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AN INSIGHT INTO INSIDER TRADING IN GREATER CHINA

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Subscription is US $40.00 per year for 4 issues (regardless of the price of individual issues) in the United States and $45.00 for Canada or overseas. Checks should be addressed to MSCAS.

Tel.: (410) 706-3870
Fax: (410) 706-1516

Price for single copy of this issue: US $14.00

ISSN 0730-0107
ISBN 1-932330-30-5

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Greg Tzu Jan Yang*

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Insider trading occurs when people considered as insiders engage in utilizing the asymmetric or private information of the company in trading for their own benefits. It is illegal in many jurisdictions. The Organization for Economic Co-operation and Development (the "OECD") Principles of Corporate Governance expressly forbid this practice, stating in its guidelines that insider trading and abusive self-dealing should be prohibited.

In the first part of the paper, I will discuss insider trading in general sense and use the practice in Australia and Hong Kong as a guideline for insider trading regulation. The reasons Australian regulatory framework on insider trading serves to be example of regulatory benchmark for measuring against with Hong Kong, Taiwan and China are mainly due two reasons. First, in comparing with
other countries, the Australia legislation regarding insider trading is relatively comprehensive and straight forward among the Asia Pacific region. Geographically, Australia is a country with western legal system within the Asia Pacific proximity, thus making the Australia standard a suitable lode star for the Greater China area (Hong Kong, China and Taiwan). Secondly, the growing business relationship between Australia and Asia, especially with China has made Australia more important for the Greater China area. This is largely due to Australia becoming the major supplier for China in the basic material market and thus when discussing insider trading in Hong Kong, China and Taiwan, the Australian experiences can not be ignored. On the other hand, Hong Kong is also regarded as a guideline for insider trading regulation with examination of the Hong Kong’s Securities (Insider Dealing) Ordinance, which came into effect on 1 September 1991. Hong Kong is important example for comprehensive insider trading framework is because it belongs to part of the Greater China area (China, Taiwan and Hong Kong). As a result, the framework adopted in Hong Kong can be used as an example for Taiwan and China to follow in improving their insider trading regulation due to their cultural similarities. Also, there will be examination of arguments for and against insider trading. I will discuss the reason why the prohibition of insider trading is difficult to enforce and use two recent Australian cases on insider dealing as an illustration.

The second part of this paper will look at the cases of insider trading in Taiwan and China, with the examination of regulations in regulating insider trading in both Taiwan and China.

A. What kind of data constitutes as asymmetric information?

To understand the situation that constitute of insider trading, we must define “insider” and the information that constitutes as “inside” information. First, each individual case is unique in its own regard, and material facts might be different from case to case. Thus it is difficult to find a general guideline that will fit for each case. This is probably why insider trading although illegal, is rarely prosecuted successfully, because when successfully prosecuted there needs to be specific facts found to establish insider dealing.¹

Generally speaking, for a person’s behavior to constitute insider trading, the person must first, possess or have access to infor-

¹ Roman Thomasic “Casino Capitalism?” Insider Trading Regulation and Law Enforcement, p103.
2. Brenda Hannigan “Insider Dealing” Chapter 3, Insider Defined, p51
3. Australian Corporations Law (Cth) Section 1013:
(a) a person possesses information that is not generally available but, if the information were generally available, a reasonable person would expect it to have a material effect on the price or value of securities of a body corporate (other than an option contract); and (b) the person knows, or ought reasonably to know, that (i) the information is not generally available; and (ii) if it were generally available, it might have a material effect on the price or value of those securities; and (c) the insider (whether as principal or agent) in contravention of subsection 1002G (2): (i) subscribes for, purchases or sells, or enters into an agreement to subscribe for, purchase or sell, any such securities; or (ii) procures another person to subscribe for, purchase or sell, or to enter into an agreement to subscribe for, purchase or sell, any such securities.
4. Ibid.
5. The Australia Corporations Act 1989. The current version is the Corporations Act 2001, relevant provisions are found in Part 7.10 Division 3. Although the relevant sections with respect to insider information may be different, the contents of it generally remains the same.
could be seen in later cases, such as the cases of Hannes (Australia); Hold Key Electric (Taiwan) and HUANG Guangyu (China).

Conclusion can be drawn that there are two main groups of candidates for potential insider trading activities, as they can easily gain access to private information unavailable to the general public. This first group includes directors, officers and employees and also people with professional and business relationships with the company. Secondly, it is government officials. This group is less obvious than the first group but no less important, as government officials possess confidential information that related with industry regulations or laws that might affect the business environment that the companies operates in.6

1. People connected with the company

a. Directors

All directors may be considered as potential candidates for insider trading on the basis that by the very nature of their positions, they are persons who are most likely to gain access to information which the public may not gain access to. This also applies to directors of related companies and subsidiaries of the company’s holdings.7 On the other hand, directors in return owe a fiduciary duty to the company. This duty requires that directors should act in good faith for their company.

Director’s fiduciary duty

It is true that directors must show special qualities of good faith, fairness and loyalty when they act for and on the behalf of the company.8 This means that they cannot take advantage of their position of trust to benefit themselves at the company’s expense. In other words, there is a fiduciary relationship that exists between directors and their company. They should act in good faith for their company.

As a result, the fiduciary duties of the directors include the duty of: (1) to act in a bona fide manner for the best interests of a company as a whole; (2) to exercise one’s powers for proper purposes (as opposed to improper collateral purposes); (3) not to fetter

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7. Ibid, p 58
8. Phillip Lipton, Abe Herzberg “Understanding Company Law” 1999 edition, Chapter 13, Duty of Directors and other Officers, p 333
their discretion in making company decisions; (4) to avoid actual or potential conflicts between one’s personal interests and those of the company; (5) and to be bound to exercise a certain standard of care on behalf of the company. In general, they must act for the best interest of their company.

Most importantly, directors are not permitted to use confidential company related information for their own benefit. What is meant by “confidential information” is discussed in the case of *Thomas Marshall (Exporters) Ltd v. Guinle* [1978] 3 W.L.R. 116. In this case, Megarry VC considered the type or the information that was regarded as confidential by stating:

“First, I think that information must be information the release of which the owner believes would be injurious to him or of advantage to his rivals or other. Second, I think the owner must believe that the information is confidential or secret, that is that it is not already in the public domain. It may be that some or all of his rivals already have the information; but as long as the owner believes it to be confidential I think he is entitled to try to protect it. Third, I think that the owner’s belief under the two previous heads must be reasonable. Fourth, I think that the information must be judged in the light of the usage and practices of the particular industry or trade concerned. It may be that information which does not satisfy all these requirements may be entitled to protection as confidential information or trade secrets: but I think that any information which does satisfy them must be of a type which is entitled to protection.”

According to the above, a director who uses insider information for his or her own benefit breaches their fiduciary duty to their employer. They must not let their duty to the company and their self-interest conflict. Such fiduciaries that gain from their position will be under an equitable obligation to account for those gains to the company. Fiduciaries in breach must account to the company for any benefits enjoyed or obtained as a result of a breach of their

11. Sir Robert Edgar Megarry FBA PC QC (1 June 1910—11 October 2006) was a British lawyer and judge.
12. Phillip Lipton, Abe Herzberg “*Understanding Company Law*” 1999 edition, Chapter 13, Duty of Directors and other Officers, p 372
fiduciary duty. Where a company claims for "secret profits" due to a breach of fiduciary duty, it is irrelevant whether the company has in fact suffered a loss. Apart from an account of profit, damages may also be awarded for a breach of fiduciary duty, where the company does suffer loss.

Furthermore, a fiduciary that abuses his position by insider trading might additionally be liable to place any gains made in a constructive trust. The principle of constructive trust is sufficiently wide to apply, not only to a fiduciary that abuses his position by insider trading, but also to a third party that assists the fiduciary. In general, a director holds a fiduciary duty towards the company. This duty should not be breached. Once breached, the directors should be account for any benefits enjoyed and the company is entitled to be compensated for the loss suffered. This extended interpretation for the equitable obligation of director to the company is a means to discourage directors from breaching their fiduciary duties.

b. Officers and employees

Not all officers and employees are potential inside traders. First, he or she must occupy a position which may reasonably be expected to give them access to unpublished price sensitive information. Further it must be found to be reasonable to expect such a person in his position not to disclose such information except for the proper performance of his functions. It should be noted that it is insufficient for the officer or employee to come across the information by chance or for him to be in a position of access to confidential information.

Regarding officers, there is obviously a strong probability that their position is one in which it may be reasonably expected for them to have access to unpublished price sensitive information, However, this may not always be the case. This depends on the professional nature of the officer in the company. For example, personnel officers probably would not access to such information, but officers in the finance department could easily gain access to price sensitive unpublished information.

Employees may occupy a position of access, but it depends on the material facts of each individual case to establish if they had

13. Ibid, p 356
15. Ibid, p 60.
access to price sensitive unpublished information. It has been suggested that in reality, most employees would not occupy a position where it may be reasonably expected to give them access to information that, in relation to the securities of a company, would be considered unpublished price sensitive information. However, even if they are not in a position of access, but they obtain that information from sources within the company, for example, from good friends during a chat, than they still may qualify as a potential inside trader. In another words, possession of private information will determine whether a person is an insider or not.

c. Professional or business relationships

This group is potentially a very high-risk group for insider dealing activities, as they could obtain sensitive information through interpersonal relationship during their business conduct. It is arguable, that their potential for insider dealing may be as high as directors.

This category of potential insiders includes a people such as solicitors, auditors, architects, surveyors, bankers, brokers, advertising and public relations agencies, management consultants, investment advisers, suppliers, major creditors, customers, or anyone else who would gain special access to private information through their business relationship.

Furthermore, through their business dealing and services, this group has the potential of having access to unpublished price sensitive information without being connected to the company in such a manner so as to immediately give rise to suspicion, as is typically the case with company directors or officers. For example, a solicitor and financial advisor will inevitably receive confidential information through their service. On the other hand, it is very easy for an officer of a underwriting department of a security firm to gain access to price sensitive information during a company’s initial offering process (IPO). It is true that they should never use such confidential information for their own advantage, as that kind of behavior is against their professional ethics codes. However, in reality, their privilege could be easily abused and it will be very difficult to enforce in charges of insider trading.

17. Ibid.
2. Government officials

One can argue that corruption is part of insider trading. Government officials are a group who potentially could involve themselves in some of the most serious insider trade situations. Positions such as city planners or financial market regulators can be involved and their activities usually involve large amount of money or benefits. This is because government officials could gain access to some of the most sensitive information, which may affect not only the individual companies, but the market as whole. Later in this paper, we will discuss a few Taiwanese cases, which involve legislators and lawmakers to demonstrate this situation.

However, it must be noted that not all forms of corruption is considered insider trading. Only a certain form of corruption should be seen as insider trading. For example, if the government official released confidential governmental information that will affect the stock price to his or her friends, who then trading stocks, and thus benefit accordingly, that will qualify as the release of insider information and constitute of insider trading.

The interesting situation here is that most of the literature available regarding insider trading fails to address the seriousness of this problem. It is submitted that, if insider trading is a form of corruption, thus, the corruption of government officials should be treated as a serious problem in undermining the competitiveness of the country as a whole. This aspect of insider trading and competitiveness will be further discussed in the section regarding Taiwan.

C. Does insider trading harm the market?

The most widely accepted view is that insider trading is bad for the market as a whole as it undermines the competitiveness of the market. This is why most governments have banned insider trading. As previously discussed, the OECD Principles of Corporate Guidelines expressly forbid insider trading. A market victimized by insider trading is not a market primed for growth. A market where insider trading is prevalent lacks probity and investors will be less likely to have confidence because investors perceive that the only people who can benefit from trading is parties who engaged in insider trading. Most investors would opt for a market where everyone has a fair chance to profit. They prefer not to play with a

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18. Especially economic officials who possess sensitive governmental information which will affect the security market.
market with built in disadvantages or handicaps. In other words, investors usually prefer to invest in fair and equitable markets and insider trading destroys that market confidence. This also undermines the long-term growth of a market because a lack of market confidence will limit its long-term growth potential.

Accordingly, a jurisdiction which considers insider trading to be a punishable offence will and is seen to be pro-active in eradicating insider trading is more likely to attract investor confidence than a jurisdiction which has no laws punishing insider trading. This is the main argument that for insider trading to be banned. As a result, most OECD countries such as US, UK and Australia are known to have strict regulations against insider trading and these markets are regarded by international investors as relative fair and competitive markets. For example, insider trading for US is governed under the Securities Exchange Act of 1934 and Securities Exchange Commission Rules. It is known to have strict law punishing insider trading with maximum sentence of 25 years for institution and 10 years for individual, along with payment of 1 million USD and 2.5 million USD indemnifications respectively. As a result, its market capital and confidence is much higher than the markets of other developing countries such as Indonesia or the Philippines.

In a global financial market where local security exchanges are competing on a worldwide basis, jurisdictions, which possess a “fair” image, would be the ones in which international investors prefer to invest. Despite this, some argues that insider trading does not affect the securities markets and could even be beneficial to the markets. This argument might have some validity in theory, however, the reality is that if a jurisdiction that does not penalize insider trading, it would considered to be unfair and thus will have difficulties in attracting international investments.

One of the most important arguments against insiders trading is that it hurts the interests of small investors and it dislocates the market resources inefficiently. Most importantly, small investors are severely disadvantaged in this respect compared to the larger

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20. Ibid,
22. Robert Charles Clark “Corporate Law” Chapter 8, Insider Trading, p 267
institutional investors, as the larger source of funds which such institutional investors possess would place them in a privileged position and thus it would be much easier for them to gain sensitive non-public information than small investors. If this situation becomes more prevalent, it will make small investors far more reluctant to invest. For a healthy competitive market it is not enough to be supported by a few large institutional investors, it also needs large investment communities composited of small individual investors as well.

Some argue that insider trading is a form of stealing. It damages the general economic system, and especially hurts the small investors. This is because the vast majority of the shareholders would miss out on the opportunities to profit or incurred loss due to the lack of sensitive information that insiders profit from. In other words, if this situation prevails, the market will turn into a rich people's party and the fairness of the market will be destroyed. Also, insider trading can also consider being a form of betrayal. This is due to the fact that insiders such as company major shareholders betray the total body of the company's shareholders for their own profit and interest.

It is submitted that insider trading is not only harmful, but it brings no benefits to the general market or the economy as a whole. Insider trading not only erodes market confidence; but it also handicaps the capital raising process as well as dilutes the efficiency of the market. Most importantly, it destroys the fairness of the market and directly harms the investment public who may lose money to those who are engaged in insider trading, and as a result deter the long-term growth of the market.

D. Alternative arguments for insider trading

From an alternative perspective, Professor Henry Manne in his book “Insider Trading and the Stock Market” published in 1966 argues that in the pure economic sense, insider trading is positively beneficial to the market and ought not to be prohibited. He argued that insider trading acts as a price accelerator and brings the price of securities to their proper level more quickly than would

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24. Roman Thomasic “Casino Capitalism?” The Effects of Insider Trading, p 56
25. Ibid.
otherwise be the case. Another argument identified with Professor Manne is that insider trading is beneficial because it provides an additional incentive to management to be more entrepreneurial in running the companies that they control, as they have the opportunity to profit before the general investment public.

It is also argued that insider trading is good for the market by providing increased activity that drives the market." In other words, insider trading is a natural market marker in the stock market. It will naturally make the market for particular securities without the market making form any investment banks. Other possible benefits of insider trading is that insider trading brings news to the market more quickly as insiders puts pressure on the bidders in takeovers to go higher and is therefore beneficial. In this sense, it should perceive to be beneficial for the company during a merger & acquisition situation as it could force the bidder to bid for higher price for the company.

Another important argument against the prohibition of insider trading is that it is difficult to justify regulation, as it is not easy to identify a specific individual victim of a insider trading case. In another words, insider trading is a victimless crime. 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 a deliberate inducement to the other party which could be construed as criminal behavior. On the other hand, most insider trading takes place on impersonal, anonymous, stock exchange circumstances where it is impossible to establish any direct relationship between the insider and the victim other than the coincidental one of having both been in the market at the same time. This is because individuals who deal in such impersonal markets have decided to do so voluntarily without any inducement from the insider.

Even though we recognize the fact that there is a camp which advocates positive aspects of insider trading, it is submitted that the argument that insider trading is beneficial for the market is not compelling and generally not acceptable. It is true that the victim of insider trading might not be as direct as for the case of murder, but as long as insider trading destroys the market fairness and under-

27. Roman Thomasic "Casino Capitalism?" The Effects of Insider Trading, p 58
28. Robert Charles Clark "Corporate Law" Chapter 8, Insider Trading, p 280
29. Roman Thomasic "Casino Capitalism?" The Effects of Insider Trading, p 58
mines confidence, ultimately the whole society suffers. This will lead to inefficiency in the market and society as a whole and eventually undermines the harmony in the society.

E. Problem of enforcement

If we use the experience in Australia as an example, despite the criminal and civil liability stated in the Australian law, there are three major obstacles that ASIC (Australian Securities and Investment Commission) faces in trying to investigate and prosecute insider trading: (1) the difficulty of detection, (2) the problem of proving one’s knowledge of that private information, and (3) the necessity to rely on expert evidence to prove materiality.

It is suggested that it is reasonably easy to detect instances where insider trading may have occurred. It is quite common to find that the ASIC investigations situation usually occurs when price sensitive information came into existence and when it was announced to the ASX (Australian Stock Exchange), in which there was a significant increase in the price and volume of the shares traded.\(^31\) This kind of situation may indicate that there may have been leakage of price sensitive information into the market prior to its public announcement. This will usually lead the Australian Securities and Investment Commission (ASIC) to initiate an investigation on possible insider trading.

When a potential insider trading case occurs, ASIC will identify the person or persons who have knowledge of the information (the insiders) and their immediate associates such as family, family companies, etc and match them with the traders identified. ASIC has sophisticated computer system available to assist them with this process. However, the problem is that the task of identifying the traders, the insiders, and inputting the data into the computer programs is very time-consuming. This means there will be a time lag and may allow some insider trade situations slip through the net.

The second problem is that when the ASIC tries to establish one’s knowledge of private information or to identify further links between the identified traders and the insiders to determine if there are people who may have received private information from an insider.\(^32\) This situation is difficult to identify the parties involved, be-

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32. Ibid, p 619.
cause it is difficult to prove that there was actually an exchange of private information. If this cannot be proven, there will be no admissible evidence to the court and thus the case may not be successfully prosecuted. The problem is that unless conversations between the parties were recorded or parties admit to a third person what was said or the third person has a written transcript detailing the communication of such information, the only evidence as to what was said is the unrecorded oral evidence of the parties.

Even if the ASIC can charge that there was an exchange of private information, it is also easy for the accused to defend otherwise. For example, he or she may say that they were following the stock on the Australian Stock Exchange (ASX) trading screens, saw the volume of turnover increase, and decided to speculate on an imminent price or they heard that there were rumors in the market about a new deal being announced, but they can’t remember where they heard them. As a result, it may be difficult to establish the direct link on the exchange of private information and thus inside trading. Finally, it may be difficult to prove that a reasonable person would expect the information in issue to have a material effect on the price or value of the relevant securities.

F. Important Australian insider trading case

Two very important insider trading cases in Australia are worth examining. One case was in Victoria (The “Hannes” Case) and another case in New South Wales (the Mount Kersey Insider trading case). The Hannes case was a great success for the ASIC as the court found Hannes guilty and he was jailed accordingly. It has been suggested that if both cases could be successfully prosecuted, then Australia might establish the toughest insider trading rules in the world. However, this is not the case, as the court in the Mount Kersey case acquitted the accused.

G. Hannes case

The former executive director of Macquarie Bank, Simon Gautier Hannes was found guilty of Australia’s biggest insider trading case. In this case, Hannes used the convenience of his position to make late-night visits to Macquarie’s city offices, to get access to the computer files on the TNT takeover deal.

Under his plan, Hannes established a private mailbox and voice mail service using the alias of Mark Booth, and bought TNT A$2 November call options using the same name through Ord Minnett stockbroker Andrew Staehli. By using the name “Mark Booth”, he spent around A$89,000 (note: USD$1 exchange around 0.92 A$) buying options over TNT shares just before the bid was announced. His profit, just days later, was two million Australian dollars. If he did not use his position to get access to the confidential information, he would never have gained such a profit. Therefore, this could be classified as a typical insider trading scenario.

After he was caught, Hannes denied his crime, claiming he was only involved in a syndicate with an English friend in an effort to make money for his less wealthy sister Mignon Booth. But On October 13, 1999, The Victoria District Court jury found Hannes guilty of insider trading.

The successful prosecution of this case is due to the fact Hannes’ insider trading practices were easily identified. He had established a private mailbox and voice mail service that serve as direct evidence for his crime. As a result of this verdict this case became quite important, as it clearly demonstrates the insider trading behavior and attitude of the court towards insider trading.

Even though this is not the first time the Australian Securities and Investment Commission had been successful on insider trading prosecution, in the other occasions the defendants had plead guilty. The question that arises after this case is: is this a direct or unique case of insider trading, or just merely the tip of an iceberg?

According to Alan Cameron, Chairman of ASIC indicated:

“If there are unusual features about this particular matter it is the size of the trading and if you like the extreme nature of it. It was such an extreme trading that it was drawn to attention almost immediately by the stock exchange and indeed by the broking firm that was used for the purpose.

In a sense it would always have come to attention. The question was whether he would get away with it and of course, as you know, he didn’t profit from it, the transac-

34. Various newspapers and TV reports. Including The Age newspaper, Courier Mail, Sydney Morning Herald, ABC report, etc.
tions were frozen, the money never reached the hands of
Mr. Mark Booth, or Mr. Hannes, as we now know. So the
money was not taken. This was always a question of ac-
countability for those actions and I think the Commission
is justifiably proud of the fact that we have ensured that
that trading has been brought to account.”

This debate is continuing at the moment but most of the com-
mentators agree that although insider trading might be happening
all the time, very few examples are as large and significant as this
particular case.\textsuperscript{36} It would have been very hard for the ASIC to
detect if the amount involved was smaller or the timing less direct.
In that case, it would have been easier to escape prosecution and
profit from insider trading.

H. Mt. Kersey case

The trial started on 4th of October 1999 and ended on 17th
November of the same year. Beside the Hannes case, this case is
seen as one of the most important decisions for insider trading in
recent years. In this case, ASIC was defeated, as both of the ac-
cused; a former JB Were stockbroker and a mining executive were
found not guilty of insider trading.

The five-week trial of Mr. Greg Doyle and Mr. Alan Evans
ended when Justice Allan McDonald of the Victorian Supreme
Court made a series of rulings that crippled ASIC’s case. In this
case, the men had been charged with two counts of insider trading
regarding Mt. Kersey Mining NL, on November 20, 1995. It was
alleged that two men agreed to buy shares of Mt. Kersey when Mr.
Evans called Mr. Doyle at 2:00pm and 2:07pm that day and asked
him to start buying shares in the company at 2:30pm. It was alleged
that at this time Mr. Doyle and Mr. Evans possessed private infor-
mation not generally available concerning a massive nickel strike by
a company named Mining Project Investors (MPI) on land adjoin-
ing Mt. Kersey.\textsuperscript{37}

Justice McDonald told the jury during the trial that it was in-
correct in law to say the telephone conversations at 2:00pm and
2:07pm were agreements to purchase Mt. Kersey shares. Instead,
the judge ruled that in these conversations Mr. Evans had ap-
pointed Mr. Doyle as his stockbroker to buy shares for him. Be-

\begin{footnotes}
36. \textit{Ibid.}
37. Various newspapers and TV reports. Including The Age newspaper, Courier
Mail, Sydney Morning Herald, ABC report, etc.
\end{footnotes}
cause the prosecution had not shown an essential element of its case - that Mr. Doyle and Mr. Evans had entered into an agreement to buy shares - the jury was recalled and directed to return a verdict of not guilty.38

Although, the court dismissed this case, it does not in any way indicate that this is not an important case. This case was dismissed due to a technicality rather than legality. During the trial, Mr. Peter O'Callaghan QC, counsel for Mr. Doyle, argued that his client had no case to answer because ASIC and the Commonwealth Department of Public Prosecutions had incorrectly presented their case. Later, Justice McDonald accepted one of Mr. O'Callaghan's arguments in ruling that there was no agreement to buy shares at 2:00pm and 2:07pm.

From this point, the prosecution sought to amend its case to allege that the agreements to purchase occurred between 2:31pm and 3:11pm when JB Were bought shares in Mt. Kersey through a computer share-trading system. Counsel for Mr. Doyle and Mr. Evans opposed these amendments, arguing it would alter the way they had run their defense. They also argued that significant evidence concerning the dissemination of news of the discovery was not led because of the original time frame under which the charges were brought.

This included 15 recorded phone calls from JB Were dealers to fund managers and investment advisers not played to the jury because they had been considered irrelevant. The judge agreed that it was too late in the case for such a "significant amendment". He also refused to grant a fresh trial, finding it would be of "grave prejudice" to the accused. As a result, the accused was found not guilty.

As discussed earlier in the paper, it is difficult for the Australian Securities and Investment Commission to successfully prosecute an insider dealing case due to various practical and technical reasons. This case seems to demonstrate this point clearly, as it is submitted that the main reason this case was dismissed was due to lack of proper evidence collected by the ASIC. This case demonstrates that the evidence of each insider trading cases may not be as straightforward as the Hannes case. Further, this case shows the difficulties in evidence collection for insider trading cases.

38. Ibid.
II. INSIDER TRADING IN HONG KONG

After examining the case of regulating insider trading in Australia, Hong Kong serves as an example of comprehensive insider trading regulation as well in the Greater China area. As for the case of Hong Kong, it is submitted that under the influence of the British legal system, Hong Kong has adopted a more comprehensive structure in managing insider trading, even when compared with the Australian system, and no doubt far more comprehensive than Taiwan or China.

A. Introduction

The Securities (Insider Dealing) Ordinance of Hong Kong (The Ordinance) came into force on September 1, 1991 and was primarily based on the UK Company Securities (Insider Dealing) Act 1985.\(^{39}\) In another words, the Hong Kong regulatory framework for insider trading was based on the United Kingdom system. As a result, the structure of Hong Kong's system is more similar with Australia rather than Taiwan and China's framework.

According to the Ordinance, a person is qualified as an insider if he falls within one of the following categories:

- a person connected with a corporation and in possession of relevant information (primary insider);
- a person contemplating or having contemplated making a take over offer for a corporation and knowing that the information is contemplated or is no longer contemplated is relevant information; (secondary insider)
- a person receiving relevant information from a primary insider or a person in secondary insider.
- a member or employee of any public body specified in Section 5 of the Ordinance.\(^{40}\)

As Section 4 of the Ordinance deals with a person’s connection to a company, it is interesting to note that according to Section 4(1) a person who was connected with the corporation within the preceding six months but is now no longer connected is also an insider.\(^{41}\) This expands the scope of insider to ex-employees. Also, there may be a situation where two persons take part in insider trading activities but one of them is not guilty as a primary insider.

\(^{39}\) The Securities (Insider Dealing) Ordinance of Hong Kong of 1991.

\(^{40}\) Ibid, Section 247.

\(^{41}\) Ibid, Section 4.
because he is not found to have relationship or connection with the corporation. In other situations, a person’s connection with the corporation is an important issue to establish insider trading.

B. Dealing in securities

The definition of dealing in listed securities in Section 6 of the ordinance includes (whether as principal or agent) the buying, selling, exchanging or subscribing for securities, agreeing to do any of the aforementioned, and the acquiring or disposing of or agreeing to acquire or dispose of the right to buy, sell, exchange or subscribe for securities. This part of the ordinance only focus on dealing in securities, it does not include dealing in future contracts. The dealing of future contracts such as dealings in respect of Hang Seng Index Futures Contracts is not securities and is regulated by the Commodity Trading Ordinance.

Section 9 of the Ordinance provides the scope of the Ordinance and is restricted to securities of the corporation (whether incorporated in Hong Kong or abroad) in question. Therefore, dealings in cover warrants, units of investment trusts, or exchange-traded options in respect of the underlying securities of the corporation are excluded because such warrants, units or options are issued by a third party in respect of ‘securities’ of the corporation but are not ‘securities’ of that corporation. Similarly, the securities in question must be listed on the Hong Kong Stock Exchange and suspension of dealings in such securities is ignored in determining whether the securities are listed. Therefore, the Ordinance is not applicable to unlisted government gilts, unlisted share options or unlisted warrants. It would not cover a situation where a person holds listed securities through a private company and then sells the shares in the private company. The focus of the ordinance is primarily on securities of corporation listed on Hong Kong Stock Exchange.

Section 12 of the Ordinance sets out exemptions for insiders who acquires securities of the corporation through exercising sub-

42. Stephen S W Leung “Regulation of insider dealing – a new regime for Hong Kong” The Company Lawyer Vol 14 No 9 p 184.
43. The Securities (Insider Dealing) Ordinance of Hong Kong of 1991, Section 6.
44. Stephen S W Leung “Regulation of insider dealing – a new regime for Hong Kong” The Company Lawyer Vol 14 No 9, p 184.
46. Philip St J Smart, Katherine Lynch, Ann Y M Tam “Insider Dealing” Hong Kong Company Law, Cases, Matererials and Comments, Chapter 8, p 289.
scription rights attaching to warrants or other convertible securities of the corporation if those subscription rights are granted to him or her or held by him or her before that person becomes aware of any inside information. This therefore allows an insider to have the flexibility to choose between exercising warrants about to be expired and allowing them to lapse.47

C. Prohibitions

Insider dealing is defined in Section 9 of the Ordinance as:

When a person connected with a corporation deals in any listed securities of that corporation or a related corporation while in possession of "information" which that person knows is relevant information in relation to that corporation or counsels (whether or not disclosing at the same time the contents of the relevant information) or procures (such as when an insider forms a shell company and causes the shell to deal in the listed securities) another to do so knowing or having reasonable cause to believe that the other would do so. It would also be difficult for a director of a target company to recommend or reject a take-over bid if this would amount to counseling or procuring another to deal in listed securities.48

It is arguable that the Ordinance may not exempt dealing by a person who has relevant information and trading is in fact carried out by an agent who has instructions to trade at a purely discretionary basis (i.e. the principal has no knowledge of the kind of shares being traded by the agent). Dealing by the agent can be attributed to the principle and the agent can be said to have procured his principle to deal in the securities.

Another point is that it is no longer necessary that the insider should 'make use of' the information, unlike under Sections 9(l)(c), (a), (2)(b) and s 10(3) of the Ordinance. The only requirement under Section 9(l)(a) of the Ordinance is that the primary insider should be in possession of price-sensitive information that is not generally available.49 According to this part of the ordinance, the

48. Ibid.
49. Ibid, p 185.
D. Insider dealing

The Ordinance makes a distinction between 'insider dealing' and 'insider dealers'. Under Section 10 of the Ordinance, although there may have been an act of insider dealing within the meaning of Section 9 of the Ordinance, a person (including a corporation by virtue of Section 3 of the Interpretation and General Clauses Ordinance) is not held to be an insider dealer if he is able to prove, on a balance of probability, the following circumstances:

1. Where a director takes up qualification shares.
2. Where a person performs a bona fide underwriting agreement.
3. Where a liquidator, receiver or trustee in bankruptcy performs their duties in good faith.
4. Where a corporation, in circumstances where relevant information was in the possession of a director or employee establishes that:
   (a) the decision that the corporation enter into the transaction was taken by a person other than that director or employee;
   (b) arrangement were in existence for securing that the information was not communicated to the person taking the decision and that no advice with respect to the transaction was given to him by a person with relevant information; and
   (c) the information was not so communicated and the advice was not so given.\(^5^0\)

This defense is only available to a corporation which is alleged to have committed insider dealing and not available to non-corporate insiders even if they have effective Chinese Walls\(^5^1\) in place within their firms (eg law or accountancy firms). The Chinese Wall as contemplated by this exemption may be different from a normal Chinese Wall. The usual purpose of a Chinese Wall is to prevent access by a person to confidential information whereas the Chinese Wall exemption requires steps to be taken to prevent a person with

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\(^5^0\) The Securities (Insider Dealing) Ordinance of Hong Kong of 1991, Section 10.
\(^5^1\) A Chinese wall is where arrangements made up within a frim for securing information obtained by individuals employed in one part of the firm, in which will not pass onto another part within that firm.
inside information from communicating it.\textsuperscript{52} In another words, the requirement for Chinese Wall in preventing insider trading is stricter than normal Chinese Wall.

E. **Validity of insider dealing**

Section 14 of the Ordinance states that, no share transaction shall be void or voidable by the sole reason that it constitutes insider dealing,\textsuperscript{53} as this is meant to avoid allegations of illegality of contract. Because shares purchased in an insider dealing may be sold to other investors, titles of those subsequent purchasers may be adversely affected if the original insider transaction is found to be void or voidable. Although Section 14 affirms the validity of an insider dealing transaction in all respects, it does not prevent the courts from declaring the transaction unenforceable by refusing to enforce the transaction (i.e. not allowing one or both parties to the transaction to sue on the transaction).\textsuperscript{54}

However, in the context of the Ordinance which does not criminalize the act of insider dealing and establishes a special tribunal to inquire into the existence of insider dealing, the Hong Kong courts seemed to reach a different conclusion not consistent with the intended target or interpretation intended by the Hong Kong legislators who enacted the law.

In the case of *Innovisions Ltd v Chan Sing Chuk*, a defense was raised that a sale and purchase of shares based on insider information was an illegal contract and therefore unenforceable. The Court of Appeal (by a majority) dismissed the appeal and Justice Fuad said that since insider dealing was not made criminal or tortuous, the legislature did not intend that any adverse consequence, other than a possible finding of culpability by the Insider Dealing Tribunal, should follow any insider dealing. Thus the courts should not take notice of any alleged breach of insider dealing law and the public conscience would not be affronted by possible conduct which was not criminal and which might not even be found to be culpable.\textsuperscript{55}

However, Justice Penlington seemed to keep his position open on the illegality issue by saying that the illegality defense, by its

\textsuperscript{52} Philip St J Smart, Katherine Lynch, Ann Y M Tam "Insider Dealing" Hong Kong Company Law, Cases, Material and Comments, Chapter 8, p 295
\textsuperscript{53} The Securities (Insider Dealing) Ordinance of Hong Kong of 1991, Section 14.
\textsuperscript{54} Philip St J Smart, Katherine Lynch, Ann Y M Tam "Insider Dealing" Hong Kong Company Law, Cases, Material and Comments, Chapter 8, p 299.
\textsuperscript{55} [1992]1 HKLR 254
very nature, could only succeed if the giving and receipt of that information was prohibited by the Ordinance and was therefore culpable, and perhaps would lead to the conclusion that a particular contract entered into based on insider information would be void. Further he stated a civil court in Hong Kong had no jurisdiction to determine the culpability of any person in relation to an insider dealing which was reserved by the Ordinance to the Insider Dealing Tribunal. It can be seen from this case that Hong Kong takes a very careful stance in examining the details and consequences of insider trading cases in order to protect the rights and responsibilities of all related parties.

F. Liability of officers

The definition of officer in Section 2 of the Ordinance is wide and includes a director, manager, secretary and a shadow director. The Ordinance introduces a new obligation on company officers under Section 13. Section 13 states that it is the duty of every officer of a corporation to take such action as may from time to time be reasonable in all circumstances for the purposes of ensuring that proper safeguards exist to prevent the corporation from perpetrating any act which would cause it to be identified as an insider dealer. Section 13 is not intended to require the officer to take the relevant measures to prevent all insiders dealings, including those where the corporation may have one of the defenses outlined in Section 10. Rather, a company officer has to ensure that either a corporation does not carry out insider dealings or those insider dealings are covered by an exemption under Section 10. The measures may include the establishment of Chinese Wall (covered by Section 10(2)) or by taking steps to alert the company’s treasurer/investment manger to the existence of inside information (through putting the relevant stock on the stop list) without disclosing to the company’s treasurer/investment manger the actual contents of the insider information.

Under Section 16, where the Insider Dealing Tribunal identifies a corporation as an insider dealer, if the insider dealing took place with the knowledge, consent or connivance of any officer of

56. Stephen S W Leung “Regulation of insider dealing – a new regime for Hong Kong” The Company Lawyer Vol 14 No 9 p 188.
57. Ibid, p 186.
59. Stephen S W Leung “Regulation of insider dealing – a new regime for Hong Kong” The Company Lawyer Vol 14 No 9, p 188.
the corporation than that officer will also be regarded as an insider dealer.\textsuperscript{60}

G. Tribunal inquiry

An inquiry by the Tribunal shall be conducted only at the request of the Financial Secretary of the Hong Kong Securities and Futures Commission whether following representations by the Securities and Futures Commission (after concluding investigations pursuant to its statutory investigatory power) or otherwise (such as public complaints).

The function of the Tribunal is to determine:

(a) whether if insider dealing has taken place;
(b) the identity of every insider dealer;
(c) the amount of profit gained or loss avoided as a result of insider dealing;
(d) the identity of every officer in breach of duty under s13;
(e) the identity of every officer where insider dealing by a corporation took place with his knowledge, consent or connivance.\textsuperscript{61}

Tribunal proceedings are inquisitorial or investigative and such proceedings are justified on the ground of public importance where the normal civil or criminal proceedings, with their long established safeguards against injustice to the individual, are considered inadequate to arrive at the truth. The Tribunal directs the inquiry and the witnesses are the Tribunal’s witnesses.\textsuperscript{62} The Tribunal has wide-ranging powers which include the powers to investigate and to obtain evidence. It can receive evidence irrespective of whether or not such evidence is admissible in civil or criminal proceedings; thus the hearsay rules as well as other rules of evidence do not apply. A person can be obliged to answer all questions that may be put to him even though the answer may be admissible and incriminate him in subsequent civil or certain classes of criminal proceedings and under the Ordinance. This attempt to take away the right to silence may be challenged on the ground of contravention of the Bill of Rights Ordinance. Failure to comply with the directions of the Tri-

\textsuperscript{60} The Securities (Insider Dealing) Ordinance of Hong Kong of 1991, Section 16.
\textsuperscript{61} Philip St J Smart, Katherine Lynch, Ann Y M Tam “Insider Dealing” Hong Kong Company Law, Cases, Materials and Comments, Chapter 8, p 301.
\textsuperscript{62} Ibid.
bunal can render a person liable to a fine and imprisonment. Thus the Tribunal is a very powerful arrangement which is unique to Hong Kong.

Beside the power of the Tribunal, there are checks and balances built into the Ordinance itself. First, rules of natural justice are fully entrenched. The Tribunal may not identify any person as an insider dealer or an officer in breach of his duty under Section 13 without first giving such a person an opportunity of being heard. In addition, under paragraph 16 of the Schedule to the Ordinance, a person summoned to attend before the Tribunal or who is connected to the hearing is entitled to be present at any sitting of the Tribunal hearing. It is therefore implicit in this right of attendance that he is entitled to see all the evidence put before the Tribunal, whether or not that evidence is relevant to the inquiry affecting him.

Secondly, appeals may be made on a point of law or, with the leave of the Court of Appeal, on a question of fact. The findings of the Tribunal could also be subject to judicial review on the grounds of a breach of natural justice, excesses of jurisdiction, or by errors of law. In general, this Tribunal seems to be able to overcome the normal hurdles of combating insider trading as discussed in the early part of this paper. It could be argued that Hong Kong's arrangements would provide other jurisdiction a direction to look at for the future updating of their legislation.

H. Penalty

Publication of the inquiry report marks the end of the formal Tribunal inquiry, and possibly, of the whole case under consideration. Those identified as insider dealers or otherwise in the report would have suffered the indignity of public exposure of their conduct. However, this ideal result may not always be obtained in practice and other penalties have been considered appropriate to be imposed on the relevant parties in the absence of criminalization of acts of insider dealing.

The Tribunal may in respect of a person identified, as an insider dealer order that:

63. Ibid, p 302.
64. Stephen S W Leung “Regulation of insider dealing – a new regime for Hong Kong” The Company Lawyer Vol 14 No 9 p 189.
65. Ibid, p 190.
(a) such person may not be a director or liquidator of, or a receiver or manager of the property of, a listed company or any other specified company or in any way be concerned in or take part in the management of a listed company or any other specified company for up to five years. The disqualification order can only be made in respect of the relevant positions in a company incorporated under the Companies Ordinance;

(b) such person be required to pay to the government an amount not exceeding the amount of any profit gained or loss avoided as a result of the insider dealing and fines of up to three times the profit gained or loss avoided by all persons as a result of the insider dealing—,

(c) such person to refund to the government expenses incurred in the investigation and inquiry.66

A disqualification order or a penalty order imposing a fine of up to three times any profit gain or loss avoided can also be made against a company officer who has breached his duty under Section 13 even if the officer has not been identified as an insider dealer by the Tribunal.67

It is possible that a director may breach their fiduciary duty owed to the company at common law as a result of dealing in company's securities on the basis of inside information his capacity as a director. If the Securities and Futures Commission appoints an inspector under Section 127 of the Securities Ordinance to investigate and finds insider dealings to have taken place, the Securities and Futures Commission or the Attorney General may, under Section 130(8) of the Securities Ordinance, commence proceedings on behalf of the company against the director for recovery of damages for any breach of their duty.68

A person identified as an insider dealer will be deemed to be guilty of misconduct for the purposes of Section 56 of the Securities Ordinance and will not be able to satisfy the ‘fit and proper’ test for registration of dealers under Securities Ordinance.69

66. Philip St J Smart, Katherine Lynch, Ann Y M Tam “Insider Dealing” Hong Kong Company Law, Cases, Materials and Comments, Chapter 8, p 303.
67. Ibid.
69. Ibid.
After examining the Hong Kong regulator framework, it can be shown that Hong Kong does have a comprehensive framework in prohibiting insider trading. In the following section, I will examine the situation of insider trading in Taiwan and China. I will examine both their regulatory framework and some insider trading cases.

III. INSIDER TRADING IN TAIWAN

As both Taiwan and China are Chinese societies, a major characteristic for a Chinese society is that it is family or social network oriented, and this includes the business structures of its companies. Often in a Chinese company and especially in a Taiwanese company, family members fill most of the top management positions and other strategic posts are typically reserved for close relatives and for those employees who have worked for the family for long period of time. This authoritarian leadership style works in Chinese society because of the moral authority inherent in “the boss” as founder of the business group and this also is compounded Confucian influences on their societal structures. This combination of owners as managers avoids many of the “agency” problems that Western business style encounter in getting executives to promote the interests of the shareholders. This was due to the fact that under the Chinese traditional and Confucian theory, the family members are the “inner “ circle of people, thus if the company belongs to the family, they should work for the best of the interest for the company and not asking for the company to feed back, financially or other wise. Within this framework, the Chinese family business provides a high degree of flexibility accompanied by intense managerial effort. This means putting ones whole heart into the management of the company. (Family as owners and managers allow the company to be more responsive to changes in business environment and reduce inefficiency in resource utilization.)

On the other hand, the downside for this family oriented business structure is that it might easily become the brewing ground for potential insider trading activities, especially between family members and affiliated parties. As such, it is arguable that how and whether insider trading can be effectively controlled given the large number of family controlled companies in both Taiwan and the social network structure which dominated companies in China. Even

as the stock market of Taiwan and China become more and more mature, and many of the publicly listed companies are no longer family structure oriented; the situation of insider trading is still unavoidable. In the following section, I will present a few Taiwan insider trading cases. Even though they do not involve family businesses, most of the top management officers were close friends and many of their relatives were major shareholders.

A. The regulation for insider trading in Taiwan

Taiwan does not have a law specifically deals with insider trading. For Taiwan, the legislation and regulatory body that deals with insider trading is contained in the Securities and Exchange Law and the Taiwan Stock Exchange acts. The Article 157 – 1 of the Securities and Exchange Law of 1968 and its 2006 amendments, covers the area for insider trading. Article 157 – 1 stated that:

The trading of information which may materially affect the price of an issuer's securities either on a centralized securities exchange market or in the over the counter markets by following persons is prohibited:

(1) directors, supervisors and managers of the said issuer;
(2) shareholders holding of more than ten percent equity shares;
(3) any person who has obtained the information due to an occupational or controlling relationship; or
(4) any person who has obtained the information from any of the persons described in the preceding items.

Persons who violate the provisions of the preceding paragraph shall be held liable, to bona fide counterparts who they have traded with, for damages which equal the difference between the selling price prior to the disclosure of the information and the average of the last reported selling price for ten business days after disclosure. The court may also, upon the request from the bona fide counterpart, treble the limit of the liability of said persons should the seriousness of their violation be severe in nature.71

As illustrated from the above legislation, insider trading is clearly prohibited in Taiwan. However, based on Article 157 – 1, it

is argued that it encompasses a wider range of area; however it may not be precise enough to combat individual trading situations. As a result, this is probably why the success rate of prosecution is not very high in Taiwan.\footnote{China Times, http://www.chinatimes.com.tw, December 12, 1999.}

In addition to Article, 157 – 1 of the Securities & Exchange Law, Article 172 and 173 of the same law cover the penalties relating to insider trading. Although, these two articles are not limited to insider trading, they also encompass penalties concerning general corruption crimes.

In order to discourage insider trading and other market misconduct, Article 172 states that:

"Any director, controller, supervisor, or employee of a stock exchange or a securities investment and trust company who demands, agrees to accept or accepts any improper benefit in connection with the performance of his/her duties shall be punished with imprisonment for a period not more than five years, forced labor detention, and/or a fine not more than NT$2.4 million (note: USD$1 exchange around NT$31.5). Any person referred above, who demands, agrees to accept or receives any improper benefits for actions in breach of his/her duties shall be punished with imprisonment for not more than seven years and in addition there to fine of not more than NT$3 million may be imposed. Any benefits received by persons who committed the offenses specified above shall be confiscated. If the whole or part of such benefits cannot be confiscated the value thereof shall be collected from the offender."\footnote{Taiwan Securities & Exchange Law of 1968 (amended in 2006/05/30) Article 172.}

Further, Article 173 states that:

"Any person who promises to offer, agrees to offer, or delivers any improper benefits to any person who acts contrary of his/her duty as specified in the preceding Article shall be punished with imprisonment for a period not more than three years and/or a fine not more than NT$1.8 million. This punishment may be pardon if the offender voluntarily surrenders himself/herself of law enforcement authorities."\footnote{Ibid, Article 173.}

Despite the legal regulations above, insider trading in Taiwan is still common and widespread in the stock market. In reality, most of the parties who engage in insider trading do not consider this as a serious offence. Most of the market participants and parties in-
volved view insider trading as a fringe benefit they should enjoy for being top management or major shareholders. Under this market mentality, Taiwan legal authorities are more active in prosecuting insider trading cases that are initiated by company management and major investors because they view market stability and protection of the interest of small investors as their priority.\textsuperscript{75}

In the following discussion, I will present a few Taiwanese examples of insider trading. Some of the cases occurred during the 1990s, but most of the cases occurred after 2005. The cases during 1990s were mostly acquitted, such as Taiwan Fertilizer, but the later cases were largely successfully in rendering a guilty verdict. Thus we use these different cases to show the change in attitude towards insider trading by the Taiwan prosecutors, how Taiwan regulators have strengthen their determination to combat insider trading, and how their techniques have improve in detecting insider trading. The successfully prosecuted cases should be viewed as strong precedent in Taiwan as direct evidence was able to be established in those cases. It also demonstrates to the Taiwanese stock market that insider trading is illegal, detectable, and can be successfully prosecuted.

B. The case of Taiwan Fertilizer

\textit{A brief history}

Taiwan Fertilizer ("TF") used to be a government owned corporation until it was privatized in September 1999. TF’s main business operation is to manufacture fertilizing products, further it can be considered as oligopoly business in the Taiwan fertilizer industry. As a result, it had a large of amount of cash on hand (NT$13 billion) and total capital of NT$56.3 billion. Further, it owned large amount of land in every major city in Taiwan. As a result, when TF became listed on the Taiwan Stock Exchange in March 1998, it attracted investors’ attentions instantly, not for its fertilizer business but for the large amount of land asset. As it became a publicly listed company, the Taiwan government started to sell its holdings in March 1998; by 1999 the government had successfully released 55% of its shareholding in TF. TF was successfully privatized on September 1st, 1999.\textsuperscript{76}

\textsuperscript{75} Chang Shih Jei, "Memoir of Goodon Chang" 2nd ed, United Publishing, 2010, p. 34-35.

TF’s case was not as clear-cut as the case of Hannes mentioned above, where an individual directly acted to benefit himself based on inside information. The case with TF was much more complicated because it started when TF’s chairman engaged in actively pushing up its share price and investing in financially unsound companies in order to benefit a few related individuals. On Oct 13th, 1999 the Ministry of Economy discovered Taiwan Fertilizer chairman’s plans and he was replaced on Oct 18th.\textsuperscript{77}

There are two parts in Taiwan Fertilizer’s case.

\textit{Part 1}

Soon after it was privatized, TF called for a board meeting on September 10 and approved to set up four subsidiary companies. Between September 18th and October 1st, these four companies borrowed NT$4 billion from their parent company, TF. On October 1st, these four companies were officially set up for business. During October 1st to 8th, the four companies had already bought NT$1.9 billion worth of TF stocks. When Taiwan’s Independent Evening News reported this matter on October 8th, these actions had caught the Ministry of Economy’s attention. On October 11th, TF’s chairman ordered the four subsidiary companies to sell all their TF stocks.\textsuperscript{78}

Thus TF’s chairman was using company capital to invest into subsidiary companies then the subsidiary used those funds to buy their parent company’s stocks, in order to push up parent company’s share price. This behavior violated the Taiwan Company Law Article 167 which states that companies can not buy back its own shares, unless the company applies to a regulator for buying back shares as treasury stocks. In TF’s case, setting up subsidiaries was just an attempt to avoid complying with Company Law article 167.\textsuperscript{79} By pushing up share price, the chairman surely was not the only one who benefited from the transaction. There were other major TF shareholders and top managements who also benefited from the rise of share price. Further, just how exactly beneficial it was for certain politicians is still unknown due to the government’s close relationship with TF. However this case did exposed the government’s connections in TF.

\textsuperscript{77} Fung Wun “The most important 72 hours of the Taiwan Fertilizer case” Win – Win Weekley, October 24 – 30, p 29.
\textsuperscript{78} Ibid , p 32.
\textsuperscript{79} China Times “Taiwan Fertilizer case exposed the loop holes of company law.” October 22 1999, p 15.
Part 2

Besides driving up their own share price, Taiwan Fertilizer also used almost NT$700 million to buy shares of Shen-Ray-Do (SRD) at a price higher than market value, which caused the Ministry of Economy to suspect TF chairman of trying to benefit a few individuals by using TF’s capital.80

During the investment process, there were also other issues that emerged:

1. As mentioned above, TF spent NT$10.75/share buying SRD, but the market price was approximately valued at NT$8/share. This was about 30% above market price. Moreover, SRD was about to issue new shares on to the market, instead of buying new shares, TF decided to buy shares from a few individuals.81

2. September 8th: chairman ordered TF officials to evaluate the possibilities of investing in SRD.
   September 13th: TF officials had to report back to him.
   September 16th: Board meeting approved to invest in SRD.
   September 21st: TF signed contract to buy SRD stocks.
   September 27th: The deal was completed.82

The deal was brokered quickly, but more interesting is that the TF report did not recommend investing in SRD as SRD was actually determined to be a financially unsound company.

The evaluation report did not provide reason on why TF should pay NT$10.75 per share for something worth only around NT$8. The report also pointed out the risk of investing in SRD would be quite high as the risks outweighed the benefits.83 Questions about the transaction began to emerge:

3. In Taiwan, when a listed company buys stocks of unlisted companies, they need to release a public official notice to the market. With the notice, there should be accompanied by an investment professional’s evaluation report on this deal. However, when TF bought SRD, it did not provide a professional report in the official notices. TF said the report

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81. Ibid.
83. Ibid.
would be filed two weeks later. The question is if there was no professional recommendation, how would TF justify paying 30% more than the market price?\footnote{China Times Nightly. "TF buys SRD in a hurry." Oct 20 1999, p 2.}

4. TF paid cash for SRD stocks, but TF did not receive the stocks on the spot. Stocks were transferred at a later date. Why the rush to buy them?\footnote{Ibid.}

5. If a company is worth investing, why did those few individuals wanted to sell their shares? There were concerns that the chairman actually used TF’s funds to help his friends to sell their troubled investment in SRD.\footnote{Wang Zho Yung “News Focus” (1999) China Daily News, Taipei Taiwan, 23 February.}

As TF used to be a government owned enterprise, most of the people involved in this case were either politicians or friends of politicians. Taiwan Fertilizer’s case exposed their connection and problems with Taiwan legal system. Further, the chairman of TF and some major shareholders of SRD were close friends.\footnote{China Times “Taiwan Fertilizer buys SRD: Suspected of benefiting few particular individuals” Oct 20 1999 p2} Also, this case served to be an illustration that insider trading network in Taiwanese companies does not limit itself with family members, but also extended to friendship and political affiliate networking relationships. In another words, as a stock market matures, the insider trading network could become more complicated and extended.

The TF case was probably the first “insider trading” case that made the Taiwanese society aware of this problem. Although to the end, other than the removal of the Chairman of TF, nothing further was done by the authority. There were no civil or criminal penalties, and if we compare the situation during that period with Australia and Hong Kong during the same time, it is not difficult to see how much further behind the Taiwanese system was both in terms of its awareness and methods of dealing with the problem of insider trading. Nevertheless, this case served as a “wake up” call for the government and the society to face the reality of the wide spread of insider dealing problem in Taiwan.
C. The case of Uni-President

A brief history

Uni-President Enterprise is the top food processing and consumer staple product manufacturer in Taiwan. This company has many subsidiaries under the name President which include President Chain Store Corp and President Securities Corp. In 1994, Uni-President decided to let its subsidiary President Chain Store to be public listed. They let their other subsidiary President Securities to underwrite the President Chain Store Corp IPO case. Since Uni-President Enterprise will IPO this subsidiary, it announced that it would release 41% of President Chain Store Corp share holding as material market impact information on the Taiwan Stock Exchange from September 1 to October 21, 2004.  

The proprietary trading of President Securities started on 9/1, 2004 and by 9/17 they had purchased 200,000 Uni-President shares. They continue to buy 8,194,000 Uni-President shares from 10/4 through 10/14. By 10/19, they had sold all their Uni-President shares and made a profit of NT$76 million.

Taiwan Stock Exchange notices this profit and the Taipei Prosecutor Office charged the CEO of President Securities TU Zong Hui on insider trading. They argued that Tu took advantage of the knowledge of the IPO and enabled his company to make a massive profit. This is because the underwriting department had already written a report on this IPO case and as he was responsible for the trading activity of the proprietary trading unit, he deliberately made profit on this private information.

Unfortunately, this straightforward case did not end in a conviction. This is because President Securities argued that the initial share release of Uni-President even though announce during 9/1~10/21, the news had already been reported by the United Evening News and Independent Evening News between 8/15~8/31. The share release information to the press was exactly the same as Uni-President’s public release. In this respect, the court regarded this as publicly known information and not private information. Also, the court regarded the level of CEO’s as too high to be responsible on

the trading details of the company. Therefore, Tu was not guilty of insider trading and the case was dismissed.89

Comparison and analysis

Even though the cases above were not successfully prosecuted, due to prosecutors being defeated on technical issues (Uni-President case) and facing strong political pressure (Taiwan Fertilizer), they served as examples to the Taiwan public that regulators do regulate this type of unlawful activities and insider trading is not a fringe benefit that should be enjoyed by top management and major investors. Although it was shocking to see politicians and business people benefiting each other and disregarding the welfare of general investors in the Taiwan Fertilizer case, it should be noted that there are still many more that have not been discovered. Even though the politicians involved in TF were not caught, in the later cases there was a legislator involved in insider trading and they were successfully sentenced. These cases act as an early example of insider trading in Taiwan and also demonstrate how governmental corruption disrupts the health of the Taiwanese market. This type of activity should be view as destructive for the market efficiency and the confidence of an economy.

As indicated by the Taiwan Fertilizer case, during the 1990s it was common for the Taiwanese businessmen to actively seek political relations with the Taiwanese government, since the government usually could influence the banking sector. With those connections, the Taiwanese business could gain a de facto control over one or more financial institutions for the purpose of getting a bank loan easier. Their next step was to attract funds from the general public or use their relations to gain access to favorable loans from the banks. When they had the funds, they transferred the money to make easy profits in the stock and real estate markets. After they made money in this process, they considered the profit as their own. When the market went bad and they lost money, they forced the government to bail them out. It is the taxpayers who actually paid for this bubble economy.90 Even though this type of formula provides short-term assistance for these struggling companies, this government assistance is no match for the huge force of market competition. These companies at the end all went bankrupt because

89. Ibid.
they only engaged in the cultivation of political relationship and not in making their business competitive. Market confidence during that period of time was hurt tremendously and this helped lead to the Taiwan business crisis in 1998-1999.

Fortunately, the Taiwanese stock market eventually regained confidence and recovered from the crisis. The Taiwanese stock market has gradually become one of the most important Asian stock markets. This is largely due to the importance of Taiwanese companies in the Chinese market. Many international institutional investors view Taiwan’s stock market as the gateway for direct investment in China. Also, because of the growth of Taiwan’s information technology and semiconductor industry, it has attracted a large amount of foreign international investment. Further, the growth of stock market has forced Taiwan’s financial regulation to become more comprehensive. This led to a few recent cases of insider trading, Hold Key Electric 2006, Inventec Appliances Corporation 2007, BENQ in 2009 and BOFA Technologies. They are some of Taiwan’s major insider trading cases in recent years and the legal authorities had prosecuted some of these cases successfully.

D. The case of Hold Key Electric

A brief history

Hold Key Electric is mid-size electric appliance company in Taiwan. Its case of insider trading started at 2003 when the company received an order for a project from the Taiwan Power Company, a government owned company and Taiwan’s only electricity provider. This was consider to be very good news for a mid-size company like Hold Key, so the company management and major shareholders decided to take this good news to speculate on their stock price. They wanted to take this chance to get cash for company expansion and personal profit. As a result, they decided to sell 20 million shares in order to provide their desired cash reserves.91

While Hold Key decided to sell 20 million shares, the daily trading volume of their stock is only around 500,000 shares. If they decided to sell the 20 million shares in the stock market outright, it would cause their stock price to crash immediately. As a result, the company co-operated with a Taiwan Legislator FU Kuen Chi and asked Fu to find them a market maker/speculator to help them use

their new order as good news to trade up their stock price. As Fu was befriended with the famous market maker/speculator in Taiwan named CHANG Shih Jei or also known as Antique Chang, on September 2003 Fu told Chang that the company wanted to get 20 million shares to speculate in the market. For a period of 6 month, the company said if Chang and Fu could trade up the stock price to above NT$16, then Fu and Change can share the profits above NT$16. Chang accepted this offer and wanted to trade up the stock to target price of NT$26. If successful, they would make a potential profit of NT$200 million.

As Chang is also the owner of a few Taiwanese investment consulting companies, he asked the stock analysts of his companies and other analysts he befriended to strongly promote Hold Key. They portrayed Hold Key as a company that will enjoy a very strong growth in order to lure the investors to buy the stock. Chang and Fu also asked his friends, family, and other legislators to buy the stock in order to share this profit. Under this strong promotion, the stock price easily shot up to NT$40 by the time of January 2004. At that time, the company management had sold all of their 20 million shares. As the company, Fu and Chang all sold their stock, the stock price gradually traded back to around NT$15-20 level.92

Because Hold Key rallied in such high profile manner, it naturally attracted the attention of Taiwan Stock Exchange and Taiwan High Prosecutor Office, Taichung Branch. Given Fu’s position as a Legislator, Chang and Fu believed the legal regulators would be afraid of Fu’s title and would not approach this case. Further Chang was a very smart careful speculator. Any case he worked on, he would always used dummy accounts and never personally sign any contract with any of the companies or dummy sub-accounts under him. Unfortunately, to Chang and Fu’s surprise, the prosecutor started to monitor Chang’s phone calls from October 2003. After one year of monitoring his phone calls, the prosecutor arrested Chang on November 2004. Since Chang was arrested on his way to the airport, he had no chance of deleting or destroying any Hold Key related documents in his office, thus the prosecutor got all the evidence they need in Chang’s office. The evidence comprised of items such as Chang’s computer, deposit book, remittance forms, dummy account lists, sales lists, stock trading records were all confiscated.93

93. Ibid.
As the evidence was very complete and the prosecution had monitored him for a year, Chang has nothing to deny. He pleaded guilty and the case was sentenced on August 2006. Chang was sentenced to one year six month in jail and indemnification of NT$28 million. As for Fu, he was sentenced to 4 years and six months in jail and indemnification of NT$50 million.94

E. The Inventec Appliances Corporation

A brief history

Inventec Appliances Corp is a handsets and IT product manufacturer in Taiwan. It was a subsidiary of top PC/Notebook manufacturer, Inventec Co., Ltd Inventec Appliance was listed at Taiwan Stock Exchange on October 25, 2005. According to Taiwan Securities & Exchange Law, the shareholding of major shareholders to an IPO (initial public offering) company has a lock-up period of 3 months.95 As for Inventec, the lock-up period ended on January 25, 2006.

When Inventec Appliances was listed on October 25, 2005, its IPO price was NT$108 per share. Besides having its own handset brand, OKWAP, Inventec Appliance is also the OEM producer for many major technology companies such as Apple Computer & HP. OEM producer stands for original equipment producer manufacturer, which means producers such as Inventec Appliances will produce for brands such as Apple and HP with original equipment production specifications and requirements. As a result, most of the international investment firms in Taiwan such as Deutsche Bank and Merrill Lynch all had a strong buy rating for the stock with target price ranging between NT$233-300 per share.96 This was because during the Inventec IPO, it generated a market flurry on investment on handset related companies. A lot of the foreign institutional investors during that time were actively trading Inventec. As a result, its market price surged to NT$238 on February 2007.97

Before the lock-up period ended on January 25, 2006, top management of the company received notice from its major customer,

94. Ibid, p. 50.
96. Cheng Shui Ming and Hsu Chia Chia, "Inventec Appliances share prices dropped sharply" (2007) United Daily News, Taipei Taiwan, 12 April.
97. Bloomberg Professional System, Bloomberg Finance LP, USA
Apple Computer that it would reduce its notebook shipments order in the first quarter of 2006 from 520,000 units to 300,000 units. As Apple Computer is one of the company’s major OEM customer, this order reduction would led Inventec’s revenue to decline from the NT$12.3 billion level in January level to NT$6.9 billion in February, a decline in 44%.98 Under Taiwan’s regulatory requirements, public listed company has to report its monthly earnings before the 10th day of next month, and as a result this drastically decline February earnings would not be known to the public until March 8, 2006. Thus the company’s top management and officers were in receipt of information at around mid-January while market investors would not know about this information until early March. As a result, this time lag advantage on information eventually led to the formation of an insider trading case.

As the lock-up period expired by January 25, 2006, seven of the top managers all started to sell their shareholdings at around February 6, 2006. By the end of February 2006, top management had sold 8000,000 shares of stock (total amount of NT$1.1 billion). The price of shares that they sold were almost at around the historic highest level of NT$238 per share.99 Thus, the top management had sold their company shares with the knowledge of Apple Computer orders reduction at the expense of general investment public. In this case, they had taken advantage of the private information to the detriment of the investment public. This aspect constituted an important aspect of insider trading as the officers, directors and shareholders had take advantage on information that would have a material impact on the price of the securities.100

When the February earnings were announced to the public on March 8, 2006, the share price plummeted by NT$14.5 to close at NT$193.5. Over the next few days the share price subsequently declined by 16%.101 By this time, top management had sold all of their shares. After they took profit on their investment, they left most of the investment public to face the free fall on the share price. As for the investment recommendations by Deutsche Bank and Merrill Lynch, they were viewed as inaccurate. This not only

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99. Ibid.
100. Taiwan Securities & Exchange Law of 1968 (amended in 2006/05/30) Article 157-1.
made the market question the investment recommendations of those firms, but also led to huge losses to their client's investment as well. Foreign institutional investment on Inventec was at around 650,000 shares when the news went public. The loss of market value on the investment had hugely impacted the market confidence at that time. This also resulted in the share price of all handset related companies to swing violently. It was a shock to the market and painful for the investor. Even though the market gradually managed to recover from this shock, however even today handset related stocks are still regarded as a risky investment sector.

The news and investor's huge loss had made the press and Taiwan Stock Exchange questioned the precise timing of the top management's gesture. Even though top management argued this to be normal profit taking for their investment, the Taiwan Stock Exchange did not take this to be a rational reason. Subsequently, Taiwan Stock Exchange and Gre Tai Securities Market (Taiwan OTC Market) spent around one year collecting evidence and investigated the company's operations and changes in shareholding. Finally on April 12, 2007 the Taiwan Financial Supervisory Commission sent the case for formal legal investigation. After receiving the case, the prosecutor decided to arrest 5 major top management officers and 7 other affiliated persons. This had astounded the Taiwan society due to the scope of this case and the large number of top management involved.

Finally, the court prosecuted this case based on the direct evidence collected during investigation. The direct evidence such as email and computer files indicated that top management were involved in trying to delete important email messages that they had sent to their friends and relatives on selling the shares after the Apple news. This evidence was collected from the officer's computer hard discs and company's mainframe computer. Investigators also found out that while the company was not a family run business, the 5 officers arrested and the 7 persons on bail were mostly friends and relatives. All the related parties knew of the Apple Computer news and had profited together to avoid the subsequent loss in their

102. Ibid.
103. Bloomberg Professional System, Bloomberg Finance LP, USA
shares value. Since the related parties sold their shares before the Apple news known to the public, the timing issue on insider trade could also be establish with this case. With next insider trading case, BENQ, it will show that timing issues are another important factor for insider trading to be established.

F. BENQ (now renamed to Qisda)

A brief history

BENQ is another Taiwan handset and notebook manufacturer. It used to be a business division in Acer Computer, the Taiwan number one PC/notebook brand and global top 5 PC/notebook brand. Similar with Inventec Appliance, it became an independent company and a publicly listed company on the Taiwan Stock Exchange. LEE Kuen Yau was the chairman of BENQ and he was also an important IT personality in Taiwan as he was also the chairman of Taiwan's number one TFT-LCD panel maker, AUO. Since Lee is an aggressive businessman, he was very active in promoting BENQ to merge with Siemens (Germany) handset unit between 1995 and 1996. Unfortunately, due to differences in corporate culture and operational issues, the merger between BENQ and Siemens was a failure. This had caused BENQ to incur huge losses and the stock prices suffered after the merger was dissolved. The market was disappointed at the news and its share price suffered as the market had given BENQ high expectations on their merger. This was because if successful, BENQ will be the first IT Taiwanese company to merge with a Western technology company.

BENQ’s huge loss and the volatility in their share price made the Taiwan Stock Exchange decide to examine BENQ’s subsequent business operation and stock price fluctuation more closely. After a period of investigation, Taiwan Stock Exchange suspected BENQ’s Lee and CEO had engaged in remitting employee’s bonus shares of around NT$800 million to overseas subsidiary company in Malaysia (CREO) and in turn remitted the amount back to Taiwan to buy BENQ’s own stock to support its share price.

After a period of investigation, Financial Supervisory Commission had presented this case for prosecution. After the court proceeding, the Taouyan District Court had finally dismissed this case.

107. Ibid
based on the fact that when the company remitted the funds back to Taiwan, the news on the loss with Siemens was already known to the public, thus there was no timing issue to serve as direct evidence to establish a case of insider trading. It was also found that as BENQ is an actively trading stock, the amount of NT$800 million would not make substantial changes to the share price. The share prices changes after the trade was less than 4% on the day, thus the court found there was no material impact established in this case. As a result, Lee and the CEO were acquitted based on no direct evidence being established, no material market impact, and no private information was unknown to the public. After this case was being dismissed, BENQ decided to rename itself to Qisda. They re-listed on Taiwan Stock Exchange on October 15, 2007 to signify the company's reborn and new identity.

G. BAFO Technologies

A brief history

BAFO Technologies is a Taiwanese company that manufactures and markets cables and computer peripherals, such as networking cables, and UBS cables. BAFO was an IPO to the Taiwan OTC Market on April 2003 at the price around NT$13.5 per share. Since BAFO was a small company and its products were very generic, this company had no obvious competitive advantage in comparing with other stock traded in the market. As a result, its stock price remain at the range between NT$13~13.9 per share for the first month it IPO.109

Unfortunately, its Chairman/CEO CHEN Hong Pi was not satisfied with its stock performance. Chen approached a market maker/speculator YU Zong Bei in May 2003. Chen asked Yu to trade up their stock price and was willing to share his profits with Yu. As a result, between May 2003 to August 2003, they drove up the stock price to as high as NT$26.5. After Chen and Yu took their profits, the stock price slipped back to its original level by August 2003 after making profit of roughly NT$50 million.

After the previous stock rally, Chen thought that this was a great way to make money. He realized to manufacture and sell products was too slow in making money, so he applied to issue con-

108. Ibid
vertible bonds on September 2003. After he issued convertible bonds, he approached Antique Chang, the same market maker/speculator in the Hold Key case. During this period of market making, Chen announced fictitious good news about the company. With this good news, Chang asked his analyst to strongly promote this stock on this TV network program. Together they drive the stock up to NT$25.4 by December 2003. After the Chen and Chang sold their stock, the stock price dropped sharply to as low as NT$3.9 by September 2006. With this huge swing in the stock price, it is easily to see how investors who believed in Chang's recommendation and good news that his company had released had suffered.

This was not the end of Chen's game. After two rounds of financial rally, he was actually in love with this money game. He approached Yu again in December 2006 and asked him to trade up the stock from the NT$5.5 level to NT$30. Yu did not disappoint him, he traded up the stock to its historic high level of NT$33.5 at July 2007. Not only that, but during the period between December 2006 to August 2007, he set up a paper company in Hong Kong to engage in fictitious sales to transfer capital from the company to his own pocket of around NT$180 million. Unfortunately for him, the stock rallies caught the attention of Taiwan High Prosecutor Office, Taichung Branch again. They approached Chen, Chang and Yu on allegations insider trading. Again, the prosecutor's got hold of importance evidence when they arrested Chang.110

Chang was an important market player for insider trading for many companies. Since this case was more complicated than the above mentioned Hold Key, the detail of prosecution is still an ongoing process. Since this is a serious insider trading case with top management deeply involved, it most likely would lead to the parties involved being prosecuted, it is just a question of sentence and amount indemnification requested.

IV. INSIDER TRADING IN CHINA

As for the China's regulatory framework on insider trading, China is considered to be a late starter. Even though some Chinese local courts began to cautiously accept the false statements involving civil compensation cases, the compensation-related cases on insider trading had not broke through until 2005. That year, the new "Securities Law" of China was implemented. The new Security Law provided a mechanism in which made it possible for people to bring

110. Ibid.
civil action for loses due to insider trading. In addition, the Supreme Court of China also prescribed “Standing for Legal Action” and within the provisions, it outlined the law for insider trading of securities and manipulation of the securities trading.\textsuperscript{111} Thus, the formal legal foundation for the prohibition of insider trading was finally established.

In 2007, China’s Securities Regulatory Commission (CSRC) prescribed “the ways to recognize insider trading” on a trial basis. In addition to that, the Supreme Court also initiated the interpretation and drafting for cases with insider trading and market manipulation.\textsuperscript{112}

According to the new “Securities Law”, securities fraud includes three categories: false statements, insider trading, and market manipulation.\textsuperscript{113} Civil actions could be brought against all three of these forms. However, in practice, the court only accepts false statements when any action on securities fraud arises. Insider trading and market manipulation and other causes of civil compensation cases are “temporarily not being accepted”.

For the people who are familiar with the development of the Chinese securities market, the reason for such actions not being accepted by the court can be traced back to September 2001, when the Supreme Court provided a formal notice of “with regards to the temporarily inadmissible of civil cases involving securities fraud” in which it stipulated: “The court must not accept cases which involves false statements, insider trading and market manipulation until further notice.”\textsuperscript{114} The reason provided by the Supreme Court was that, during that time, the system of civil compensation for securities related cases was very weak, the qualities of legal personnel were limited, and the legislations in relation to such issues were not properly enacted. Therefore, the courts did not possess the ability to determine such kind of cases during that period.

A year later in 2002, the Supreme Court promulgated a notice on “the admissibility on cases for civil disputes arising out due to false statements in the securities market.” In 2003, it further enacted “with several guidance on civil actions arise due to false statements in the securities market”.\textsuperscript{115} With the issue of these two

\textsuperscript{112}. Ibid.
\textsuperscript{113}. Ibid.
\textsuperscript{114}. Ibid.
\textsuperscript{115}. Ibid.
documents, a concrete, operational way to deal with false statements cases by the courts became possible, and thus this has been seen as a major breakthrough with a court that had “temporary not accepted” a way of dealing with this kind of issues as described above.

Some local courts began to cautiously accept cases on compensation involving civil litigation on false statements, but the admissible on cases on insider trading was not accepted by the court until 2005, in which during this year, the new Securities Law was implemented and the enactment of such legislation made actions under insider trading and market manipulation became possible. The People's Supreme Court of China also prescribed “Standing for Legal Action” and within the provisions, insider trading and manipulation of market has formally become two causes of action to sue in civil action. Thus, legal foundation for civil actions against insider trading has formally been established.

One thing that needs to be noted is, as China is a Civil Law country, unlike Common Law countries, in which usually one needs to exam a chain of cases in able to determine the accurate standing of the court when dealing with insider trading cases. In China, one case, or one MAJOR case would be enough, as government policy is usually more important than court decisions, thus one land mark case usually would reveal the intentions of the government in relation to a particular area of law. The following case is one such case.

A. HUANG Guangyu insider trading case

The detention of HUANG Guangyu, Chairman of Gome Electrical Appliances Holdings Ltd, China’s biggest electrical appliance retailer, in late November 2008, came as a huge surprise to the Chinese public. Due to the success of his retail electrical appliances business, under the China consumer market booming in recent years, Huang was once ranked as the richest man in China. However, the Chinese police had been pursuing Huang ever since they first investigated him in 2006. After two years of investigation, the police had uncovered evidence of 70 billion RMB or Yuan (note: USD$1 exchange around RMB$6.85) in suspicious capital transactions under Huang’s name, and have linked him with seven economic misdeeds including share price manipulation and money laundering.

116. Ibid.
On November 28, Gome Electrical Appliance Holdings Ltd, which was listed on the Hong Kong Stock Exchange, released a statement admitting that its Chairman HUANG Guangyu was under police investigation for alleged involvement in economic crimes. ZHOU Yafei, the company's chief financial officer was also being questioned in connection with the same case, Gome noted.117

On the same day, officials from the China Securities Regulatory Commission (CSRC) confirmed that Beijing Eagle Investment Co Ltd – a company controlled by Huang – was suspected of manipulating the share prices of Sanlian Commercial Co Ltd, and Beijing Centergate Technologies Co Ltd.118 According to the Xinhua News Agency, HUANG Junqin, the elder brother of HUANG Guangyu, the CEO of Beijing Towercrest Group, and Chairman/President of Beijing Centergate Technologies Co Ltd, XU Zhongmin were all being held in custody by the Beijing police.119

1. Seven deadly sins' with 70 billion Yuan

On November 23, a police source told the Economic Observer that HUANG Guangyu had been taken into custody by the Beijing police on November 19, but he had been released three days later. On that occasion, Huang was only being questioned about the manipulation of the share prices of Beijing Centergate Technologies and Shandong Jintai Co Ltd; however the police had evidence showing Huang was involved in suspicious capital movements totaling of around 70 billion Yuan.120 Since the amount of money involved was very huge, the Beijing police were very concerned in dealing with Huang's case.

According to the source, Huang is now suspected of seven crimes: bribing senior officials before Gome's listing in Hong Kong, evading tax by injecting assets into an overseas shelf company during Gome's merger with Shanghai-based electronics retailer Yongle; money laundering concerning Shandong Jintai; manipulating the share prices of Beijing Centergate Technologies and Sanlian Commercial; and transferring company assets through the underground banking system to his own accounts.121

118. Ibid.
119. Ibid.
120. Ibid.
Back in July 2006, HUANG Guangyu and HUANG Junqin were investigated by the police for illegally receiving 1.3 billion Yuan of loans from a Beijing branch of the Bank of China more than a decade ago. Even though Gome had announced on January 16, 2007 that HUANG Guangyu had been cleared of all charges, but the police didn’t remove Huang from their list of suspects. According to police insiders, instead of the CSRC, the Ministry of Public Security (MPS) took the lead in the current investigation. Investigations have continued without a break for the past two years, and only a very few people within the police authorities kept in the loop in order to prevent Huang from using bribes to gain knowledge of the investigation. “Only recently was the case handed over to the Securities Crime Investigation Bureau of the MPS, and was acted on by the Beijing police,” said a source close to the matter.122

An industry insider suspects that Huang may have used an underground banking system for money laundering or transfers. Although the HK-listed Gome had ample capital, the Chinese government conducts strict supervision of foreign exchange inflows. On the other hand, the takeover of Sanlian Commercials and Beijing Centergate Technologies and the merger with Dazhong Electronics all of which required huge amounts of funds. As a result, it is very likely that Huang turned to China’s underground banking system to illegally transfer funds out of Gome for his merger and acquisition needs. The insider noted that many of the major players in the underground banking business come from Chaoshan, a city in south China’s Guangdong Province, which also happens to be Huang’s hometown.123

From April to June 20, 2006, Huang spent 155 million Yuan buying 29.58 percent of Beijing Centergate Technologies through Pengtai Investment Co Ltd, one of Gome’s subsidiaries, and became the company’s biggest shareholder. Huang later invested more than 900 million Yuan in the company through a series of capital injections. Based on information from the police, it was during this period that Huang was suspected of manipulating Gome stock prices and embezzling funds. Moreover, since 2007, Huang has been transferring large amounts of capital out of the country for unknown reasons.124

122. Ibid.
123. Ibid.
124. Ibid.
2. **Gome's speedy merger with Yongle**

On August 2008, the Central Commission for Discipline Inspection of the Chinese Communist Party (CCP) launched an investigation into high-level corruption in the foreign investment administration. Several Ministry of Commerce (MOFCOM) officials were forced to step down and HUANG Guangyu's name came up during the investigation. People close to the investigation said that some officials confessed to accepting bribes from Huang before Gome's listing in Hong Kong and during its merger with Yongle.\(^{125}\)

The story on Yongle started when it was in huge trouble during the summer of 2006. Yongle received a conditional investment of US$50 million from Morgan Stanley in 2005; in return, Yongle would give 4.1 percent of its equity to Morgan Stanley if its net profit failed to break 600 million Yuan level in 2006. Since Yongle didn't reach this target, its Chairman CHEN Xiao was on the verge of losing control of the company.\(^{126}\)

At that time, Gome stepped in and announced its plan to acquire Yongle. On June 18, 2006, Gome proposed the merger to Yongle and on June 26, only 8 days later, the entire transaction was approved and completed. At a news conference held on July 26, 2006, Huang announced that Gome would acquire Yongle via a share swap plus a cash payment – Gome would swap one of its shares for each three of Yongle's shares and pay an additional HK$402 million of cash.\(^{127}\)

Even though this merger which appeared as Gome's timely rescue of Yongle, it was in fact designed to serve Huang's own interests. This was because in 2006, Gome was facing a major cash flow crunch. At the time Huang and his brother's bank accounts had been frozen by the police because of the on-going investigation of their possible involvement in an illegal lending with Bank of China. Huang decided to use this merger to get on hold of Yongle's capital and save Gome. According to people close to the matter, the HK$402 million Gome promised in the merger was not paid until a year later.\(^{128}\)

What is more, MOFCOM's approval of the merger was surprisingly swift. As it was registered on the British Virgin Islands

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(BVI), Gome was actually a foreign invested company. Therefore, it was very unusual for MOFCOM to have spent only eight days on the reviewing process for a merger involved a foreign invested company. As it was later being discovered, two of the MOFCOM officials under investigation – GUO Jingyi, inspector of the Department of Treaty and Law, and DENG Zhan, former deputy director of the Department of Foreign Investment Administration – played a key role in the approval of the merger.129

On November 28, 2008, Gome said that preliminary checks indicated no evidence of misappropriation of company assets, but it had set up a special committee to monitor and assess the company’s financial condition and operations.130 Meanwhile, Gome has appointed its president CHEN Xiao as the company’s acting chairman.

3. Who is HUANG Guangyu?

Huang had his first taste of the capital markets in 2006, when he took Gome public through a back-door listing. Since then, Huang has been attracted to the capital markets because of the high risks and still higher yields. Although Huang dropped out of school at the age of 16, he later managed to obtain a bachelor degree from Renmin University of China. Huang’s wife Du Juan graduated from Beijing University of Science and Technology and once worked in the Bank of China as a credit officer. Later, Du joined Gome as head of Pengtai Investment Co. Ltd. “Du is in charge of Gome’s business in Hong Kong; she’s good at handling investment business,” said a source within Gome.’

Before 2005, Huang also owned Eagle Legend Securities Limited and Eagle Legend Futures Limited. In April 2005, Gome announced that it had sold both companies in order to focus on the electrical appliance business. However, according to sources with Gome, the two companies were sold because Huang lost 4 billion Yuan in a futures transaction earlier that year. That’s also how Huang lost all his hair, they said.132

At present, Huang is assisting the police with their on-going investigation. He is not allowed to go abroad or leave Beijing. On the other hand, his arrest for the insider trading had made the stock

129. Ibid.
130. Ibid.
132. Ibid.
price of his cash cow, Gome suffered as well. Gome’s stock price was as high as HK$27 per share, but later only traded at around HK$2-$3 per share level in recently.

In Huang’s case of insider trading, he was focused on using funds from one company to finance the merger & acquisition of other companies in his group. Also, he had bribed high officials to ensure his transferring and laundering scheme was not uncovered. In other words, his behavior had hugely undermined the confidence of investors who invested in his company and market confidence in government officials. This had made the market start to question the relationship between financial officials and rich businessman like Huang.

It would be a prediction from the author that although this case is still in the process of being settled during the writing of this article, judging from the past methods that the Chinese government has employed, there is little doubt that Huang will be found guilty on criminal charges, and will also face a hefty fine.

B. **Insider trading case for Xinjiang Tianshan Cement Ltd.**

Even though the defendant involved in Xinjian Tianshan Cement (Tianshan) insider trading is not as high profile as Gome’s case, Xianjian Tianshan Cement case is significant in serving as precedent for future China insider trading cases because it compose of two parts and each part can serve to be a useful precedent. Also, the Tianshan case is actually the first case that China Securities Regulation Commission actually punished the company’s management for insider trading behavior under the claim of using of private information to make personal profit.

* A brief history

Xianjian Tianshan Cement is a public trading company listed in Shenzhen Stock Exchange. It is also a subsidiary under the Tieh Long Holding Company and Tieh Long biggest shareholder is Xianjian Tunghei Investment Company. On June 24, 2004, Xianjian Tunghei Investment Company had signed a Stock Transfer Agreement with China Non-Metal Material Corp to transfer 51 million shares of Tianshan to China Non-Metal Material. After this transfer, China Non-Metal Material would own 29.42% of Tianshan as its number one shareholder. This news was publicly released on June 29, 2004.\(^{133}\)

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As the Chinese stock market in 2007 was in its booming stage, any news of corporate structural change or acquisition would all be regarded as positive news for the stock and could lead the stock to rally significantly. As one of the top management of Tianshan or Vice President, CHEN Jian Liang, Chen bought 1,650,000 shares of Tianshan between June 21 and June 29, 2004. After end of June, Chen sold 200,000 shares and still owned around 1,450,000 shares. His cost was around RMB$7 per share and profit at around RMB$11 per share with a handsome profit of between 40 and 50%.\textsuperscript{134}

Part 1

As a regulator and monitor of abnormal activities in the stock market, China Securities Regulation Commission took note of Chen's trading activity. After years of investigation, CSRC announced to the public that it had completed the investigation on Tianshan. They had established Chen's behavior had already violated the Securities Law as top management cannot take advantage of private information unknown to the public and buy company shares prior to the information publicly released. This was established as insider trading behavior and Chen was punished for indemnification of 200,000 Yuan with no market participation for 5 years.\textsuperscript{135}

Part 2

The insider trading case of Tianshan has a second part that should be consider as the first civil lawsuit regarding insider trading. This case started when the insider trading case and penalty of Xianjian Tianshan Cement has been disclosed to the public by May 2007. An individual investor CHEN Lin had realized that as he traded Xianjian Tianshan Cement during the period of June 2004, he was a victim of the stock price volatility during that period. The news release and large volume of CHEN Jian Liang traded during June 2004 had made CHEN Lin incurred a trading loss of RMB$9,383 on the stock.\textsuperscript{136}

As a result, CHEN Lin located a lawyer SONG Yi Shin as his attorney to handle this case and demanded compensation from Xi-

\textsuperscript{134} Ibid.
\textsuperscript{135} Ibid.
\textsuperscript{136} Oh Bi Lan, “The First Serious Case of Insider Trading”, Legal Rules and Democ- ratic Times, October 13, 2008, p. 5.
anjian Tianshan Cement. By August 2010, Chen and Song had received a court hearing notice as their case against corporate insider trading was being established with the Nanking Court and their court hearing was being scheduled on September 4, 2010.137

By the time Song, the plaintiff lawyer got to the court on September 4, the court notified him that CHEN Lin had written a withdraw application that was handed to the court by the defendant's lawyer. This means the plaintiff had reached a settled agreement with the defendant and would like to withdraw the case. Even though Song questioned the validity of this application as it was being supplied by the defendant lawyer, this case was still withdrawn on September 25. By September 28, CHEN Lin had provided Song with an apology letter and legal fee of RMB$3,000.138

This second part of Tianshan case was dramatic and interesting. It was the first civil insider trading case initiated, but the settlement process was a surprise. The quick settlement between the investor and defendant indicated that financial compensation is the key for investors who suffer financial loss for insider trading case. Individual investors will not be concerned about their rights being abused under the existence of insider trading. Their only concern is on their financial loss. If the settlement amount is acceptable and agreeable, they would easily withdraw their case. As a result, in dealing with insider trading in China, civil action may not be useful. The regulator should resort to criminal penalties in order to reduce insider trading effectively. Currently, the only insider trading case has landed the player into criminal responsibility is the case of HUANG Guanyu as discussed previously. The Huang's case is still in the process of finalization. Another paper would be devoted into the detail discussion of that case. However, it is indeed important to note that the HUANG Guanyu case certainly would change the landscape of insider trading in China.

V. CONCLUSION

After closely examining the regulatory framework for insider trading in Hong Kong, Taiwan and China with Australia acting as benchmark for regulation, it is submitted that when insider trading occurred in the market, it is detrimental to the competitiveness of the market. The existence of insider trading will not only negatively

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137. Ibid.
impact the market confidence; it will also affect the social stability when serious.

From the above analysis, Australia serves to be a benchmark jurisdiction in terms of regulating and prohibiting insider trading actively. Accordingly, as a jurisdiction which considers insider trading to be a punishable offence, Australia will be seen to be proactive in eradicating insider trading and would be more likely to attract investor confidence than a jurisdiction which has no insider trading laws. Thus, insider trading should be prohibited. Australia serves to be an example that active prohibition on insider trading should be constructive for investor confidence and market competitiveness.

The author cannot agree with Professor Manne's opinion that insider trading might actually be good. This view seems to be too extreme. To promote insider trading will lead to the result that the rich may get richer and the poor get poorer. The big company will always have an advantage over small investors regarding access toward inside information. In this case, the investment of small investors may easily be damaged or wiped out by the big money of corporations. This is morally wrong and will lead to adverse social consequences.

On the other hand, the corruption of governmental officials should also be seen as a type of insider trading. These officials could gain access to some of the most sensitive information, which will have a material impact on the market.

In regarding to regulatory framework with Greater China area for insider trading, it is submitted that Hong Kong has a more comprehensive and specific law (The Securities (Insider Dealing) Ordinance) in prohibiting insider trading. On the other hand, Taiwan's insider trading activities is regulated under the Securities and Exchange Law. As for China, its insider trading activities is regulated under the Securities Law.

As a result, Hong Kong has a more effective insider trading rule compared with Taiwan and China. Although the whole prohibition of insider trading does not fall under the criminal jurisdiction, the Tribunal is very powerful and, thus the decision from the Tribunal for the offender would probably be more effective than criminal penalties. It is submitted this is highly desirable, and the successful Hong Kong's model will no doubt provide other jurisdictions with a direction for consideration.

As for the regulatory framework of Taiwan and China, there are several issues need to be addressed.
A. Issues for Taiwan

Based on the Taiwanese cases above, we can conclude that the factors for successful prosecution of insider trading should based on direct evidence being collected, timing issue being established, and the material impact on share prices. The successful prosecution on Inventec is due to the fact that the timing for profiting on private information was clear and the impact on share price was material (decline of 16% next few days). On the other hand, the case of BENQ lacked direct evidence as the trading and timing was unable to be established, along with immaterial impact on share price. As for the case of Hold Key and BAFO, insider trading was established due to direct evidence being collect and phone calls being monitored. From the perspective of market, the material impact on share price should be the most important aspect to affect market confidence. If there is a lack of significant changes in share price, the market usually will not pay much attention. On the other hand, from the perspective of legal investigators, these three determining factors should be regarded as equally important because they are all important components for insider trading to establish in a court of law.

Even though TF, Uni-President and BENQ were both unable to establish direct evidence for prosecution, the TF case should be regarded as having more of a negative impact on market confidence. This is because the impact on its share prices was material as its share prices had weakened for a period of time after TF was being investigated. Also, the liaison between interest groups and related parties for the TF case was obvious to the investment public; however the punishment for TF was the removal of the company chairman. It is a very light gesture in order to serve as a deterrent to this type of future insider trading. It is also not enough to help to rebuild the market confidence after the harm already done to the market, as the market viewed this case as an example of protection for politicians and their related parties. As for the BENQ case, there were no politicians involved and the related parties were confined within the company, so its impact on market confidence is less significant.

On the other hand, the comparison of these cases above indicates the importance of direct evidence. Without direct evidence, it will be very difficult for a successful prosecution of insider trading. The case of Inventec and Hold Key indicate that in this age of information technology, all communication and information sent through email and computer systems are traceable and detectable.
As a result, it is actually easier for the regulatory body to collect evidence as all information and communication can be collected and traced by the Internet and mainframe computer system. As the TF case occurred during the early 1990s, many direct evidences were hand written and in paper documents and thus easier to destroy. As a result, important improvements in modern technology has enabled the regulatory bodies to better detect insider trading and hence provide better protection for the investment public.

Also, as the common participant of Hold Key and BAFO cases the market maker/speculator Antique Chang plead guilty in both cases. After he finished his jail term, he wrote a memoir and releases the general model of cooperation between company management/major shareholders and market speculators like himself. He declared this is the common model of insider trading in recent years such as the Hold Key Electric and BAFO cases. The model consists of the following characteristics:

1. The market maker/speculator will first set the general term of co-operation with the company management/major shareholders such as the number of shares that can be traded, the base price, and the target price. For example, if the stock price is currently at NT$12 per share, then they could use NT$11.5 per share as base price. The target for the company is NT$13 per share and above, so if the stock price had raised above that price the company/major shareholders will sell around 5,000,000 shares for a period of 2 months. The part of share price of above NT$13 will belong to the market maker/speculator or share with major shareholders.

2. After these terms are set, the company management will start to disseminate positive company news in the press or on TV, such as new orders, possible mergers, acquisitions, or new improvements in production.

3. Since most of market maker/speculators have their own stock recommendation/analysis program on TV network, they will ask the host/analyst of their company to strongly recommend the stock on TV.

4. Their cooperation will help the company management/major shareholders to sell their stock at a high price and thus dump their shares onto the general investment public.

5. After they all sold their shares, the share price usually will return back to its original level or even lower, such as the case of BAFO.
6. If the parties need extra protection for their deal, they will usually let a legislator, politician, or even a gangster to involve in their share rally, such as the case of Hold Key Electric. They believe that when they involve such figures they will be immune from investigation and prosecution. However, as discussed above, recent cases suggest this may no longer be true, as a legislator was sentenced in the Hold Key Electric case.\textsuperscript{139}

After examining the above cases, we can see that Taiwan regulation is improving. Despite the involvement of politicians and legislators, the prosecutors are still able to find both the insider traders and the corrupt officials equally guilty. The age of Taiwan Fertilizer is over. The politicians being caught are being prosecuted and sentenced without any favourable treatment.

Even though it has improved, the Taiwanese regulatory framework can further improve by amended the Article 157 – 1 of the Securities and Exchange Law in the following aspects:\textsuperscript{140}

1. To expand the scope of what is considered an insider. As the company structure has become more and more complicated in recent years, so too should the definition of insider to include holding companies, subsidiary, and affiliate companies.

2. To expand the duration of being insider. This is because some major shareholders/company management can still sell their shares and take advantage of private information after they have resigned or retired from the company. As a result, the duration of control should be extended to avoid this aspect.

3. To more clearly define how a transfer of private information should be governed and regulated. If the news is already on the newspaper, then it is not to be considered as private information as the case of Uni-President. If the information is in the news, then it can not be considered as private information and can not prosecute successfully. On the other hand, the investor's rights are affected such as in Uni-President, so the issue maybe that future regulation should be

\textsuperscript{139} Ibid, p. 104.

\textsuperscript{140} Chen Chih Long, "Discussion on How to Prevent Insider Trading" Taiwan Stock Exchange Discussion Paper, 2004, December, p. 70–76.
regulated more clearly, then insider will not be able to take advantage of this loophole.

4. As the Taiwan market is becoming more and more internationalized, it is very common for Taiwanese companies to raise capital in international security markets by issuing ADR (American Depository Receipt), GDR (General Depository Receipt) and ECB (Euro Convertible Bond). As these financial instruments can be converted back to the company’s common share that is listed in Taiwan stock market, the Taiwan Stock Exchange should regulate them in the same way as Taiwan stocks. ADR and GDR are depository receipts that Taiwanese companies issue in America or Europe. They are usually traded like stock and often one unit of GDR can convert into 10 unites of common shares in the Taiwan stock market. As for ECB it is a corporate bond issued by the company that with an option to convert back to common shares. Unfortunately, these financial instruments are all traded as over the counter financial products with no common exchange, so it may be hard for the Taiwan Stock Exchange to regulate them in the same way as it does common stocks. The only way to remedy this issue is for the Taiwan Stock Exchange to audit the issuing companies regularly to avoid insider trading taking place.

If the regulatory framework can be improved in the above aspects, the Taiwan Stock Exchange, the Gre Tai Securities Market, and the Taiwan Financial Supervisory Commission can take a more active role in preventing insider trading and improve market confidence.

B. Issues for China

In general, the problem for China’s insider trading situation can be summarized in the following points:

1. There has been no strict regulation in the regulation and monitoring of the timely release of market impacting information to the public. In the Tianshan case, there was a time lag from June 24 to the public release of June 29. This time lag can be used as a loophole for insider trading to take place as in the case of CHEN Jian Liang. Chinese regulators should better regulate the process of market information release.
2. The second issue is that the penalties are too lenient. CHEN Jian Lian, for example, was only fined for RMB$200,000 and suspended for five years from market participation. The amount of penalty is too small of an amount compared with the volume of Tianshan stock he traded. Thus the financial penalty is not comparable with the financial profit he made. Secondly, even if he can not participate in the market for five years, he could still use his friends or family as dummy account to continue his trading. Thus the suspension also does not serve as an adequate deterrent to his type of behavior.

3. As the Chinese stock market is relatively immature compared with that of Hong Kong and Taiwan, it is very easily misled by rumors and fake news in the marketplace. For example, fake reorganization news can be used to channel such “news” to make stocks rally and mislead investors. Most of such fake information was initially using “small media” as a tool, such as QQ (A Chinese version of MSN), BBS forums, emails, and mobile phone short messages. This is problematic as it is very difficult for the relevant departments to monitor this evidence to prevent the dissemination of such false information.

4. As China is a Civil Law country, unlike Common Law countries, China does not need to have a chain of cases in able to determine the status of law. One MAJOR case will be enough, and usually one major landmark case will reveal the government’s intentions and policies concerning this area, and thus would be reflected in the decision of the Chinese courts.

C. Final words on regulatory framework of Taiwan and China

The Taiwanese law regarding insider trading does not seem to be sophisticated enough to handle the Taiwanese stock market as it becomes more internationalized and globalized. In order to continue to deter insider trading on the island, a review to develop a specific law regarding insider trading may be warranted in the future.

China’s capital market is an emerging market. To prevent price manipulation and insider trading, there is still a lot to be done in the legal and technical perspective in order to be perfected. However, enforcement departments for the securities market can focus on some typical cases such as HUANG Guangyu and intensify pun-
ishment to serve as a warning. Whenever price variation occurs or companies re-organize in an abnormal way, such departments should treat such situations as a warning bell and follow suit and investigate. By doing such, it would eventually make the security market more transparent and fairer.
GLOSSARY
Selected Chinese Names, Cases
I. Taiwan

Acer Computer
Antique Chang
AUO
BENQ
BOFA Technologies
CHANG Shih Jei
CHEN Hong Pi
FU Kuen Chi
Gre Tai Securities Market
Independent Evening News
Inventec Appliances Corporation
Inventec Co., Ltd
LEE Kuen Yau
Qisda
Shen-Ray-Do (SRD)
Taiwan High Prosecutor Office, Taichung Branch
Taiwan Power Company
The case of Hold Key Electric
The case of Taiwan Fertilizer (TF)
The Inventec Appliances Corporation Case
The case of Uni-President
   Uni-President Enterprise
   President Securities Corp
   President Chain Store Corp
TU Zong Hui
United Evening News
YU Zong Bei

宏碁電腦
古董張
友達
明碁
聯豪科技
張世傑
陳弘丕
傅崑萁
證券櫃檯買賣中心
自立晚報
英華達
英業達
李焜耀
佳世達
新瑞都
台中高檢署
台灣電力公司
合機案
合肥案
英華達案
統一案
統一企業
統一證券
統一超商
杜緯輝
聯合晚報
俞宗碧
II. China

Beijing Centergate Technologies Co Ltd
CHEN Jian Liang
CHEN Lin
China Non-Metal Material Corp
Dazhong Electronics
Du Juan
Gome Electrical Appliances Holdings Ltd
HUANG Guangyu
HUANG Junqin
Pengtai Investment Co Ltd
Sanlian Commercial Co Ltd
SONG Yi Shin
Tieh Long Holding Company
Xinjian Tianshan Cement (Tianshan)
Xianjian Tunghei Investment Company
Yongle

中關村科技
陳建良
陳林
中國非金屬材料總公司
大中電器
杜鵬
國美電氣
黃光裕
黃俊欽
鵬泰投資
三聯商社
宋一欣
德隆
新疆天山水泥股份有限公司
新疆屯河投資股份有限公司
中國永樂