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Wai Yee WAN

Singapore Management University, wywan@smu.edu.sg

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Civil liabilities for false or misleading statements made by listed companies to the securities market in Singapore

Wai Yee Wan*

This article examines the scope and efficacy of the civil remedies available to investors against listed companies which have made false or misleading statements in the secondary securities market in Singapore, both at common law and the statutory compensation scheme under the Securities and Futures Act. It argues that there are a number of limitations faced by such investors in bringing claims founded in tort law against the listed companies. While the statutory compensation scheme attempts to improve the position of investors, there are a number of deficiencies in the scheme, the most significant of which is the ceiling on the overall damages recoverable against the contravening listed companies. These deficiencies largely stem from the fact that the scheme is strongly influenced by the desire to achieve optimal deterrence, rather than compensation. This article argues that the aim of the statutory compensation scheme should be clarified and that it should be founded on compensation for losses incurred by investors in having relied on the false or misleading statements, and not on optimal deterrence. Reforms are suggested to the statutory compensation scheme to achieve this aim.

INTRODUCTION

About 10 years ago, the Corporate Finance Committee (CFC), which was tasked with making recommendations to enhance Singapore's position in international corporate fundraising in the aftermath of the Asian financial crisis, recommended that the securities market should move towards a disclosure-based regime that is in line with developed markets.¹ A strong regulatory framework was viewed as necessary to enhance market confidence and the CFC recommended that the civil liability regime under the *Securities Industry Act 1986* (Sing)² should be overhauled. In particular, the CFC recommended that statutory compensation claims should be made available for persons who had traded contemporaneously with insider traders, up to a ceiling, instead of confining these claims only to counterparties who had traded directly with the insider dealer. It also recommended that the securities regulator may commence or intervene in civil actions for insider trading.³ The recommendations were accepted and statutory compensation orders and civil pecuniary sanctions were first introduced for insider trading.⁴ This civil liability regime was subsequently extended, via the *Securities and Futures Act* (Sing), Cap 289 (2006 rev ed),⁵ to other types of market misconduct, including the dissemination of false or misleading statements. Accordingly, contemporaneous traders may make statutory compensation claims to recover their losses, subject to a ceiling, where there has been a contravention of the prohibition on the dissemination of false or misleading statements.

* LLB (NUS), BCL (Oxford), Assistant Professor, School of Law, Singapore Management University. The author is grateful to Professor Hans Tjio, Associate Professors Pearlie Koh, Lee Pey Woan and Gary Chan for reviewing earlier drafts of this article. She also thanks the anonymous referee for the comments given. All errors are hers alone.

¹ Corporate Finance Committee, *The Securities Market: Final Recommendations* (1998) (CFC Report).

² *Securities Industry Act*, Cap 289 (repealed).

³ CFC Report, n 1, pp 31-33.

⁴ *Securities Industry (Amendment) Act 2000* (Sing). This Act came into force on 8 February 2000. The *Securities Industry Act*, together with the amendments, were later consolidated into the *Securities and Futures Act* (Sing), Cap 289 (2006 rev ed).

⁵ The *Securities and Futures Act* is a consolidation of the *Securities Industry Act 1986* and the other legislation relating to securities regulation in Singapore. The provisions relating to liability for market misconduct in the *Securities and Futures Act* came into force on 1 October 2002.

However, even though statutory compensation claims for the dissemination of false or misleading statements have been available since 2002, there has not been a single reported claim.⁶ This is surprising, particularly in view of the number of high-profile corporate scandals involving financial misreporting⁷ of listed companies that occurred in 2004 and 2005.⁸ These corporate scandals in Singapore occurred shortly after financial failures in the United States and Australia involving improper or inaccurate disclosures.⁹ The regulatory response in Singapore to these corporate scandals, taking into account experiences in the United States and Australia, focused only on additional prescriptive standards to be adhered to in financial reporting. For example, r 705(4) of the *Listing Manual of Singapore Exchange (Listing Manual)*, which has statutory backing under s 203 of the *Securities and Futures Act*, was introduced, requiring directors of listed companies to give a negative assurance when announcing the companies' interim financial results. Little attention was paid to the issue of whether the current enforcement measures available under the statutory compensation scheme were effective to ensure the integrity of statements disseminated to the securities market.¹⁰

This article addresses the problem of misreporting by listed companies to the securities market in Singapore differently, by re-examining the scope and efficacy of the civil remedies available to investors at common law and statutory compensation under the *Securities and Futures Act*. The focus is on civil remedies that are available to investors against the listed companies which have disseminated the information in the secondary market.¹¹

⁶ The lack of civil claims has been observed by commentators: eg see Lee J, "The Americanisation of the Civil Liability Regime for Insider Trading in Singapore" (2005) 23 C&SLJ 396. There was a report of a class action suit brought in the United States in connection with the false and misleading disclosures made by China Aviation Oil (Singapore) Corporation but that suit was brought under the *Securities Exchange Act 1934* (US) and not under the *Securities and Futures Act*: see *Burke v China Aviation Oil (Singapore) Corp* 421 F Supp 2d 649 (2005).

⁷ Recent high-profile corporate scandals involving the publication of false and misleading financial statements by directors or senior managers of publicly listed companies in Singapore include Accord Customer Care Solutions (*PP v Tan Hor Peow Victor* [2006] SGDC 148; *PP v Yip Hwai Chong* [2006] SGDC 27); China Aviation Oil (Singapore) Corporation (*PP v Chen Jiulin* (unreported), cited in *PP v Wong Tai* [2006] SGDC 193; *PP v Lim Tiong Sun Peter* [2006] SGDC 160); and IHL Holdings (*PP v Wong Tai* [2006] SGDC 193).

⁸ In respect of the cases listed in n 7, all of the charges were brought under one of the relevant subsections of s 199 read with s 331(1) of the *Securities and Futures Act*. Section 199 of the *Securities and Futures Act* contains the basic prohibition against the dissemination of false or misleading statements. See discussion below. Even though the listed companies were not directly prosecuted for the offences relating to financial misreporting, certain of their directors or managers were successfully prosecuted under s 331 of the *Securities and Futures Act*, which requires a finding that their companies had committed an offence under s 199 of the *Securities and Futures Act* in the first place.

⁹ The catastrophic financial failures in the United States included Enron, Tyco and WorldCom. False disclosures in the financial statements of Enron and WorldCom led to, inter alia, the enactment of the *Sarbanes-Oxley Act 2002* (US). In Australia, the Australian Government undertook a review of its audit and corporate disclosure framework and enacted the *Corporate Law Economic Reform Program (Audit Reform and Corporate Disclosure) Act 2004* (Cth). The legislation was passed as part of the ninth phase of the Corporate Law Economic Reform Program and was also a response to, inter alia, the financial failure of the HIH Insurance Group: see HIH Royal Commission, *Final Report* (April 2003) Ch 3, <http://www.hihroyalcom.gov.au> viewed 5 February 2008.

¹⁰ Recently, there were proposals by the Monetary Authority of Singapore (MAS), the securities regulator, to amend the *Securities and Futures Act* to, inter alia, plug the loopholes in respect of certain perceived deficiencies in the civil remedies for market misconduct generally, but the statutory liability regime remains largely intact. These proposals include imposing civil liabilities on the employer company for the employee's insider trading gains and imposing disqualification orders for persons who are either convicted of, or found to be liable for, a civil pecuniary penalty order in respect of an offence under Pt 12 of the *Securities and Futures Act*. See *MAS Consultation Paper: Policy Consultation on Amendments to the Securities and Futures Act and Financial Advisers Act* (December 2006). See also *MAS Consultation Paper: Draft Securities and Futures (Amendment) Bill 2007 and Draft Financial Advisers (Amendment) Bill 2007* (October 2007).

¹¹ This article does not focus on the liability regime of the defendant listed companies arising from prospectuses that are registered with the MAS. Prospectuses are required, inter alia, where listed companies issue new securities to the purchasers and offer such securities to the public. Prospectus liabilities are governed by an entirely separate regime under Pt 13 of the *Securities and Futures Act*.

This article begins by outlining the types of reporting and disclosure requirements of a Singapore company listed on the Singapore Exchange.¹² It reviews the common law limitations for imposing civil remedies in connection with the dissemination of false or misleading information to the securities market. The common law is important as it serves as a baseline for measuring the improvement brought by the statutory compensation regime. The article then examines the scope and workings of the statutory compensation regime and contends that, despite its many investor-friendly features, it has a number of deficiencies. The most significant of these is the ceiling on the overall damages recoverable against a contravening person, which is a strong disincentive for claims to be brought. These deficiencies stem from the fact that the current statutory compensation regime is strongly influenced by the desire to achieve optimal deterrence rather than compensation. It is argued that the aim of the statutory compensation regime should be properly clarified and that its underlying justification should be founded on compensation for the losses incurred by the plaintiff in having relied on the false or misleading statement, and not on optimal deterrence. Thus, the aim should be consistent with the objective of an award of damages at common law. Based on this aim, only plaintiffs who establish reliance on the misstatement may obtain compensation and the ceiling on the recoverability should be abolished. However, there remains the issue that the lifting of the ceiling on compensation may encourage unmeritorious claims and may potentially lead to excessive liabilities on the part of listed companies, leading to such companies engaging in defensive and unhelpful reporting. The final part of the article suggests that the problem may be better resolved by awarding discretion to the courts to have the power of relieving a person of civil liability, which is similar to the statutory power to relieve an officer of liability for breach of duty under s 391 of the *Companies Act* (Sing), Cap 50 (2006 rev ed) (*Companies Act*). This suggestion is not as radical as it seems and has, in fact, been adopted in Australia.

FINANCIAL REPORTING AND ANNOUNCEMENTS BY LISTED COMPANIES

As a preliminary point, it is useful to outline the reporting requirements for Singapore companies listed on the Singapore Exchange. Consistent with a disclosure-based regime, these companies are required to disclose not only periodic reporting (which refers to financial information and disclosures over the relevant period following the closing date of the relevant financial statement) but also episodic reporting (which refers to immediate disclosures made, including disclosures made under the mandatory disclosure requirements). All of the mandatory disclosures must be made via a centralised website.¹³

The periodic reporting requirements are set out in the *Companies Act* and the *Listing Manual*. Under the *Companies Act*, a listed company's directors are required to lay before each annual general meeting audited accounts, together with the directors' statement verifying the accounts, the directors' report and the auditors' report.¹⁴ The *Listing Manual* requires these directors to issue the annual report, which comprises audited accounts¹⁵ and other narrative disclosures, including a discussion of

¹² In this article, the focus is on Singapore-incorporated companies listed on the Singapore Exchange and references to listed companies refer to Singapore-incorporated listed companies, unless otherwise stated. Foreign-incorporated companies listed on the Singapore Exchange are not subject to periodic reporting requirements under the *Companies Act* but are subject to periodic and episodic requirements under the *Listing Manual* and under the *Securities and Futures Act*.

¹³ All mandatory disclosures disseminated by listed companies must be effected via SGXNET under the *Listing Manual*, r 702.

¹⁴ *Companies Act* (SGP), Cap 50 (2006 rev ed), ss 201 and 203.

¹⁵ A company has the option of sending summary financial statements to its shareholders, which are briefer than the full statutory accounts under s 203A of the *Companies Act*.

the listed company's operating and financial performance and business outlook¹⁶ and the corporate governance disclosures.¹⁷ The inclusion of an operating and financial review¹⁸ in the annual report is encouraged but not mandated.

Apart from the audited accounts, a listed company is also required to disclose interim financial reports for each of the first three quarters of each year.¹⁹ The interim financial report comprises not only a list of numbers but also a commentary on the significant trends and competitive conditions of the industry in which the listed company operates and any known factors or events that may affect the listed company in the next reporting period and the next 12 months.²⁰

In addition to periodic financial reporting, under the *Listing Manual* a listed company must announce any price-sensitive information immediately, subject to very limited exceptions.²¹ There are also additional requirements under the listing rules in relation to interested person transactions and significant acquisitions or disposals. Although the obligations relating to periodic and episodic reporting are set out in the *Listing Manual*, all of these obligations are statutorily backed by s 203 of the *Securities and Futures Act*.²² Contravention of s 203 may lead to criminal sanctions, civil pecuniary penalties or statutory compensation claims.²³

COMMON LAW LIABILITIES ARISING FROM FALSE OR MISLEADING STATEMENTS TO THE SECURITIES MARKET

Where a listed company has disseminated false or misleading information to the securities market, the issue is whether a plaintiff, who has suffered a loss by having traded in the securities of a listed company in the secondary market,²⁴ has a possible claim at common law against the company in the tort of deceit or negligence.²⁵ In order to succeed, the plaintiff must establish:

¹⁶ *Listing Manual*, r 1207(4).

¹⁷ Corporate governance disclosures are set out in the *Code of Corporate Governance*, first issued by the Corporate Governance Committee. The current *Code of Corporate Governance 2005* is issued by the Ministry of Finance.

¹⁸ *Listing Manual*, Practice Note 7.4. Compliance is voluntary, not mandatory, though companies are encouraged to adhere to the *Guide for Operating and Financial Review* (OFR). The OFR has its roots in the United Kingdom statutory OFR, enacted in the form of the *Companies Act 1985 (Operating and Financial Review and Directors' Report etc) Regulations 2005*, SI 2005/1011 but the regulations were repealed by the *Companies Act 1985 (Operating and Financial Review) (Repeal) Regulations 2005* (SI 2005/3442).

¹⁹ *Listing Manual*, Ch 7. A listed company is required to perform quarterly reporting if its market capitalisation exceeded S\$75 million as at 31 March 2003; it is listed after 31 March 2003 and its market capitalisation exceeded S\$75 million; or its market capitalisation is S\$75 million or higher on the last trading day of each calendar year commencing from 31 December 2006.

²⁰ *Listing Manual*, App 7.2 at [10]. The contents of the interim financial reports are prescribed in *Financial Reporting Standard 34, Interim Financial Reporting*, which was first issued by the Council on Corporate Disclosure and Governance in January 2003. These standards are now prescribed by the Accounting Standards Council.

²¹ *Listing Manual*, r 703(1). The exceptions allow for a delay in the immediate disclosure where, inter alia, the matters involved are confidential and one of the following applies in respect of the information: it concerns an incomplete proposal; it is not sufficiently definite to warrant disclosure; it is meant for internal purposes; or it concerns a trade secret.

²² Section 203 is based on s 1001A of the Australian *Corporations Law* (which has since been repealed and replaced by s 674 of the *Corporations Act 2001* (Cth) (*Corporations Act*). The regime in Singapore relating to mandatory disclosure is similar to the Australian regime, where the requirements are contained in the *ASX Listing Rules* and are statutorily enforced by s 674 of the *Corporations Act*. See Golding G and Kalfus N, "The Continuous Evolution of Australia's Continuous Disclosure Laws" (2004) 22 C&SLJ 385.

²³ Where a contravention of s 203 is committed intentionally or recklessly, such breach constitutes an offence and the listed company is also liable to compensatory claims and civil penalties. Where the contravention is committed negligently, the listed company has not committed an offence but is liable to civil penalties and compensatory claims: *Securities and Futures Act*, ss 203, 232, 234 and 236.

²⁴ In the secondary markets, the securities are not purchased from the listed company. If the securities are purchased from the listed company and misleading statements are found in the selling document, the investor will have remedies in contract law and under the *Misrepresentation Act* (Sing), Cap 390 (1994 rev ed).

²⁵ A breach of the *Securities and Futures Act*, in itself, will not give rise to the availability of the tort for a breach of statutory duty at common law as the tort for breach of statutory duty has not generally been imposed for pure economic loss: see

- all the ingredients of liability for the relevant tort;
- that the loss is caused by the wrong; and
- that the loss falls within the appropriate measure of recoverable loss.

The basic aim of these damages in tort law is to compensate the plaintiff for having relied on the misstatement.²⁶ The following sets out the significant hurdles faced by the plaintiff investor in bringing such an action in tort law against the listed company.

Ingredients of liability: Deceit

Under the tort of deceit, it must be established that the false or misleading statement, being a representation of fact, was made by the defendant, the statement was made fraudulently, the defendant intended the plaintiff to rely on the statement and the statement actually induced the plaintiff to rely on it.²⁷ There are two significant difficulties with investors suing in the tort of deceit. First, it was established in *Derry v Peek* (1889) 14 App Cas 337 that a statement is fraudulent only if the maker makes a representation knowing it to be false or without belief in its truth or is reckless as to whether it is true or false, intending the plaintiff to act on it. There is no fraudulent misrepresentation if the maker believes that the representation is true, even if the belief is unreasonable. A high burden of proof is required in respect of allegations of fraud.²⁸ Allegations of fraud must be supported with particulars, and cannot be pleaded generally.²⁹ Secondly, the plaintiff must show that the defendant had made the false or misleading statements for the specific purpose of inducing the specific plaintiff to enter into the transaction.³⁰ Periodic and episodic reports, which are made by listed companies pursuant to their listing obligations, are generally made for the purpose of informing the market, and are not normally made for the purpose of inducing any specific person into entering a particular securities transaction.

Ingredients of liability: Negligence

The question as to whether the disseminating listed company is liable to investors for misstatements under tort of negligence is more complex. In order to establish liability under the tort of negligence, the plaintiff must first establish a duty of care owed to the plaintiff. The modern test of duty of care in the tort of negligence is set out in *Caparo Industries plc v Dickman* [1990] 2 AC 605 (*Caparo*). *Caparo*, which was followed by the Singapore Court of Appeal in *Ikumene Singapore v Leong Chee Leng* [1993] 3 SLR 24 (*Ikumene*), held that the test for duty of care is the three-part test based on “foreseeability” of damage, “proximity” of relationship and that the situation is one which the court considers is “fair, just and reasonable” (at 617-618, Lord Bridge). *Caparo* involved the scope of the duty of care owed by auditors in respect of statutory accounts and the House of Lords held that the purpose of the statutory accounts was to enable shareholders to monitor the management of the company by directors and to decide how to exercise their powers in general meeting, and not to enable them or other investors to make investment decisions. Accordingly, reliance on the statutory accounts was not reasonable as it was not consistent with the purpose for which the statement was made. Notwithstanding that *Caparo* concerned the issue of the scope of duty of care owed by auditors of a

Stanton K et al, *Statutory Torts* (Sweet & Maxwell, 2003) at [11.002]. Further, civil remedies for breaches are, in fact, prescribed under the *Securities and Futures Act*, which will tend to exclude the availability of remedies for breach of statutory duties. See Dugdale AM and Jones MA (gen eds), *Clerk & Lindsell on Torts* (19th ed, Sweet & Maxwell, 2006) at [9-19].

²⁶ *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254 at 282 (Lord Steyn).

²⁷ *Bradford Third Equitable Benefit Building Society v Borders* [1941] 2 All ER 205. See also Cartwright J, *Misrepresentation, Mistake and Non-disclosure* (Sweet & Maxwell, 2007) at [5.05].

²⁸ *Hornal v Neuberger Products Ltd* [1957] 1 QB 247.

²⁹ *Wallingford v Mutual Society* (1880) 5 App Cas 685.

³⁰ *Bradford Third Equitable Benefit Building Society v Borders* [1941] 2 All ER 205. See also Cartwright, n 27 at [5.19].

company to the company's shareholders, it has been assumed that the same analysis applied to the issue of whether there is a duty of care owed by companies or their directors to their shareholders.³¹

This three-part test on duty of care was recently reconsidered by the Singapore Court of Appeal in *Spandek Engineering v Defence Science & Technology Agency* [2007] SGCA 37 (*Spandek*). In summary, after reviewing the various tests, the court rejected the three-part test in *Caparo*³² and held that there should be one unifying test for duty, based on "proximity" and "policy considerations", subject to the preliminary requirement of "factual foreseeability". However, an incremental approach continues to remain relevant in determining the scope of "proximity" and "policy considerations"³³ and the concepts of "assumption of responsibility"³⁴ and "reasonable reliance" are relevant in determining "proximity". It is beyond the scope of this article to discuss the merits and differences between this new test and the three-part test. Suffice to say that, notwithstanding the rejection of the three-part test, *Caparo* remains important in Singapore for two reasons. First, *Caparo* was applied in *Ikumene* and its reasoning relating to the scope of auditors' duty and its conclusion in respect of duty of care arising from audited accounts were not doubted in *Spandek*. Secondly, the court in *Spandek* advocated the use of an incremental approach which is based on reasoning by analogy from decided cases in determining whether a duty of care exists on a set of specific facts. Accordingly, *Caparo* remains relevant in analysing how the conclusions of proximity and policy are reached in respect of the auditors' non-liability to shareholders for audited accounts, and the decision is likely to be a useful guide for the duty of care owed by listed companies to their shareholders in respect of audited accounts and other financial statements.

In *Caparo*, Lord Oliver left the possibility of a wider duty of care owed by the provider of information to the reader if the provider allows it to be used by someone for a particular purpose.³⁵ Cases subsequent to *Caparo* have tested the limits of this wider duty of care but the English courts have generally adopted a restrictive approach.³⁶ However, outside of statutory accounts, it is arguable whether other disclosures made by the listed company serve a wider purpose than merely providing information for shareholders to exercise their voting rights at shareholders' meetings. Particularly in the case of the disclosures required to be made under the *Listing Manual* (such as interim financial results and episodic reporting), the *Listing Manual* makes it clear that the purpose of such disclosures is to provide investors with information on such listed company's affairs to enable them to make

³¹ In *Al-Nakib Investments (Jersey) Ltd v Longcraft* [1990] 1 WLR 1390, it was assumed that the principles developed in *Caparo* in respect of the auditors' scope of duty of care would be applied equally to the corresponding duty of care owed by directors.

³² The Singapore Court of Appeal considered the various tests: the three-part test in *Caparo*; an "incremental" approach which directs the court to reason analogically on existing cases from recovery, also found in *Caparo*; a two-stage test based on *Anns v Merton London Borough Council* [1978] AC 728, an earlier House of Lords decision which was subsequently overruled by *Murphy v Brentwood District Council* [1991] 1 AC 398; and a method based on "assumption of responsibility" and "reasonable reliance" by the plaintiff.

³³ The Singapore Court of Appeal stated that the test was to be applied "incrementally, in the sense that when applying the test in each stage, it would be desirable to refer to decided cases in analogous situations to see how the courts have reached their conclusions in terms of proximity and/or policy": *Spandek Engineering v Defence Science & Technology Agency* [2007] SGCA 37 at [73].

³⁴ Assumption of responsibility was laid down in *Henderson v Merrett Syndicates Ltd* [1995] 2 AC 145.

³⁵ Lord Oliver held that this situation could arise if it can be shown that the accounts and the report are required for a purpose which is made known to the advisee; will be communicated to the plaintiff, either specifically or as a member of an ascertainable class, in order that it should be used by the advisee for that purpose; it is known that the advice so communicated is likely to be acted upon for that purpose without independent inquiry; and it is so acted upon to his detriment: *Caparo Industries plc v Dickman* [1990] 2 AC 605 at 638.

³⁶ For example, *Galoo Ltd v Bright Grahame Murray* [1994] 1 WLR 1360; *Morgan Crucible Co plc v Hill Samuel* [1990] 1 Ch 295.

informed decisions.³⁷ Unlike statutory accounts,³⁸ interim financial results and episodic reporting are not laid before any shareholders' meeting. Further, the listed companies know, or ought to know, that such disclosures, which are not subject to statutory audit, will be acted upon by investors without further inquiry, since investors generally have no ready means of verifying the accuracy of these disclosures.³⁹ Arguably, it follows that it is reasonable for investors to rely on these disclosures.

Nevertheless, there are two major arguments against imposing a duty of care on the listed company to investors arising from interim financial results or episodic reporting. First, there is no "voluntary" assumption of responsibility in favour of the investor for the task undertaken in this case, being an essential element of proximity, as held in *Spandeck*. The interim financial results and episodic reporting are made pursuant to the *Listing Manual* read with s 203 of the *Securities and Futures Act*, and are not made voluntarily, even on an objective test.⁴⁰ Secondly, the refusal to impose a duty of care in favour of investors in respect of their investment decisions arising from statutory accounts is that such a duty of care is likely to lead to indeterminate liability of an indeterminate amount against the listed companies.⁴¹ These are likely to be the same policy reasons against imposing a duty of care for statutory accounts to investors or even shareholders in respect of their investment decisions.

Causation and measure of recoverable loss

Having established the ingredients of liability for tort (that is, the wrong), the plaintiff then must show that the loss is caused by the wrong. Causation refers to factual and legal causation.⁴² In respect of factual causation, proof of reliance establishes that the false or misleading statement had in fact caused the plaintiff to enter into the securities transaction.⁴³ In respect of legal causation, there must be a sufficient link between the loss and the false or misleading statement, and it depends on the type of tort in question. For example, in the case of fraud, the plaintiff is able to argue that but for the fraud, he would not have entered into the securities transaction and hence the defendant is liable for all the direct losses incurred by the plaintiff as a result of entry into the securities transaction, including the

³⁷ For example, the *Listing Manual*, App 7.1 at [17], provides that "the issuer must make a prompt announcement so that the market remains properly informed if the rumour or report is materially incorrect and may mislead investors"; the *Listing Manual*, App 7.1 at [25], provides that an announcement issued must "contain sufficient quantitative information to allow investors to evaluate its relative importance to the activities of the issuer".

³⁸ *Companies Act* (Sing), ss 201(3) and 201(3A).

³⁹ In the United Kingdom, it has been accepted by the government that, with the adoption of the *Transparency Directive* (2004/109/EC), whose express purposes include enhancing investor protection and market efficiency, there were significant litigation and liability risks faced by the issuers and their directors in view of the fact that the outcome in *Caparo* on statutory accounts may not be the same as that for periodic reporting of ad hoc disclosures that are subject to the *Transparency Directive*. Such risks were sufficiently serious for the United Kingdom Government to enact the new ss 90A and 90B of the *Financial Services and Markets Act 2000* (UK), which was introduced by s 1270 of the *Companies Act 2006* (UK), to address such concern. See Davies P, *Davies Review of Issuer Liability: Liability for Misstatements to the Market: A Discussion Paper by Professor Paul Davies* (March 2007) p 24 (Davies Discussion Paper).

⁴⁰ In *Commissioners of Customs & Excise v Barclays Bank* [2007] UKHL 28, the House of Lords held that whether there was an assumption of responsibility was an objective test. In that case, an injunction order was granted to a third party against one of the bank's customers and the order was notified to the bank. It was held that the bank did not assume responsibility to comply with the order because it was under a legal obligation to comply with an order of court.

⁴¹ In *Caparo Industries plc v Dickman* [1990] 2 AC 605 at 621, Lord Bridge cautioned against using reliance exclusively as the touchstone of liability in respect of statements that are circulated generally as such a test would lead to wide-ranging liability, citing the classic words of Cardozo CJ in *Ultramares Corp v Touche* 174 NE 441 at 444 (1931) that liability is created "in an indeterminate amount for an indeterminate time to an indeterminate class".

⁴² See Dugdale and Jones, n 25 at [2-03] and [2-04]. For a recent discussion of the purpose of, and approach to, causation, see Lord Hoffmann, "Causation" (2005) 121 LQR 592.

⁴³ A lack of reliance on the defendant's statement would be a defence to a claim in tort: *JEB Fasteners Ltd v Marks Bloom & Co* [1983] 1 All ER 583.

fall in the market value of the securities unconnected to the fraud.⁴⁴ In the case of negligence, the defendant is only liable for the losses that fall within the scope of the defendant's duty;⁴⁵ generally, the losses would be limited to the consequences of entering into the securities transaction on a false basis, that is, believing that the securities are worth more than they actually are. The defendant will not be liable for the subsequent fall in the market value of the securities as it is not within the defendant's duty to prevent the plaintiff from incurring such a loss.

Finally, the measure of damages must be within the scope of recoverable loss. This requires a consideration of the rules on remoteness. Again, as in the case of legal causation, the applicability of the rules on remoteness depends on the kind of tort. For fraud, the plaintiff is entitled to argue that the only cause of the plaintiff's entry into the securities transaction is the false or misleading statement made fraudulently and hence all losses are recoverable. However, recoverability of damages is subject to the rules on remoteness for negligence.⁴⁶

STATUTORY LIABILITIES ARISING FROM MISSTATEMENTS TO THE SECURITIES MARKET

Securities and Futures Act framework for market misconduct

Under the *Securities and Futures Act*, the contravention of the prohibition on specific types of market misconduct⁴⁷ may result in liability for statutory compensation under ss 234 and 236. In addition, such infringement may also result in the defendant incurring criminal liability (a maximum fine of S\$250,000 and/or seven years imprisonment (for an individual) and a maximum fine of S\$500,000 (for a corporation)) or a civil pecuniary sanction (three times the amount of profit gained or loss avoided, subject to a minimum sum of S\$50,000 for an individual and S\$100,000 for a corporation).⁴⁸ There is no distinction drawn as to the fault elements that must be proved in order to attract any such consequences.

Ingredients of liability

The relevant provision in the *Securities and Futures Act* relating to dissemination of misstatement is s 199. Section 199 prohibits the making of a statement that is false or misleading in a material particular, and which is likely to

- induce other persons to subscribe for securities;
- induce the sale or purchase of securities; or

⁴⁴ In *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254, the House of Lords held that all losses flowing from the tort of deceit, including losses arising from the fall in market value of the securities, are recoverable, where the fraudulent representation is continuing or where the representee is locked into the transaction as a result of the fraud. Lord Steyn stated (at 278-279) that a policy of imposing more stringent remedies on intentional wrongdoers is justified on moral grounds.

⁴⁵ *South Australia Asset Management Corp v York Montague Ltd* [1997] 1 AC 191.

⁴⁶ *Smith New Court Securities Ltd v Citibank NA* [1997] AC 254 at 266-267.

⁴⁷ The forms of prohibited market misconduct under the *Securities and Futures Act* are insider trading (ss 218 and 219); creating a false and misleading appearance with respect to volume of trading, the price of or market for securities (s 197(1)); "wash sales" (s 197(2)); market manipulation (s 198); making false or misleading statements (ss 199 or 200); and breach of the continuous disclosure requirements (s 203).

⁴⁸ *Securities and Futures Act*, s 232(2). To address issues relating to double jeopardy, civil penalty proceedings will not be instituted against a person if the person had been convicted or acquitted in criminal proceedings unless the person was acquitted on the ground that the charge was withdrawn (s 233). Likewise, criminal proceedings will not be instituted against a person after a civil penalty order has been made against the person (s 204).

- have the effect of raising, lowering, maintaining or stabilising the market price of securities.⁴⁹

Section 199 was based on the Australian *Securities Industry Act 1980* (Cth).⁵⁰

In relation to the mental requirement under s 199:

- s 199(i) requires the maker of the statement either to have knowledge that the statement or information is false or misleading in a material particular or is reckless as to whether the statement or information is true; and
- s 199(ii) requires the maker to “know or ought reasonably to have known” of the falsity or misleading nature of the information.

The inter-relation between s 199(i) and 199(ii) was examined in the recent High Court of Singapore decision in *PP v Wang Ziyi Able* [2007] SGHC 204. In that case, it was held that:

- the first limb of s 199(ii) requires actual and subjective knowledge of the false or misleading nature of the statement being disseminated;
- the second limb of s 199(ii) requires objective constructive knowledge directed against negligence; and
- s 199(i) requires the mental state of not caring whether the statement or information is true or false, which requires some subjective dishonesty on the part of the contravening person and is akin to the concept of subjective recklessness found in *Derry v Peek* (1889) 14 App Cas 337.⁵¹

In effect, s 199 imposes liability for fraud, recklessness or negligence.

Measure of recoverable loss

As against a person who has contravened s 199, s 234 permits a person who has traded “contemporaneously” with the contravention⁵² to claim losses against such contravening person, and these losses are statutorily (and conclusively) presumed to be the difference between the price at which the contemporaneous trader dealt in the securities and the price at which the securities would have been traded “if the contravention had not occurred”. Section 234 applies irrespective of whether the contravening person has been convicted or has a civil penalty imposed.

Alternatively, under s 236 of the *Securities and Futures Act*, a contemporaneous trader may also prove claims for compensation against a person convicted of an offence under s 199. For such claims, the amount of compensation is the amount that the claimant would be entitled to claim had the claimant proceeded under s 234 or a pro-rated portion of the maximum recoverable amount, whichever is lower. These private rights of actions may only be brought by the contemporaneous trader and, unlike Australia⁵³ and the United Kingdom,⁵⁴ the securities regulator in Singapore has no standing to obtain compensation on behalf of these investors.

⁴⁹ Another potentially relevant provision is s 200 of the *Securities and Futures Act*, which prohibits the dissemination of false or misleading information to induce or attempting to induce another to deal in securities by the making or publishing of any statement, promise or forecast that the maker knows or ought reasonably to have known to be misleading, false or deceptive; the dishonest concealment of material facts; the reckless making or publishing of any statement, promise or forecast that is misleading, false or deceptive; or by recording or storing in, or by means of, any mechanical, electronic or other device information that the person knows to be false or misleading in a material particular. However, it is less common to rely on s 200 of the *Securities and Futures Act*, which requires, inter alia, proof that the misstatement was made to induce or attempt to induce another to deal in securities.

⁵⁰ Section 199 of the *Securities and Futures Act* was based on s 125 of the repealed Australian *Securities Industry Act 1980* (Cth). Section 125 of the *Securities Industry Act 1980* (Cth) was the statutory predecessor to s 1041E of the *Corporations Act 2001* (Cth).

⁵¹ The High Court of Singapore referred to the views taken by Baxt R, Ford HAJ and Black A, *Securities Industry Law* (5th ed, Butterworths, 1996) p 122, on s 999 of the *Corporations Law* (which had been replaced by s 1041E of the *Corporations Act*). Section 1041E of the *Corporations Act* is the Australian equivalent of s 199 of the *Securities and Futures Act*.

⁵² The term “contemporaneously” is not defined in the *Securities and Futures Act*.

⁵³ *Corporations Act 2001* (Cth), s 1325(3). Under that provision, the Australian Securities and Investments Commission has standing to make applications for compensation in connection with, inter alia, a contravention of Pt 7.10 of the *Corporations Act* (of which ss 1041E to 1041I are part), on behalf of persons harmed by compensation with the consent of such persons. See also *Australian Securities and Investments Commission Act 2001* (Cth), s 12GM(2) and (3).

⁵⁴ *Financial Services and Markets Act 2000* (UK), ss 382 and 383. Under these provisions, the Financial Services Authority (FSA) may apply to the court for a restitution order for the contravening person either to make payment to the FSA for the

Comparison between the common law and statutory regimes for civil remedies arising out of false or misleading statements

Like the tort of deceit or negligent misstatement, culpable conduct is required of the contravening person under the statutory compensation regime. The statutory compensation regime ostensibly improves upon the position under tort law in two significant respects. First, the statutory compensation regime dispenses with the requirement that the defendant must have intended that the plaintiff rely on the statement (under the tort of deceit) or that the plaintiff's own reliance on the statement is reasonable (under the tort of negligence). Secondly, the plaintiff is relieved of the burden of proving factual causation, given that actual reliance on the misstatement is not a prerequisite to making the claim. In fact, the regime assumes that the loss will flow from the contravention of the prohibition, and prescribes a statutory formula on the calculation of the loss.

Despite these features in the regime which makes it more plaintiff-friendly, the regime has a number of features which tend in the opposite direction. The first problem is the lack of clarity as to how the class of plaintiffs, that is, the "contemporaneous traders", is to be determined. Does it refer to persons who have traded on the same day on which the misstatement was made (but after the misstatement was disseminated) or is it extended to persons who have traded between the time the misstatement disseminated was made up to the time the misstatement was corrected? The prescribed factors in s 234(5) are unhelpful in providing guidance on the class of plaintiffs.⁵⁵ There are United States case authorities on s 20A of the *Securities Exchange Act 1934* (US) (*Exchange Act*),⁵⁶ upon which s 234 of the *Securities and Futures Act* was based, that suggest that trading within one week of the defendant's improper trading satisfies the contemporaneous trading requirements.⁵⁷ However, as s 20A of the *Exchange Act* provides private rights of action for contemporaneous traders in respect of insider trading violations only and not other types of market misconduct, the United States case authorities may be distinguished on the ground that the considerations are different. In the case of insider trading, the contemporaneous trading requirement enables the plaintiff to demonstrate privity between the plaintiff's trades and the insider's trades, which is not possible in an anonymous securities market, and this consideration is absent in the case of the making of a false or misleading statement. It is submitted that the better argument is that the misstatement by the listed company is a continuing misstatement until corrected and a person trading who is trading under the misstatement up to the time of correction falls within the class of contemporaneous traders. In any event, on the basis of either view, in the case of widely traded securities, the number of contemporaneous traders may be potentially very large.

Secondly and more significantly, there is an overall ceiling on the maximum recoverable sum by the contemporaneous traders, which is pegged to the amount of profit that the contravening person has gained or the loss avoided, less all amounts of compensation that the court has ordered the contravening person to pay to other claimants in respect of the same contravention. Accordingly, if there is more than one contemporaneous trader and the aggregate of the claims exceeds the maximum recoverable sum, each contemporaneous trader would receive a proportion of the maximum recoverable sum based on the sum that the trader would have otherwise been entitled to and all

profits accrued or losses incurred as a result of the contravention. The payment would then be distributed to persons to whom the profits are attributable or persons who have suffered losses. However, the FSA has indicated that this power to apply for restitution orders would not be used routinely, in view of the scarcity of resources. See Financial Services Authority, *Enforcement Guide* (Financial Services Authority, London, 2007) at [11]; *Davies Discussion Paper*, n 39, pp 28-29.

⁵⁵ Section 234(5) of the *Securities and Futures Act* sets out matters that the court may consider in determining whether a person is a contemporaneous trader. They include volume of securities trading at the date and time of contravention; the date and time the contravention was cleared or settled; whether the dealing took place before or after the contravention; and other factors as the court considers relevant. However, it remains unclear whether contemporaneous traders include persons who have traded with the contravening person within a few days or whether contemporaneous trading is confined only to dealings on the same day (whether at or before the time the contravening acts took place). See Lee, n 6 for a discussion on how these factors may be applied.

⁵⁶ 15 USC s 78u-1 (2000).

⁵⁷ For example, Hazen TL, *Treatise on the Law of Securities Regulation* (5th ed, West Publishing Co, 2005) Vol 3, p 534.

amounts proved in court.⁵⁸ The result is that unless the contemporaneous trader's proportion of the maximum recoverable sum is sufficiently large, it is hardly worthwhile bringing the claim.

The main features of the statutory compensation regime, namely the potentially wide class of plaintiffs, taken together with the ceiling on the aggregate damages, suggest that the underlying policy motivation for the regime is not limited to investor compensation, but is strongly influenced by the desire to achieve optimal deterrence. This is supported by the CFC Report which stated that the civil liability regime should primarily be to deter market misconduct,⁵⁹ but in recognition of the fact that the potential liability for compensation may be completely disproportionate to the defendant's gains (or avoidance of losses), the problem was dealt with by putting a ceiling on the recoverable amount.⁶⁰ However, this ceiling can work injustice to victims of market misconduct where there is no gain made or loss avoided by the listed company. For example, in the case of fraud perpetuated by senior employees of a company which is in the "last period",⁶¹ that is, where these employees attempt to conceal the true condition of the company with the aim of keeping it from going into imminent insolvency and/or preventing its share price from plummeting, there is no direct benefit obtained or loss avoided by the listed company. Hence, the victims will not recover by reason of the ceiling on the statutory compensation. The "last period" problem has led in part to the serious securities frauds in Singapore, including that involving the China Aviation Oil (Singapore) Corporation.⁶²

CLARIFICATION OF THE AIM OF THE STATUTORY COMPENSATION REGIME FOR MISSTATEMENTS MADE TO THE SECURITIES MARKET

Compensation versus optimal deterrence

It is critical to identify whether the proper objective of a statutory compensatory regime is compensation or optimal deterrence as the choice of the objective will influence the regulation in different ways. Compensation focuses on the plaintiff's losses and why he is entitled to make the claims. In this regard, the rules on causation and the measure of recoverable losses are crucial as they form the basis of the plaintiff's entitlement to make the claim. The mere fact that there is a contravention of the *Securities and Futures Act* is not, in itself, sufficient justification for the plaintiff's claim. Optimal deterrence, on the other hand, focuses on the contravening person's misconduct, and is geared towards determining the optimal price which makes it too costly for it not to comply.

It is submitted that the proper aim of the statutory compensation regime should be limited to compensation for the following reasons. First, there currently exists criminal and civil pecuniary sanctions for contravention of the prohibition on market misconduct, and each of these sanctions plays the role of punishment and deterrence. In the case of the civil pecuniary order, it is payable to the Monetary Authority of Singapore (MAS), though in the case of insider trading, there was one reported incident where part of the payment by the defendant pursuant to the settlement of the civil pecuniary order was distributed to minority shareholders.⁶³ However, it does not detract from the fact that the

⁵⁸ *Securities and Futures Act*, s 236(3).

⁵⁹ CFC Report, n 1, p 27.

⁶⁰ CFC Report, n 1, 32.

⁶¹ In these cases, most of the companies affected by such behaviour will end in bankruptcy. See Arlen JH and Carney WJ, "Vicarious Liability for Fraud on Securities Markets: Theory and Evidence" (1992) Univ Ill LR 691.

⁶² The chief executive officer (Chen) of China Aviation Oil (Singapore) Corporation pleaded guilty to a number of charges, including charges for market misconduct relating to the making of false and misleading statements relating to the financial performance and failure to disclose massive options losses of approximately S\$895 million. See an account in relation to the sentencing hearing of Chen in "Chen Pleads Guilty to Six Criminal Charges", *Business Times* (17 March 2006), where it was stated that it was common ground between the prosecution and Chen that he did not derive any personal gain from the market misconduct. Chen's counsel argued that Chen acted in what he thought were the best interests of the shareholders.

⁶³ *Securities and Futures Act*, s 232(6). China Aviation Oil Holding Co, the parent company of China Aviation Oil (Singapore) Corporation, entered into a civil penalty settlement agreement with the MAS in 2005. This arose out of the former's sale of securities in its listed subsidiary while in possession of price-sensitive information that its subsidiary was in dire financial straits, and the proceeds of the sale were on-lent to the subsidiary. Pursuant to the civil penalty settlement agreement, China Aviation Oil Holding Co agreed (in addition to paying S\$8 million) to give up its rights over the new shares which it would

civil pecuniary sanction bears no relation to the loss in question. Criminal and civil sanctions are more appropriate in achieving optimal deterrence and the court can have regard to the seriousness of the market misconduct and relate the appropriate sanctions to the fault involved. In contrast, compensation is concerned with the recovery of losses suffered by the plaintiffs and is not related to the defendant's conduct.

Proponents of the deterrent value of civil liability to investors may argue that, given that the making of misstatements to the securities market is detrimental to the public interest,⁶⁴ civil liability, which carries a lower burden of proof, would be useful to bring the contravening persons to account as to their actions, particularly where such liability exceeds the maximum fine or sanction involved. However, this argument is unpersuasive as the *Securities and Futures Act* already has in place a system of civil pecuniary penalties which are subject to a lower standard of proof than criminal prosecutions.

Secondly, it is doubtful that the statutory compensation will be useful as a tool for setting the optimal deterrent measure in view of the current rules on liability for costs and legal fees. In Singapore, a losing plaintiff has to pay her or his own costs and the bulk of the opponent's costs. In comparison with jurisdictions such as the United States, the plaintiff is not liable for an opponent's costs if he or she loses. Also, contingency fee arrangements are prohibited in Singapore⁶⁵ but are widely used in the United States. Unless radical changes are made to the organisation of legal services and civil procedure, it is unrealistic that private actions for statutory compensation would play a significant deterrent role in enforcing prohibitions on market misconduct.

Principles for awarding compensation

Assuming that compensation should be the primary objective under the statutory compensation regime, the question arises as to what is the nature of the plaintiff's compensable interest the infringement of which deserves a civil remedy. Under tort law, damages compensate the plaintiff for the losses caused by having relied on the misstatement.⁶⁶ Accordingly, proof of reliance on the defendant's misstatement is essential in an action based on tort. In contrast, the statutory compensation regime does not compensate the plaintiff's reliance on the defendant's misstatement but rather on the loss that is presumed to flow from the artificial inflation (or deflation) of prices on the securities as a result of the misstatement.⁶⁷

In this regard, ss 234 and 236 draw from the fraud on the market theory adopted by the United States Supreme Court in *Basic Inc v Levinson* 485 US 224 (1988).⁶⁸ In *Basic Inc v Levinson*, the listed company made false representations on the state of the takeover negotiations that were taking place. It

have otherwise received (pursuant to the conversion of its loan into shares) to minority shareholders. See http://www.mas.gov.sg/news_room/press_releases/2005/MAS_Takes_Civil_Penalty_Enforcement_Action_Against.html viewed 5 February 2008. This illustrates the possibility that the MAS may use the civil pecuniary sanction to recompense investors for market misconduct within the existing framework.

⁶⁴ In *PP v Wang Ziyi Able* [2007] SGHC 204 at [2], the High Court of Singapore described the necessity for taking a "firm judicial stance" against securities offences and market misconduct as the "development of a vibrant financial sector must be supported by a legal system which places a strong emphasis on the integrity and the efficiency of our financial markets".

⁶⁵ *Legal Profession Act* (Sing), Cap 161 (2001 rev ed), s 107.

⁶⁶ In the case of the tort of negligence, the plaintiff must additionally show that the loss was within the scope of duty in question: see *South Australia Asset Management Corp v York Montague Ltd* [1997] 1 AC 191.

⁶⁷ See Loke A, "The Investors' Protected Interest Against Market Manipulation in the United Kingdom, Australia and Singapore" (2007) 21 AJCL 22 at 33 where the author argues that the *Securities and Futures Act* creates a statutory right of action that accords the investor a compensable right to the integrity of the information being disseminated into the securities market.

⁶⁸ Blackmun J referred to *Peil v Speiser* 806 F 2d 1154 at 1160-1161 (1986), which held that "Misleading statements will therefore defraud purchasers of stock even if the purchasers do not directly rely on the misstatements ... The causal connection between the defendants' fraud and the plaintiffs' purchase of stock in such a case is no less significant than in the case of direct reliance on misrepresentations." For a discussion on the "fraud on the market" theory, see Avgouleas E, *The Mechanics and Regulation of Market Abuse* (OUP, 2005) pp 479-483.

was held that in respect of claims under r 10b-5⁶⁹ and s 10(b) of the *Securities Exchange Act*,⁷⁰ the main anti-fraud securities provisions containing the prohibition on the making of misstatements or omissions in relation with the trading of securities, the class of plaintiffs who had traded in securities was not required to show individual reliance on the alleged misstatements. Instead, its reliance on public material misrepresentation was presumed, though such presumption was rebuttable. The fraud on the market doctrine is premised on the economic theory based on the efficient capital markets hypothesis (EMH).⁷¹ Likewise, ss 234 and 236 presume that the misstatement having an effect on the market price has caused the plaintiff loss, even though the plaintiff has not relied on the statement. It is beyond the scope of this article to discuss the criticisms of the EMH but suffice to say that the EMH has not, perhaps with this exception, been the basis of the securities regulation in Singapore.⁷² It should also be noted that ss 234 and 236 go further than the “fraud on the market” theory in completely eliminating the relevance of reliance; the lack of reliance is not a defence under those provisions but is a defence under the fraud on the market theory.

Comparative approaches on reliance for statutory civil liabilities in the United Kingdom and Australia

It is instructive that the absence of the requirement to prove reliance on the contravening conduct under the statutory compensation regime goes further than the approaches adopted not only in the United States but also in the United Kingdom and, arguably, in Australia. In the United Kingdom, under s 90A of the *Financial Services and Markets Act 2000* (UK), statutory civil claims may be made by purchasers of shares against issuers on the basis of their fraudulent misstatements to the securities markets.⁷³ Section 90A(5) makes it clear that reliance on the misstatement is required. There is no proposal to abolish the reliance requirement.⁷⁴

The equivalent provision in Australia for s 199 of the *Securities and Futures Act* is s 1041E of the *Corporations Act 2001* (Cth). In addition, s 1041H of the *Corporations Act* prohibits a person from engaging in misleading or deceptive conduct in relation to financial products (which includes securities).⁷⁵ Under s 1041I of the *Corporations Act*, a person who suffers loss or damage by conduct of another person engaged in contravention of, inter alia, ss 1041E and 1041H, may recover the amount of loss or damage by action against that other person or any person involved in the contravention. It is unclear whether it is essential for the plaintiff to prove that he or she has relied on the contravening conduct. There is case law on other similarly worded statutes which suggests that the Australian courts are prepared to consider claims by persons who have suffered losses as a result of

⁶⁹ 17 CFR s 240.10b-5 (2005).

⁷⁰ 15 USC s 78j(b) (2000). Section 10(b) prohibits the use of deception and manipulation related to the sale and purchase of securities. Rule 10b-5 makes it unlawful to engage in a scheme to defraud, make a false or misleading statement regarding a material fact or engage in any deceptive act in connection with the purchase or sale of security. The courts have held that contravention of s 10(b) and r 10b-5 allows the plaintiffs an implied right of action.

⁷¹ *Basic Inc v Levinson* 485 US 224 at 241-242 (1988).

⁷² See Walker G, “Securities Regulation, Efficient Markets and Behavioural Finance: Reclaiming the Legal Genealogy” (2006) 36 Hong Kong LJ 481 which argues that the efficient market hypothesis has no application to securities regulation in the United Kingdom and other Commonwealth countries such as Malaysia, Singapore, Australia and New Zealand.

⁷³ Section 90A of the *Financial Services and Markets Act 2000* (UK) makes it clear that negligence claims against the issuers are precluded.

⁷⁴ See Davies P, *Davies Review of Issuer Liability: Final Report* (June 2007).

⁷⁵ *Corporations Act 2001* (Cth), ss 764A(1)(a) and 761A. A provision similar to s 1041H exists under s 12DA of the *Australian Securities and Investments Commission Act 2001* (Cth).

third parties' reliance on the misstatements, and direct reliance may not be necessary.⁷⁶ Nevertheless, the Australian courts have not gone so far as to say that reliance is completely unnecessary under the civil liability regime under s 1041I.⁷⁷

Assessment of the compensable interest under the statutory compensation regime

Thus, it can be seen that ss 234 and 236 relieve plaintiffs from having to show causation (specifically, in the form of reliance) for their loss, which may explain the necessity for limiting the aggregate damages that may be awarded. This approach has not been adopted in the United States, the United Kingdom or Australia. Notwithstanding the difficulties with ss 234 and 236, however, it is not advocated that the current basis of liability for statutory compensation order, being a contravention of s 199, be abolished. Statutory compensation is essential in order for victims of such misconduct to be able to have redress; the current remedies under common law are too restrictive. This article suggests that once there is a contravention of s 199, the basis for awarding compensation for losses, by analogy with common law, should be founded ultimately on investor compensation, not by achieving optimal deterrence. In other words, plaintiffs must demonstrate that they had relied on the misstatement and ultimately suffered a loss as a result of such reliance. Eliminating the requirement to prove factual causation under the current statutory compensation regime is contrary to the objective. It is submitted that the better approach is to adopt the common law approach of a rebuttable presumption of reliance where the misstatement had a material influence on the price of the securities in question.⁷⁸ Thus the plaintiffs are presumed to have relied on the misstatements when they traded in the securities during the period where the prices of the securities were either artificially inflated or deflated but the presumption can be rebutted if reliance is found to be lacking. The statutory compensation regime should not be extended to contemporaneous traders who have not relied on the misstatement.

Measure of recoverable loss

Sections 234 and 236 allow for recovery of the difference between the price at which the securities are dealt with and the price of the securities "if the contravention had not occurred", subject to the ceiling. Though there is no decision on this point, this is likely to refer to the difference between the price at which the securities are transacted by the plaintiff and the hypothetical price at which the securities would have traded at the date of such transaction if the false or misleading statement was not made and the true state of affairs was in fact known to the market. In effect, the plaintiff is required to show that the false or misleading statement would have actually impacted on the price of the securities. It does not compensate the plaintiff for a decline in the share price unrelated to the misstatement (such as a decline in stock prices caused by other factors nor does it allow for the recovery of consequential losses. This measure of recoverability under ss 234 and 236 is closer to the negligence measure of damages at common law (where the recovery is restricted to the losses caused by having entered into the transaction on the basis that was represented to the plaintiff than on the true basis), as opposed to the fraud measure (where all losses flowing from the falsity are recoverable), save that consequential losses are not recoverable. Given that ss 234 and 236 do not differentiate the measure of recoverability depending on whether the contravention was fraudulent or negligent, it is submitted that the current measure of damages is consistent with the proposed aim of statutory compensation, namely that of compensation. The deceit measure of damages at common law was influenced by deterrence. However, an important change to be made is that the ceiling on recoverable losses should be removed as it is inconsistent with compensation principles.

⁷⁶ See Baxt R, Black A and Hanrahan P, *Securities and Financial Services Law* (6th ed, LexisNexis Butterworths Australia, 2003) pp 141-143. In *Janssen-Gilag Pty Ltd v Pfizer Pty Ltd* (1992) 37 FCR 526, a case involving s 82 of the *Trade Practices Act 1974* (Cth), which is similar to s 1041I of the *Corporations Act*, the Federal Court allowed the claim by a plaintiff who did not rely on the contravening conduct but suffered damage as a result of a third party's reliance.

⁷⁷ For a discussion on the possibility that the Australian courts may take an expanded view of the causation requirement in the context of securities non-disclosure, see Duffy M, "Fraud on the Market: Judicial Approaches to Causation and Loss from Securities Non-disclosure in the United States, Canada and Australia" (2005) 29 MULR 621.

⁷⁸ *Redgrave v Hurd* (1881) 20 Ch D 1 at 24.

A POWER TO GRANT RELIEF FROM LIABILITY?

Objections may be raised that allowing investors to sue for their losses caused by reliance on the misstatements may encourage unmeritorious claims (being claims where market misconduct is alleged based on weak arguments in the hope that the defendants will settle) and potentially lead to excessive liabilities of the listed companies that are out of proportion to any gain they may receive. There is the concern of over-deterrence where the listed company then responds by engaging in defensive and unhelpful reporting. The problem is compounded by the fact that the statutory compensation order is available not only where the defendant is fraudulent or reckless but also where it is negligent.

It could be argued the fears of unmeritorious claims and over-deterrence are exaggerated. The current prohibition on contingency fees is likely to limit litigation over unmeritorious claims. Further, under the analogous prospectus regime, there is no cap on the compensation recoverable for misstatements made in prospectuses even though the threshold of statutory liability for such misstatements in prospectuses is even lower than that for market misconduct and these rules have not apparently led to excessive liability.⁷⁹ There is no easy solution in balancing the conflicting interests of investor protection and ensuring that listed companies disseminate information that is not only accurate but also meaningful. The question is one of alternatives. One possible solution is that the *Securities and Futures Act* be amended to allow the court to have the power to grant statutory relief from liability, which currently exists for breaches of duties under s 391 of the *Companies Act*, if the defendant has acted honestly and reasonably and it ought fairly to be excused. This power to relieve civil liability for contravention of the prohibition on dissemination of misstatements is present in the *Corporations Act*.⁸⁰ The benefit of such a power is that the court's discretionary jurisdiction is very wide and the court can take into account the full range of factors, including the conduct of the parties in question. Hence, if the listed company has been reckless or fraudulent, it should not be able to seek relief from liability. If it had been negligent but has nevertheless acted honestly and reasonably, the court can take into account its actions in relieving its liability.

CONCLUSION

Private action to enforce securities laws is important as it currently provides the only means of enabling investors who have been misled by misstatements made by the listed companies to obtain compensation. The current civil liability regime is unsatisfactory. At common law, investors face significant limitations in bringing claims. The statutory compensation framework has a number of deficiencies, which largely result from the fact that its objective is to achieve optimal deterrence and not compensation.

This article argues that the aim of the statutory compensation regime should be founded on compensation for plaintiffs who have relied on the misstatement. Securing optimal deterrence should be left to the criminal and civil pecuniary sanctions. In line with such objective, it is suggested that while contravention of s 199 be retained as the basis of liability, the class of plaintiffs who can claim compensation should be those who have incurred losses consequent upon reliance on the misstatement. The concept of contemporaneous trader requirement and the ceiling on losses recoverable should accordingly be abolished. Finally, as for the criticism that the effect of the proposed reform may lead to excessive liability on the part of the defendant, the solution is the introduction of a statutory equivalent of s 391 of the *Companies Act* for relief of liability where the defendant has acted honestly and reasonably and ought fairly to be excused.

⁷⁹ *Securities and Futures Act*, s 254. Under the prospectus liability regime, certain parties, including the listed companies, are strictly liable for misstatements, subject to, inter alia, a very limited due diligence defence. There is as yet no reported civil claim under s 254 of the *Securities and Futures Act*.

⁸⁰ *Corporations Act 2001* (Cth), s 1041I, read with s 1317S. The *Corporations Act* does not have a requirement that the defendant must have acted reasonably.