mixture of both fiduciary notions and proprietary rights in information.

By virtue of this statutory definition in s.3(1) a public issuer will always be an insider of itself as any public issuer dealing in its own shares<sup>272</sup> would be the "most inside of insiders."<sup>273</sup> The next category of insiders are those traditionally thought of as having fiduciary duties to the company, i.e., directors, company secretaries and employees. However, this proposition may be somewhat tenuous in the case of employees.<sup>274</sup> There is however a new category of persons who are now charged with a statutory duty towards their fellow shareholders; namely "substantial security holders"<sup>275</sup> (being persons holding a relevant interest in at least 5 percent of the voting securities of the public issuer<sup>276</sup>). This definition of an "insider" will also cover persons who receive inside information "in confidence"<sup>277</sup> from an insider (i.e., a secondary insider) and the confidants of those persons (i.e., a tertiary insider).

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<sup>272</sup> However, given that the general rule under *Trevor v Whitworth* (1887) 12 App Cas 409 is that a company may not purchase its own shares (note, however that there is a statutory exception to this general rule contained in s.66 of the Companies Act 1955); and that s.62 of the Companies Act 1955 prevents a company from financially assisting any other person to acquire its shares, any further prohibition on a company was regarded as superfluous by the Securities Commission. See, Securities Commission, "Insider Trading: Report to the Minister of Justice", above n.2, Vol. I, para 5.3. However, the fact that s.3(1) of the Securities Amendment Act 1988 expressly includes the public issuer within the definition of an "insider" may be an express recognition of Parliament's intention to relax the prohibition on a company dealing in its own securities. See, e.g., Companies Bill 1990 (as introduced into Parliament on 5 September 1990) clause 50.

<sup>273</sup> *Broder v Dane* 384 F. Supp 1312, 1319 (S.D.N.Y. 1974) per Cannella J. See also, P. Anisman, *Insider Trading Legislation for Australia: An Outline of the Issues and Alternatives*, above n.23, 22.

<sup>274</sup> See, above n.87 and n.88.

<sup>275</sup> This proposition is somewhat less radical than it may first appear if it is kept in mind that the substantial security holder will only be treated as an "insider" in circumstances where they have acquired inside information *by reason* of their relationship with the issuer. It is the writers opinion that there is something to be said for the idea that where securities are traded on a market that purports to require disclosure of all relevant information that investors who acquire large stakes in a company ought not to have a right to better information about that company than fellow shareholders who have a relatively small stake in that company.

<sup>276</sup> Securities Amendment Act s.2.

<sup>277</sup> Whether information is imparted "in confidence" is a question of fact which depends ultimately upon the circumstances of each case. Certain relationships will automatically imply an obligation of confidentiality, e.g., that of a solicitor and their client. Otherwise confidentiality must be



Therefore, the advisers and consultants (i.e., lawyers, accountants, sharebrokers, investment advisers, etc) of a public issuer or another insider would appear to be caught, in certain circumstances, by the statutory definition of an "insider". It must however be emphasised that in order for such advisers and consultants to qualify as insiders under s.3(1)(c) and s.3(1)(e) of the Act those persons must receive the information "in confidence."<sup>278</sup> Thus, a financial analyst may not be caught by this definition as there is some doubt as to whether or not information imparted to a financial analyst by an insider is given "in confidence". For in most cases financial information given to financial analysts (even if it is price-sensitive non-public information) is given with the intention or expectation that the analyst will disclose that information to others.<sup>279</sup> By way of comparison, it is interesting to observe that in the case of *SEC v Dirks*<sup>280</sup> the United States Supreme Court held that a financial analyst of a broker dealer firm who received inside information from a corporate insider concerning the fact that a particular company's assets were vastly overstated as a result of fraudulent financial practices, did not breach the provisions of Rule 10b-5<sup>281</sup> by disclosing that inside information to clients of their firm and other investors who consequently sold their shareholdings in that company before the scandal was publicly disclosed. One of the reasons that the Supreme Court provided for its decision was that the financial analyst did not receive the information "in confidence", as the corporate insider had communicated this information to the analyst for the purposes of exposing the fraudulent activity.<sup>282</sup> The Court also emphasised the fact that the analyst did not personally benefit from the disclosure of such information.<sup>283</sup>

The Act imposes liability upon persons that may be classed as insiders who breach the provisions of the Act relating to insider trading within sections 7, 9, 11 and 13.<sup>284</sup> An

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shown to arise from the nature of the communication and whether it was imparted in circumstances importing an obligation of confidence. See above, n.193.

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See, above n.277.

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See, P. Ratner and C. Quinn, *Insider Trading*, above n.13, 11. Note, however, that an insider who discloses inside information to a financial analyst knowing or believing the analyst or another person will, or is likely to, trade on that inside information may be in breach of s.9(1)(b) of the Securities Amendment Act 1988 for the act of "tipping". Unlike tippee trading, liability for tipping is not conditioned upon the disclosure of the information being for a confidential purpose. See, Securities Amendment Act 1988, s.9(1).

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463 US 646 (1983). For further discussion on this decision, see, above n.163.

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Promulgated under §10b of the Securities Exchange Act 1934.

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463 US 646, 656-657 (1983).

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463 US 646, 657 (1983).

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However, under the Securities Amendment Act 1988 there are a number of exceptions to liability under the insider trading provisions. Firstly, there is the so-called "Chinese Wall" exception which is recognised in sections 10, 12(2) and 14 of the Act. This exception provides that no action can be brought against an insider of the public issuer under the Act where arrangements exist to ensure that no person who made the decision to buy or sell securities, or advised others in connection with the purchase or sale of securities, received, or had access to, inside information or was



insider who deals in the securities of a public issuer while possessing inside information is liable under s.7 to the public issuer itself, or to the persons with whom they deal. That liability is extended under s.9 to the "tipping" situation in circumstances where the insider advises or encourages another person to buy or sell securities, or advises or encourages that person to advise or encourage some third person to buy or sell the securities. Similarly, the insider will be liable if the insider communicates the information or causes the information to be disclosed to a person knowing or believing that person or another person, will, or is likely to, deal in the securities, or advise or encourage some third party to deal in the securities.

A parallel set of provisions applies under sections 11 and 13 to the situation in which an insider of a public issuer has obtained inside information about another public issuer and subsequently engages in dealing or tipping in relation to the securities of that other public issuer. Therefore, an insider of public issuer A who has inside information about another public issuer B and who deals or tips in relation to the securities of public issuer B, will be liable to the person with whom they deal or to public issuer A. It is important to observe however that in order for their to be liability the person concerned must first be an insider in relation to public issuer A within the meaning of s.3(1).

However, it must be pointed out that an insider will not be liable under the provisions referred to in the preceding paragraphs if the insider uses inside information in a decision not to purchase or not to sell securities of a public issuer in respect of which the insider has

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influenced by a person who had inside information about the public issuer; and no person who took part in the decision to buy or sell securities, or who advised others in connection with the sale or purchase of securities, received, or had access to, inside information about the public issuer or was influenced by a person who had inside information about the public issuer. Secondly, section 8(1) of the Act provides that no action may be brought against a director, company secretary or employee of a public issuer for insider trading under s.7 if:

- (a) that person deals in the securities in that person's own name or in the name, or on behalf of that person's spouse or child; and
- (b) that person complies with a procedure operated by the public issuer for ensuring that no director, company secretary or employee who has inside information about the public issuer's securities uses that information in dealing in those securities for personal gain;  
and
- (c) the procedure is approved by the Securities Commission by notice in the *Gazette*; and
- (d) the Commission has not withdrawn that approval.

See, The Insider Trading (Approved Procedure for Company Officers) Notice 1991 made pursuant to s.8(1)(c) of the Securities Amendment Act 1988. Thirdly, an exception also exists in respect of a formal takeover offer made in accordance with s.4 of the Companies Amendment Act 1963. See sections 7(2) and 12(1) of the Securities Amendment Act 1988. Fourthly, there is an exemption contained in s.12(3) of the Securities Amendment Act 1988 by which an insider is exempted from liability under s.11(3) of that Act if the insider first obtains the consent of the public issuer of which they are an insider, for the purchase or sale of securities in that public issuer.



inside information, or where the insider uses that inside information to tip others not to buy or not to sell securities of that public issuer.<sup>285</sup>

Under the insider trading provisions of the Act an insider may be liable to the public issuer in relation to which they are an insider and the persons with whom they or their tippee have traded.<sup>286</sup> The quantum of damages is set as the amount of the gain made or loss avoided by the insider or tippee.<sup>287</sup> The gain or loss is calculated by comparing the value of the securities at the time of the dealing by the insider with the value the securities would have had if the inside information used by the insider had been publicly known.<sup>288</sup> Furthermore, the public issuer may recover from the insider an additional pecuniary penalty imposed by the High Court of an amount up to three times the value of the gain made or the loss avoided by the insider, or the consideration paid for the securities.<sup>289</sup>

The Act expressly recognises that it may be potentially difficult to enforce any such proscription against insider trading as directors of a public issuer may be reluctant (for whatever reason) to bring any such action against an insider in the name of the company.<sup>290</sup> Hence, Part I of the Act equips members of a public issuer with two important procedural advantages. Firstly, a shareholder who considers that the public issuer has or may have the right to sue an insider may, with the prior approval of the Securities Commission, require the public issuer at its own expense to obtain an opinion from a barrister or solicitor approved by the Commission, as to whether or not the public issuer has a cause of action against the insider.<sup>291</sup> The ability to require the public issuer to obtain such an opinion is enjoyed not only by present members of the public issuer but also by past members who were shareholders at the time the insider trading was alleged to have occurred.<sup>292</sup> Secondly, any one or more of the same members may themselves, with the leave of the High Court,<sup>293</sup> exercise the public issuer's right of action against an

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285 Presumably, the policy reason for this is that there will be few (if any) persons harmed in those circumstances. The other, and more practical reason, is the virtual impossibility of proving in most cases that any such decision was ever made by an insider.

286 See, Securities Amendment Act 1988 ss. 7(2), 9(2), 11(2) and 13(2).

287 See, Securities Amendment Act 1988 ss. 7(2), 9(2), 11(2) and 13(2).

288 See, Securities Amendment Act 1988 s15.

289 See, Securities Amendment Act 1988 ss. 7(4), 9(4), 11(4), 13(4) and 16.

290 See, Securities Commission, "Insider Trading: Report to the Minister of Justice", above n.2, Vol I, paras 11.10.4. - 11.10.5.

291 Securities Amendment Act 1988, s.17(1).

292 Securities Amendment Act 1988, s.17(2).

293 The High Court may only refuse leave to bring an action if the public issuer does not have an arguable case against the insider, or there is good reason for not bringing the action. The High Court must give leave for members to take over proceedings commenced by a public issuer unless it is satisfied that the public issuer is conducting the proceedings in a proper manner or there is good reason for not continuing the proceedings. See, Securities Amendment Act 1988 ss.18(2) and 18(4).



insider<sup>294</sup> or take over the conduct of proceedings already commenced by the public issuer against the insider.<sup>295</sup> Furthermore, costs incurred in bringing or continuing such an action in place of the public issuer are to be borne by the public issuer rather than the individual movant.<sup>296</sup>

As regards any monetary relief recovered by a public issuer in an action against an insider, such funds are to be held on trust for distribution in accordance with the directions of the court.<sup>297</sup> The Court may direct that the amount recovered shall be either retained by the public issuer,<sup>298</sup> or distributed to:

- any other person who has also obtained, or satisfies the court that they could obtain, a judgement against the insider in respect of the same transaction:<sup>299</sup>
- any member of the public issuer:<sup>300</sup>
- any person who, at the time the securities were brought or sold, was a member of the public issuer.<sup>301</sup>

In circumstances where both the public issuer and another person obtain judgements against the insider in respect of the same transaction, the court must give priority to satisfying the other person's judgement out of the moneys recovered by the public issuer.<sup>302</sup> Finally, the court must ensure that in giving directions as to the distribution of any amount recovered by the public issuer from an insider, no part of those funds are paid to, or for, the benefit of that insider.<sup>303</sup>

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294 Securities Amendment Act 1988, s.18(1).

295 Securities Amendment Act 1988, s.18(3).

296 Securities Amendment Act 1988, s.18(5).

297 Securities Amendment Act 1988, s.19(1).

298 Securities Amendment Act 1988, s.19(2)(b).

299 Securities Amendment Act 1988, s.19(2)(1)(i) and (ii).

300 Securities Amendment Act 1988, s.19(2)(a)(iii).

301 Securities Amendment Act 1988, s.19(2)(a)(iv).

302 This would also apply where the court is satisfied that the other person in question "could obtain judgement in a claim against the insider". See, Securities Amendment Act 1988 s.19(3).

303 Securities Amendment Act 1988 s. 19(5). Therefore, where the insider in question is a member of the public issuer the court may be hesitant to allow the public issuer to retain any funds recovered from that insider as theoretically any payment to the public issuer would find its way back to (i.e., benefit) the insider, in their capacity as a member of that public issuer. See, above n.?







## PART V

### 5. CONCLUSION

The foregoing examination of Part I of the Securities Amendment Act 1988 has made it apparent that many of the various problems and limitations which have traditionally characterised pre-existing common law constraints on insider trading have to some extent been addressed by Parliament with the introduction of this legislative scheme. Thus, by way of conclusion it would be helpful to discuss the various means by which the statutory solutions provided under the Act have extended the scope of possible civil causes of action against persons indulging in insider trading within New Zealand's securities markets.

The fact that a much broader range of persons may now be liable under the Act for their insider trading or tipping activities than would otherwise be the case under common law actions for breach of fiduciary duty and breach of confidence may be demonstrated by the following examination of an insider trading type scenario.<sup>306</sup>

#### *Example*

Company B wishes to acquire a controlling parcel of shares in Company A from Company C. Company A is a party to a listing agreement with the

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This example has been drawn from a similar such example discussed in; Securities Commission, "Proposed Practice Note on Insider Trading; A Discussion Paper" (Wellington, 1992), para 3.24. The discussion of the example within this paper will be for the sole purpose of demonstrating the broad range of persons who may be caught by the statutory definition of an "insider" in s.3(1) of the Securities Amendment Act 1988. Hence, there will be no discussion within this paper in regard to the perplexing question of whether or not a public issuer that willingly allows another party to become aware of inside information about that company by means of due diligence, for the purpose of facilitating a transaction in that issuers securities, can subsequently initiate an action against that party for insider trading under Part I of the Securities Amendment Act 1988. However, the Securities Commission in discussing a similar such example in its "Proposed Practice Note on Insider Trading; A Discussion Paper," above n.306, appears to suggest at paras. 3.24 and 3.27 that; such a situation would involve "no informational disadvantage as between the contracting parties, no disadvantage to the public issuer, no malpractice or generally unethical behaviour, and no transactional disadvantage to any other shareholder other perhaps than the lack of an opportunity to participate in the particular transaction in terms of which may be more attractive than those applying in the market." Thus, by reading between the lines of this publication the writer is left with the impression that in the hypothetical situation discussed at para 3.24 concerning "due diligence," the Securities commission is likely to decline a request by a shareholder under s.17 for approval to require the public issuer (e.g., Company A in the above example, above n.306) to obtain a legal opinion on the question of whether or not the public issuer has a cause of action against an insider. It should also be pointed out that in regard to a members ability to exercise or take over the public issuer's right of action under s.18 of the Act, the member must obtain the leave of the Court. Therefore, it is possible that a Court may be satisfied that it has sufficient grounds to refuse such leave to a member on the basis that under ss.18(2)(b) and 18(4)(b) "there is good reason for not" bringing the action or continuing the proceeding.



New Zealand Stock Exchange, however, the prospective purchaser (Company B) is a private unlisted company. Company C has appointed a nominee as a director of A and that director has communicated inside information about Company A to C. In order to ascertain whether Company C's asking price was a fair one, Company B requested a grant of due diligence from Company A. The board of directors of Company A resolved after due consideration to grant "due diligence" to Company B so as to facilitate the purchase by B from Company C. The directors of A had disclosed relevant interests prior to considering the matter, interested directors refrained from voting on the resolution and the evidence shows that the resolution is not "tainted" in any way. The "due diligence" process conducted by Company B involved a detailed examination of price-sensitive information about Company A (e.g., present and pending contracts and commitments concerning Company A, that company's financial figures and forecasts etc) which had not been publicly disclosed. Company B and Company C subsequently completed the share transaction after arduous negotiations at a price significantly different to that applying on the market.

In this hypothetical situation it may be deduced that companies A, B, and C are all potentially liable as "insiders" under Part I of the Securities Amendment Act 1988. Information obtained by Company B in the course of due diligence is price sensitive and not publicly available, thereby Company B must be regarded as having received "inside information."<sup>307</sup> Therefore, Company B is an insider by virtue of having obtained inside information from the public issuer (i.e., Company A) "in confidence."<sup>308</sup> Hence, Company B may possibly be liable under the Act for purchasing shares in Company A while being in possession of inside information.<sup>309</sup> Company A as the public issuer of the securities that were traded by B and C may also be categorised as an "insider" under the statutory definition of that term.<sup>310</sup> Thus, Company A may possibly be liable for "tipping" Company B, as Company A communicated inside information to B in the course of due diligence with the knowledge that B would purchase securities from Company C.<sup>311</sup> Furthermore, Company C may be regarded as an insider as it obtained inside information by reason of its position as a substantial security holder in Company A<sup>312</sup>(i.e., it obtained

307 See, Securities Amendment Act 1988, s.2.

308 See, Securities Amendment Act 1988, s.3(1)(c). Assuming of course, that information communicated in the course of due diligence is to be regarded as having been given and received "in confidence" for the purpose of s.3(1)(c) of the Securities Amendment Act 1988.

309 See, Securities Amendment Act 1988, s. 7(1)(a).

310 See, Securities Amendment Act 1988, s.3(1)(a).

311 See, Securities Amendment Act 1988, s.9(1)(b)(i).

312 See, Securities Amendment Act 1988, s. 3(1)(b).



inside information from the nominee director it appointed to the board of Company A). Thus, it is possible that Company C may be liable under the Act for selling its controlling parcel of shares to Company B while being in possession of inside information.<sup>313</sup>

In turning to consider the possibility of civil liability under the common law actions for breach of confidence and breach of fiduciary duty it becomes apparent that a much narrower range of persons would attract liability. In the context of an action for a breach of confidence based on the general equitable jurisdiction<sup>314</sup> it appears to be obvious that Company A has no cause of action against Company B as the inside information was received by B (in the course of due diligence) for the limited purpose of determining whether or not to purchase the shares from Company C. Thus, in the circumstances as set out in the above example, Company B has not used the inside information for any purpose other than that for which it was confided. Therefore, it would follow that Company B has not breached any obligation of confidence by purchasing shares from Company C on the basis of this inside information.<sup>315</sup> However, as regards the nominee director, it may be assumed that inside information communicated to a director is usually imparted in circumstances importing an obligation of confidence which requires a director to utilise the information for the limited purpose of performing their functions as a director.<sup>316</sup> Thus, the actions of the director in "tipping" Company C may constitute an actionable breach of confidence. Moreover, Company C, who assumedly obtained this inside information from the nominee director with actual knowledge or notice of the fact that it was being received under a breach of confidence, may perhaps also be liable to Company A as a third party recipient of such confidential information.<sup>317</sup> In considering the possible application of the fiduciary duty approach it would seem clear that Company B will attract no such liability as B would not be considered to be in a fiduciary relationship with Company A or its shareholders.<sup>318</sup> It would also seem that company C, who is a mere shareholder in Company A, would not generally be classified as a fiduciary of Company A or its shareholders.<sup>319</sup> However, the nominee director appointed by Company C is obviously in a fiduciary relationship with Company A. Thus, by the act of communicating

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313 See, Securities Amendment Act 1988, s. 7(1)(b).

314 See, above n.180.

315 See, above n.193.

316 See, above n.202.

317 See, above n.226.

318 See, above n.92.

319 See, L.H. Leigh, V.H. Joffe & D. Goldberg, *Northey & Leigh's Introduction to Company Law* (3 ed., Butterworths, London, 1983) 199-201.



confidential information to Company C that director may well incur liability to Company A for a breach of their fiduciary duty to act bona fide in the interests of the company.<sup>320</sup>

Therefore, the examination of this example has served to demonstrate the fact that Part I of the Securities Amendment Act 1988 has imposed potential liability upon a much broader range of persons that may have the opportunity to trade on inside information or engage in "tipping" than is the case under the pre-existing common law causes of action for breach of fiduciary duty and breach of confidence. It would therefore be true to say that the Act has solved one of the major failings of those pre-existing common law causes of action that has been identified with this paper.<sup>321</sup> However, the fact that such a wide scope of persons may be categorised as "insiders" under the Act gives rise to the risk that this legislation may possibly operate to prohibit certain activities which are viewed as commercially desirable within New Zealand's securities markets (e.g., the practice of "due diligence" (as carried out by Company B in the above example<sup>322</sup>) being conducted in relation to a particular company's financial affairs, by potential purchasers of a large holding of that company's securities, assuming of course that such an activity is to be viewed as commercially desirable). The legislature has however attempted to mitigate such a risk in many respects by including numerous exceptions to liability under the insider trading provisions of the Act.<sup>323</sup>

In regard to the remedies for insider trading a certain similarity may be detected between Part I of the Act and the pre-existing common law causes of action by reason of the fact that the Act focuses its principal deterrent and compensatory efforts through the rights of the public issuer whose securities were traded by the insider.<sup>324</sup> This observation is based on the fact that, with its broad proscription against persons indulging in insider trading or tipping, the Act accords the public issuer a right of action against the insider for the gain that insider has garnered.<sup>325</sup> Additionally, the issuer may also recover a fairly sizeable penalty, up to the greater of the price of the securities traded or treble the insider trading profits.<sup>326</sup> To be sure, the Act also accords contemporaneous traders who purchased from or sold to the insider (hereafter referred to as "contemporaneous traders") a right to recover any gain they were deprived of, or any loss incurred, because of the insider's failure to

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320 See also, J. Farrar & M. Russell, *Company Law and Securities Regulation in New Zealand*, above n.22, 228-229.

321 See, above n.25.

322 See, above n.306.

323 See, above n.284.

324 See, J.D. Cox, "An Economic Perspective of Insider Trading Regulation and Enforcement in New Zealand", above n.43, 279.

325 See, Securities Amendment Act 1988, ss. 7(2), 9(2), 11(2) and 13(2).

326 See, Securities Amendment Act 1988, s. 7(4).



disclose before trading.<sup>327</sup> However, because this civil remedy will never exceed more than the profits the insider wrongfully obtained or the loss they have illegally avoided, the contemporaneous trader's remedy should be viewed as secondary to that of the public issuer.<sup>328</sup> Such reasoning is further reinforced by s.19 of the Act which provides that any sums recovered through the public issuer's action against an insider may be distributed by the High Court to contemporaneous traders, members of the public issuer and other persons who could obtain a judgement against the insider in respect of the same transaction. Hence, this provision would appear to recognise the primacy of the issuer's action against insiders while at the same time appreciating that insider trading may visit financial loss upon others.

While it may be said that the public issuer is granted the primary remedy against an insider it must, however, also be recognised that Part I of the Act has sought to overcome one of the main difficulties which has been identified with common law causes of action in the context of insider trading; namely the ability of individual shareholders of the issuer and contemporaneous traders (who may or may not be current members of the issuer) to initiate proceedings against persons indulging in insider trading or tipping.<sup>329</sup> As pointed out previously, this has been achieved under the Act by supplementing the possibility of proceedings initiated by the public issuer with the prospect of a private action by a contemporaneous trader who has been a "victim" of such insider trading.<sup>330</sup> In addition, the public issuer may be indirectly stimulated to initiate an action to impose the pecuniary penalty against an insider as a member of the public issuer or contemporaneous trader may under section 17 of the Act, with the prior approval of the Securities Commission, cause the issuer to secure an opinion of a barrister or solicitor approved by the Commission as to whether or not the issuer has a cause of action for insider trading. Certainly, if the consulted barrister or solicitor renders a positive reaction to the allegations the board of directors of that public issuer would be hard pressed not to proceed with such an action.<sup>331</sup>

327 See, Securities Amendment Act 1988, s. 7(2)(a) and (b).

328 It would appear that mere disgorgement of profits garnered or losses avoided will provide a very mild disincentive for insider trading as an insider is hardly worse off by trading on inside information and being reprimanded in terms of having to disgorge any financial advantage obtained from such transactions, than where they abstained from trading on the inside information altogether. See, J.D. Cox, "An Economic Perspective of Insider Trading Regulation and Enforcement in New Zealand", above n.43, 279-280.

329 See, above n.251.

330 See, Securities Amendment Act 1988 ss.7(2), 9(2), 11(2) and 13(2).

331 This observation is made in light of the fiduciary duty of directors to act bona fide in the interests of the company. See, J. Farrar & M. Russell, *Company Law and Securities Regulation in New Zealand*, above n.22, 228-229. Thus, directors who fail to proceed with such an action against an insider in circumstances where a legal opinion obtained under section 17 of the Securities Amendment Act 1988 has determined that the company has a good chance of success in an action against an insider, may not be acting in the "best interests" of the company. However, it is possible that the board of directors may argue that it would not be in the "best interests of the



Moreover, section 18 of the Act permits the High Court to grant standing to a person who was a member of the public issuer at the time the securities were traded<sup>332</sup> or a contemporaneous trader to prosecute the public issuer's cause of action against the insider. The advantages of initiating such an "issuer based" action under s.18 include the fact that the costs of litigation incurred by the movant are to be absorbed by the public issuer, and that the remedy available is not simply disgorgement of the insider's profits, but the greater of the price of the securities traded or three times the value of the profits garnered by the insider. Therefore, by providing a mechanism by which contemporaneous traders and members of the public issuer (at the time the securities were traded) may enforce the issuer's primary remedy against an insider and have their legal fees paid for by that public issuer, Part I of the Act contains an important incentive for private enforcement of the proscriptions contained within that Act.

By way of conclusion it must be emphasised, however, that while the various remedies and the breadth of coverage provided under Part I of the Securities Amendment Act 1988 may initially appear to overshadow and obviate the need for common law causes of action in the context of insider trading, it is to be realised that this Act is not of universal application as it only prohibits insider trading and tipping activities relating to the securities of a listed public company.<sup>333</sup> Therefore, those common law causes of action that have been discussed at length within this paper will continue to have application and relevance in regard to instances of insider trading and tipping which occur in the securities of unlisted private or closely held companies in New Zealand. Therefore, Part I of the Securities Amendment Act 1988 should not be depicted as having provided a complete solution to those problems which manifest themselves when problems arising from insider trading activities are sought to be remedied by means of reliance upon the common law causes of action for breach of fiduciary duty and breach of confidence.<sup>334</sup>

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company" to proceed with such an action as it may "cast a cloud on the corporation's name, injure stockholder relations and undermine public regard for the corporation's securities"; *Diamond v Oreamuno* 248 NE 2d 910, 912 (1969), per Fuld C.J.

332 See, Securities Amendment Act 1988, s.18(1)(b).

333 See, C. Quinn, "The Securities Amendment Act 1988 and the Chinese Wall" (1989) 7 Otago L. Rev. 141, 141.

334 However, the Companies Bill 1990, which intends to provide coverage in relation to both public and private companies, proposes to cover some of the ground that has been already been covered by Part I of the Securities Amendment Act 1988 (which only covers publicly listed companies); see, above n.16 for a discussion of the relevant clauses of the Companies Bill 1990 in the context of insider trading. It must be pointed out however that there is no such provision within the Companies Bill 1990 for any pecuniary penalty to be recovered against an insider, such as that provided under Part I of the Securities Amendment Act in favour of the public issuer (ss.7(2), 9(2), 11(2), and 13(2)), and which is also available in certain circumstances to members of the public issuer under s.18.



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