

Using Short-Swing Trading Regulation as an Alternative Insider Trading Regulation: Focus on Taiwan's Experience

*Andrew Jen-Guang Lin**

- I . Introduction
 - II . Prohibition of Illegal Insider Trading
 - A. Brief Introduction of U.S. Insider Trading Law
 - B. Taiwan's Insider Trading Law and the Recent Development
 - III . Theoretical Basis for Disgorgement of Short-Swing Trading Profits
 - A. The Invention of Short-Swing Trading Law
 - B. Definition of Short-Swing Trading
 - C. Liability for Short-Swing Trading
 - IV . Distinctions between Short-Swing Trading and Insider Trading Laws
 - A. Different Scopes of Persons Subject to Short-Swing Trading and Insider Trading Laws
 - B. Different Elements for Constituting Short-Swing Trading and Insider Trading
 - C. Different Liabilities
 - V . Issues Arising from Short-Swing Trading Law and Challenges on the Appropriateness of Short-Swing Trading Law
 - A. Statutory Short-Swing Transactions Subject to Disgorgement— What Constitutes “Acquire” or “Obtain” of Securities under the Short-Swing Trading Law
 - B. Calculation of Short-Swing Profits
 - C. Exemptions
 - VI . Conclusion: Recommendation on Taiwan's Short-Swing Trading Law
 - A. Long-Term Goal: Repeal of the Short-Swing Trading Law
 - B. Modification of the Current Short-Swing Trading Law
- Appendix I Short-Swing Cases Handled by the SFIPC
Appendix II Taiwan's Short-Swing Trading and Insider Trading Provisions under the TWSEA

* Professor of Law at National Taiwan University College of Law, Email: andrewlin@ntu.edu.tw

Abstract

Although there have been literatures discussing whether insider trading should be regulated, insider trading regulations exist in most developed and developing securities markets. For example, insider trading law has been a focus of the U.S. federal securities regulation since the passage of Securities and Exchange Act of 1934. However, some jurisdictions enact insider trading law much later than the U.S. Taiwan's Securities and Exchange Act (TWSEA) was patterned after the U.S. federal securities regulations. With regard to the insider trading law, the relevant provisions of the TWSEA are also closely corresponding to the evolution of the U.S. legislation. Currently, both Taiwan and the U.S. prohibit insider trading and authorize the issuer to sue corporate insiders to disgorge the short-swing trading profits if they buy and sell corporate equity securities within six months.

Both short-swing trading regulation and insider trading law are enacted to prevent insider trading. However, the former one is applied without proving that insiders obtain nonpublic material information though there is no criminal sanction on short-swing trading. Historically, short-swing trading regulation existed much earlier than the insider trading law in both Taiwan and the U.S. The reason is that short-swing trading regulation is easy to apply as long as the fact that corporate insider buy and sell corporate securities within six months. However, short-swing trading regulation also raises many regulatory issues and possibly touches the issues of legitimacy and justice. Many countries do not have short-swing trading regulation. This article intends to address the issues arising from the application of short-swing trading regulation. It will discuss the short-swing trading cases and comparing the regulation in selected foreign jurisdictions. The author recognizes the function of such regulation. However, if this regulation remains in force, it is necessary to amend the TWSEA and the regulation promulgated by the competent authority.

Keywords: Insider Trading, Short-swing Trading, Securities Regulation, Securities Fraud

I . Introduction

Securities fraud has been regulated by most jurisdictions aiming to ensure the fair playing ground at the securities market. Among various types of securities fraudulent activities, insider trading is a major type of trading behaviors that have gained attentions to the legislative department and securities regulators of both developed and emerging securities markets. Although there have been vigorous arguments on whether insider-trading activities should be prohibited or punished,¹ the trend is that the securities regulators of different jurisdictions have continuously devoted efforts to develop more effective insider trading law to regulate insider-trading activities.² Moreover, it is also perceived from the regulatory evolution that classical theory³ of insider trading regulates traditional insiders and temporary insiders, such as lawyers, accountants and consultants, and supplemented by the misappropriation theory⁴ regulating outsiders owing a fiduciary duty to the source of information.⁵ All of these efforts are to ensure that no one, including insiders and quasi-insiders, is unfairly benefited from his or her position being able to access nonpublic material corporate information and to rebuild investors' confidence in the securities markets.⁶

1. For discussion of the debate on whether insider trading should be regulated, *see generally*, Stephen Clark, *Insider Trading and Financial Economics: Where Do We Go from Here?*, 16 STAN. J.L. BUS. & FIN. 43, 57-65 (2010).

2. *See* THE EMERGING MARKET COMMITTEE OF THE INTERNATIONAL ORGANIZATION OF SECURITIES COMMISSIONS, INSIDER TRADING—HOW JURISDICTIONS REGULATE IT (March 2003).

3. For discussion of classical theory, *see*, Griffin Finnan, *Securities Fraud*, 48 AM. CRIM. L. REV. 1129, 1161-63 (2011).

4. For discussion of misappropriation theory, *see generally* Randall W. Quinn, *The Misappropriation Theory of Insider Trading in the Supreme Court: A (Brief) Response to the (Many) Critics of United States v. O'hagan*, 8 FORDHAM J. CORP. & FIN. L. 865 (2003); David Cowan Bayne, S.J., *Insider Trading: The Misappropriation Theory Ignored: Ginsburg's O'hagan*, 53 MIAMI U. L. REV. 1 (Oct. 1998); David M. Brodsky & Daniel J. Kramer, *A Critique of the Misappropriation Theory of Insider Trading*, 20 CARDOZO L. REV. 41 (Sept. 1998).

5. *See e.g.*, Securities and Exchange Commission v. Matthew H. Kluger and Garrett D. Bauer, Case No. 11-cv-1936 (D. N.J. April 6, 2011)(Corporate attorneys and Wall Street traders were charged for insider trading activities in advance of the announcement of at least 11 mergers and acquisitions of the law firm's clients.)

6. For discussion of the development of legal theories how outsiders became subject to the insider trading, *see generally*, Matthew T.M. Feeks, *Turned Inside-Out: The Development of "Outsider Trading" and How Dorozhko May Expand the Scope of Insider Trading Liability*, 7

Different countries have adopted different regulatory philosophies and approaches to regulate insider trading. Most countries have imposed criminal liabilities on insider trading. Some has imposed administrative civil penalties, such as the United States.⁷ Some jurisdictions grant investors private rights of action to recover damages.⁸ Some jurisdictions, including the U.S. prior to the enactment of Insider Trading and Securities Fraud Enforcement Act of 1988, do not grant private right of action. One major reason is because there is no causation between the loss of private investors and the insider trading, and the lack of privity in the open-market trading.⁹ Because to prove an insider trading case needs sufficient evidence showing the traders have obtained nonpublic material corporate information, have the actual knowledge of the existence of the material information, and actually trade on the basis of the information, the successful conviction ratio remains very low. The U.S. invented the short-swing trading regulation, requiring corporate insiders to disgorge trading profits if they buy and sell corporate securities within six months, when the Securities and Exchange Act of 1934 was enacted.¹⁰ Some jurisdictions, such as Taiwan¹¹ and Korea¹², have adopted the same regime to require corporate insiders to disgorge short-swing profit.

In contrast, literatures discussing short-swing trading regulatory mechanism are significantly fewer than those of insider trading laws.¹³ Moreover, not

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7. The Insider Trading Sanction Act of 1984 amended Section 21(d) of the Securities and Exchange Act of 1934 authorizing the SEC to seek civil penalties for up to three times of the profits realized or losses avoided from insider trading, and such penalties are determined by the court. 15 U.S.C. §78u(d)(3)(A) (July 22, 2010).

8. See generally, Alexander Loke, *The Protected Interests in the Private Right of Action for Insider Trading: A Comparative Perspective*, 7 J.C.L.S. 307 (2007).

9. See e.g., *Fridrich v. Bradford*, 542 F.2d 307, 318 (6th Cir. 1976); See also, Veronica M. Dougherty, *A [Dis]Semblance of Privity: Criticizing the Contemporaneous Trader Requirement in Insider Trading*, 24 DEL. J. CORP. L. 83, 131-36 (1999).

10. 15 U.S.C. §78p (b).

11. TWSEA §157.

12. Financial Investment Services and Capital Markets Act §172 (2010) (Korea).

13. In fact, both short-swing trading law and insider trading law were designed to regulate corporate insiders' trading activities to avoid the existence of information asymmetry. However, the regulatory approaches, the regulated persons, the elements, and liabilities of both regulatory mechanisms are significantly different. For the convenience of discussion, in this article, short-swing trading law focuses on the short-term buy and sell activities of corporate insiders and principal shareholders, e.g., §16(b) of the 1934 Act in the US, and Article 157 of the TWSEA.

many countries have enacted law to regulate short-swing trading. However, short-swing trading law, aiming to deter insider trading, has a longer history than the insider trading law. When enacting the 1934 Act, disclosure requirements and short-swing trading provision under Section 16 of the 1934 were the major mechanisms to deter insider trading. This provision has existed since it was enacted and coexisted with the insider trading law. Taiwan's Securities and Exchange Act (TWSEA) was modeled after the US Securities Act of 1933 (1933 Act) and the 1934 Act. With regard to the short-swing trading law and the insider trading law, the TWSEA was following the tempo of the 1934 Act. When Taiwan enacted the TWSEA in 1968, short-swing trading law was codified into Article 157 of the TWSEA. At that time, similar to the status of the 1934 Act, there was no provision regulate insider trading. Immediately after the passage of the Insider Trading and Securities Fraud Enforcement Act of 1988 by the US Congress, the TWSEA was amended in the same year to add Article 157-1 to regulate insider trading. Both the 1934 Act and the TWSEA keep the short-swing law even after the insider trading law was enacted.

The technical application of short-swing trading regulation has been welcome by the securities regulators whose jurisdiction has adopted this regime. Because it requires no proof of insider's intent and existence of material nonpublic information, once the insider has consummated a buy transaction and a sale transaction of the corporate securities within six months, the short-swing profits will be required to disgorge to the company. However, there has been different voice challenging the appropriateness of the short-swing trading regulation for various reasons.¹⁴

This article will examine the insider trading law and the short-swing trading law, particularly using latter as alternative mechanism to prevent insider trading. Particular focus will discuss issues surround the theoretical basis and the appropriateness of the short-swing trading law. Whether short-swing

In contrast, insider trading law in this article indicates corporate insiders, significant shareholders, those who obtain nonpublic corporation information because of contractual or other relationship with the issuer or the corporate insiders, and tippees who obtain material nonpublic corporation information and trade on the equity securities of the issuer, *e.g.*, §10(b) and Rule 10b-5 of the 1934 Act, §§20A, 21A, and Article 157-1 of the TWSEA.

14. *See generally*, Michael H. Dessent, *Weapons to Fight Insider Trading in the 21st Century: A Call for the Repeal of Section 16(B)*, 33 AKRON L. REV. 481 (2000); Marleen A. O'connor, *Toward a More Efficient Deterrence of Insider Trading: The Repeal of Section 16(B)*, 58 FORDHAM L. REV. 309 (Dec. 1989).

trading should be prohibited? If so, what should be the legal liabilities for engaging in short-swing trading? What are the distinctions between the short-swing trading and the insider trading laws? Whether it is appropriate to have short-swing trading law and insider trading law to exist contemporaneously? Whether the constructive formula for calculation of short-swing trading profits, subject to disgorgement, is a sound formula, or should the disgorgement be based on the actual profits realized by the short-swing traders? All of these issues are worth discussing and will be discussed in this article.

In this article, Part II introduces the theory and basic concept of insider trading law in the U.S. and Taiwan. Part III discusses the theoretical basis of the short-swing trading regime. Part IV compares the fundamentals of the two regulatory mechanisms—short-swing trading law v. insider trading law. It explores why the securities laws of the U.S. and Taiwan adopted short-swing trading law much earlier than the insider trading law. What are the different regulatory approaches between these two mechanisms? In Part V, it will identify the issues arising from the short-swing trading law and challenges on the appropriateness of the short-swing trading law. After the discussion of the issues, Part VI is conclusion. In this part it provides recommendations for reforming Taiwan's short-swing trading law.

II. Prohibition of Illegal Insider Trading

A. Brief Introduction of U.S. Insider Trading Law

The United States can be awarded as the pioneer and the most hard-working country in developing the insider trading law. This is evidenced with the enactment of Section 10b of the Securities and Exchange Act of 1934 (1934 Act)¹⁵ and promulgation of Rule 10b-5 by the Federal Securities and Exchange Commission (SEC), plenty of judicial decisions, and literatures relating to insider trading. Section 10b of the 1934 Act and Rule 10b-5 have been recognized as one of the most powerful tools for the SEC to strike fraudulent

15. Section 10b of the 1934 Act is a general anti-fraud provision to prohibit any type of securities fraud. However, it was not specially designed to regulate insider trading. Therefore, after the passage of the 1934 Act, the number of insider trading scandals did not decrease. JAMES D. COX ET AL., *SECURITIES REGULATION—CASES AND MATERIALS* 775 (2nd ed., 1997).

activities in connection with securities trading, and are used as the legal the foundation for prosecuting illegal insider trading. In the 1980s, the U.S. Congress passed two major pieces of insider trading legislation. The first piece of legislation named after insider trading is the Insider Trading Sanctions Act of 1984, which increases the criminal fine from US\$10,000 to US\$100,000.¹⁶ However, this legislation was criticized for not being able to effectively deter the insider trading because the number of insider trading cases increases dramatically after the passage of the 1984 Insider Trading Sanctions Act.¹⁷ The U.S. Congress took a further step to enact the Insider Trading and Securities Fraud Enforcement Act of 1988¹⁸. The sanctions and enforcement of insider trading were enhanced by the 1988 Act in at least three aspects:¹⁹

1. It extended the sanctions of insider trading by broadening the scope of statutory insiders to include the controlling persons of the insider traders by adding Sections 21A(a)(3) and (b)(1) to the 1934 Act.²⁰

16. Insider Trading Sanctions Act of 1984, Pub. L. No. 98-376, 98 Stat. 1264 (codified as amended at 15 U.S.C. § 78u); Insider Trading Sanctions and SEC Enforcement Legislation: Hearing on H.R. 559 Before the Subcomm. on Telecomms., Consumer Protection, and Finance of the H. Comm. on Energy and Commerce, 98th Cong. 29-30 (1983) [hereinafter H.R. Ser. No. 98-33] (statement of Hon. John S.R. Shad, Chairman, Securities and Exchange Commission).

17. Thomas W. Joo, *Legislation and Legitimation: Congress and Insider Trading in the 1980s*, 82 IND. L. J. 575, 578-579 (Summer 2007).

18. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, 102 Stat. 4677 (amending Securities and Exchange Act of 1934 in scattered sections).

19. For general discussion of the Insider Trading and Securities Fraud Enforcement Act of 1988, see generally, Randy N. Chism, Note: *Private Rights of Action under the Misappropriation Theory: Insider Trading and Securities Fraud Enforcement Act of 1988*, 21 MEM. ST. U. L. REV. 333 (Winter, 1991); Bruce A. Teeters, Comment: *Insider Trading and Securities Fraud Enforcement Act of 1988: Just How Much Are Employers Going to Pay?*, 59 U. CIN. L. REV. 587 (Fall, 1990); Howard M. Friedman, *The Insider Trading and Securities Fraud Enforcement Act of 1988*, 68 N.C. L. REV. 465 (March, 1990).

20. Insider Trading and Securities Fraud Enforcement Act of 1988, Pub. L. No. 100-704, § 3(a), 102 Stat. 4677, 4678. Section 21A(a)(1) authorizes the SEC to bring judicial actions against insider traders for civil penalties. 15 U.S.C.A. § 78u-1(a)(1) (July 30, 2002) The Insider Trading and Securities Fraud Enforcement Act of 1988 created the “controlling person liability” by imposing civil penalties on the controlling persons for the maximum of “\$1,000,000, or three times the amount of the profit gained or loss avoided as a result of such controlled person’s violation.” (Added in Section 21A(a)(3), 15 U.S.C.A. § 78u-1(a)(3) (July 30, 2002). The controlling person shall be held liable for the controlled person’s insider trading activities if:

(A) such controlling person knew or recklessly disregarded the fact that such controlled person was likely to engage in the act or acts constituting the violation and

2. It raised the ceiling of the criminal fine on the illegal trader from US\$100,000 to US\$1,000,000 (if the illegal trader is a legal person, the maximum criminal fine is US\$2.5 million) and if found guilty can be sentenced to jail for the maximum term of 10 years.²¹
3. It imposed civil liabilities on insider traders to contemporaneous traders for insider trading, i.e., to grant contemporaneous traders a private right of action against the insider traders for civil remedies.²²

Because persons engaging in insider trading could be convicted for violation of Section 10b, Rule 10b-5, Sections 20A (Liability to Contemporaneous Traders for Insider Trading) and 21A (Civil Penalties for Insider Trading), the Congress, the SEC, academia, and the courts all have paid attention to what constitutes illegal insider trading and what elements must be satisfied in order to convict the insider traders. From the historical evolution of the insider trading regime, at the initial stage, the SEC has actively taken the role to enforce the securities law aiming to foster fair play in the securities market. After the 1934 Act was enacted, the SEC promulgated Rule 10b-5 in 1942 to impose administrative sanctions. The SEC also brought judicial actions against insider trading. *In re Cady, Roberts & Co.* was one of the most famous early actions initiated by the SEC, in which the theory of equal access to information was strongly emphasized.²³ The enforcement of illegal insider trading was the ongoing task of the SEC. Although the SEC has a dominant role, the Federal courts have decided many insider trading cases

failed to take appropriate steps to prevent such act or acts before they occurred; or (B) such controlling person knowingly or recklessly failed to establish, maintain, or enforce any policy or procedure required under section 78o(f) of this title or section 80b-4a of this title and such failure substantially contributed to or permitted the occurrence of the act or acts constituting the violation.

(Added in Section 21A(b)(1), 15 U.S.C.A. § 78u-1(b)(1) (July 30, 2002).)

21. Insider Trading and Securities Fraud Enforcement Act of 1988, § 4 (amending 1934 Act, §32(a), 15 U.S.C.A. § 78ff (July 30, 2002).) The criminal sanctions for insider trading were further increased by the Sarbanes-Oxley Act of 2002, by increasing the individual's criminal liability to the maximum of US\$5 million and jail term of 20 years, and increasing legal person's liability to US\$25 million. Pub. L. No. 107-204, 116 Stat. 745.

22. Insider Trading and Securities Fraud Enforcement Act of 1988, § 5 (amending 1934 Act by adding §20A, 15 U.S.C. §78t-1 (2000).) See generally, Michael J. Chmiel, Note: *The Insider Trading and Securities Fraud Enforcement Act of 1988: Codifying a Private Right of Action*, 1990 U. ILL. L. REV. 645 (1990).

23. 40 S.E.C. 907 (1961).

and have established many precedents to prohibit insider trading. In the second stage mainly in the 1980s, we found that Supreme Court has modified the equal access theory by requiring a “fiduciary relationship” to establish the insider trading liability.²⁴ Although different Circuit Courts of Appeals have held different views as to what constitutes insider trading that violates securities laws, particularly on whether to apply the misappropriation theory to reprimand securities traders who obtained material nonpublic information and traded securities based on that confidential information, the Federal Supreme Court finally upheld the misappropriation theory to convict a lawyer for insider trading in *United States v. O’Hagan* in 1997.²⁵ It is also observed that under the classical theory, the securities traders, such as corporate insiders, are subject to insider trading laws. The classical theory also applies on lawyers, accountants and consultants, who are considered as “temporary fiduciary” of the corporation.²⁶ The insider trading law further expands its application to outsiders who misappropriate material nonpublic information and breach their fiduciary duties to the source of information.²⁷ Another aspect is that the insider trading activities subject to securities laws were expanded from the face-to-face transactions to the open securities market.

Notwithstanding the high usage ratio of insider trading law for both civil remedies and criminal sanctions, an abundance of literatures have raised critiques on the lack of certainty for not providing clear and unambiguous guidance for what kind of trading behaviors constitute violation of insider trading law, particularly the application of the misappropriation theory in convicting securities traders for violation of Section 10b and Rule 10b-5 and the insider trading law. Even a decade after the U.S. Federal Supreme Court has expressly upheld the misappropriation theory in the *United States v. O’Hagan* in 1997, the critiques still exist.²⁸

24. See e.g., *Chiarella v. United States*, 445 U.S. 222, 228, 100 S.Ct. 1108, 1114, 63 L.Ed.2d 348 (1980).

25. *United States v. O’Hagan*, 521 U.S. 642 (1997).

26. *Dirks v. SEC*, 463 U.S. 646, 655, n. 14, 103 S.Ct. 3255, 3262 (1983).

27. See Elizabeth A. Ordian, Note: *SEC V. Dorozhko’s Affirmative Misrepresentation Theory of Insider Trading: An Improper Means to a Proper End*, 94 MARQ. L. REV. 1313, 1318-24 (Summer 2011).

28. See Matthew R. Manning, Case Comment: *Securities Law--First Circuit Limits Scope of “Safe Harbor” Disclosure Loophole under Misappropriation Theory Of Insider Trading—SEC V. Rocklage*, 470 F.3D 1 (1ST CIR. 2006), 41 SUFFOLK U. L. REV. 435 (First Circuit Re-

B. Taiwan's Insider Trading Law and the Recent Development

The provision that regulates insider trading was added to the TWSEA in 1988. Article 157-1 of the TWSEA prohibits those who hold undisclosed inside information from trading the company's securities. Who is subject to the insider trading provision? Obviously, the law prohibits those who obtain non-public inside information from taking advantage of this unfair position to trade the company's securities. The following types of persons are prohibited from trading the company's securities if they learn any undisclosed material price-sensitive information:

- (1) Directors, supervisors, and managers;
- (2) Shareholders who own more than 10 percent of outstanding shares;
- (3) Those who obtain the information because of their occupation or controlling relationship;
- (4) Those who obtain the information from the previous three types of persons.

The inside information obtained by these persons must have three elements. First, it must be material information. Second, it must be price-sensitive. Third, it must not yet be disclosed. All of the three elements must exist. Article 157-1 defines "material and price-sensitive" information to include corporate financial numbers, business plans, and the supply and demand of the issuer's securities in the market that would materially affect the prices of the securities or the investment decision of investors. The competent authority promulgated "Regulations Governing the Scope of Material Information and the Means of its Public Disclosure under Article 157-1, Paragraphs 5 and 6 of the Securities and Exchange Act" to further interpret the scope of material price-sensitive information and how to publicly disclose such information.²⁹ The reason for promulgating this regulation is to provide guidance for the courts to determine the insider trading cases.

view, 2008).

29. This Regulation was promulgated by the Financial Supervisory Commission on May 30, 2006 (last amended on Dec. 22, 2010).

On June 2, 2010, Article 157-1 of the TWSEA was amended. The major amendments including the following:

1. Waiting period is changed from twelve hours to eighteen hours.³⁰ After the material information has been announced, there is a waiting period designed for the public to evaluate the information and corporate insiders are prohibited from trading during this waiting period. The trading hours of Taiwan's stock market are from 9:00 to 13:30. To prevent corporation from disclosing material information in the late night and allow investors more time to absorb the information, the waiting period is lengthened from twelve hours to eighteen hours.
2. Change the wording from "upon learning" of material information to "upon actually knowing" of material information.³¹ The change of the wording was by the request of the Legislative Yuan requiring the prosecutors to prove that defendants have actual knowledge of the material nonpublic information when they trade the corporate securities. From past practice and from competent authority's point of view, this change shall not have material impact on the prosecuting and judicial decisions on insider trading cases because the perception is that disregarding the wording, prosecutors, in the past, has to prove that defendants have actual knowledge.
3. Adding new elements requiring information is "precise" and its "specific content" is price-sensitive.³² The new elements are added to clarify that the insider trading becomes illegal after the material nonpublic information becomes precise and the specific content of the information has material impact on the price of the corporate securities.
4. Non-equity debt securities are covered by the insider trading law.³³ Previously, only trading of equity securities is prohibited under Article 157-1. The amendment of the TWSEA expands the application to the trading of non-equity debt securities if corporate insiders actually know the material nonpublic information relating to the ability of the company paying back its debt.

30. TWSEA §157-1, paras. 1 & 2.

31. TWSEA §157-1, paras. 1 & 2.

32. TWSEA §157-1, paras. 1, 2 & 5.

33. TWSEA §157-1, paras. 2.

In the 2010 TWSEA amendment, an issue remain unsolved is whether the TWSEA should introduce the affirmative defense for insider trading. Corporate insiders frequently expose themselves in the environment filled with material nonpublic information. Therefore, it is easily for their trading to be considered illegal insider trading. Some countries have developed affirmative defenses for corporate insiders to escape from prosecution because their trading activities, if comply with the specific affirmative defense provided by law or regulation, will be considered not on the basis of material nonpublic information. For example, in 2000, the U.S. SEC promulgated Rule 10b5-1 under the 1934 Act interprets that trading while in possession of material nonpublic information is considered trading on the basis of material nonpublic information and constitutes illegal insider trading.³⁴ However, Rule 10b5-1 also provides affirmative defenses, such as trading according to a previously engaged contract or trading plan, which allow corporate insiders' trading not violating insider trading law.³⁵ There is a strong request from the industry and the Legislative Yuan on the introduction of the affirmative defense into the TWSEA. However, there has not yet been a satisfactory proposal to meet the need of the industry leaders and legislators and contemporaneously to exclude the doubts of the competent authority and the academia that the application of the affirmative defense would not defeat the function of the insider trading law. The proposed amendment to add an affirmative defense of insider trading is currently pending.

III. Theoretical Basis for Disgorgement of Short-Swing Trading Profits

A. The Invention of Short-Swing Trading Law

The short-swing trading law was adopted by the US Congress and codified into Section 16(b) of the 1934 Act.³⁶ The legislative philosophy for invent-

34. See Stanley Veliotis, *Rule 10b5-1 Trading Plans and Insiders' Incentive to Misrepresent*, 47 AM. BUS. L.J. 313 (Summer 2010).

35. Rule 10b5-1(c) provides the affirmative defense. 17 C.F.R. §240.10b5-1(c) (2009).

36. Section 16(b) sets forth: "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and

ing the short-swing trading law is to prevent corporate insiders and principal shareholders to unfairly use corporate information to trade corporate equity securities for personal profits.³⁷ Prior to the enactment of the 1933 and 1934 Acts, the securities market was not effectively regulated.³⁸ In order to rebuild investors' confidence on the securities market, the 1933 and 1934 Acts were enacted to regulate both primary and secondary markets.³⁹ Although 1934 Act was enacted, there were no precise and special provisions to regulate insider trading. Instead, the initial strategy was to create Section 16 of the 1934 Act, focusing on the disclosure of corporate insiders' shareholding and a preventive mechanism on short-swing trading.

Section 16(a)(1) imposes disclosure obligations on directors, officers and principal shareholders (i.e., 10% shareholders) to register with the SEC the ownership of the equity securities of the issuer or file a statement with the SEC within 10 days after they become a director, officer or principal shareholder.⁴⁰ Moreover, if there is a change in his ownership, he shall file a statement with the SEC indicating the change within 10 days after the close of

purchase, of any equity security of such issuer (other than an exempted security) or a security-based swap agreement (as defined in section 206B of the Gramm-Leach-Bliley Act) involving any such equity security within any period of less than six months, unless such security or security-based swap agreement was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security or security-based swap agreement purchased or of not repurchasing the security or security-based swap agreement sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security or security based swap agreement (as defined in section 206B of the Gramm-Leach Bliley Act) involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection." 15 U.S.C. §78p (b).

37. See JAMES D. COX ET AL., *supra* note 11, at 813.

38. Although there was no effective federal law to regulate the securities market prior to 1933, the federal courts in several judicial decisions have declared illegal if the purchaser of stock concealed the facts that affect its value. *Eleanor Erica Strong, v. Francisco Gutierrez Repide*, 213 U.S. 419, 29 S.Ct. 521 (May 3, 1909).

39. See Senate Report No. 1455, 73rd Congress, 2d Session 55 (1934).

40. 15 U.S.C. §78p (a).

the calendar month.⁴¹ Section 16(b) imposes a disgorgement liability on the aforesaid persons, as indicated in Section 16(a), if they buy and sell or sell and buy the equity securities of the issuer within six months. The purpose is to prevent those persons from using their position and to take the advantage of possessing material non-public information regarding the business and financial affairs of the issuer and trade the equity securities of the issuer for personal profits.⁴² To avoid heavy burden of proof, Section 16(b) does not require the issuer or shareholders who sue on behalf of the issuer to prove the existence and use of material nonpublic information by the short-swing traders. The reason why Congress did not use insider trading law to prevent and regulate insider trading when the 1934 Act was enacted is that it think direct regulation was not practicable.⁴³ It is important to note that insider trading is considered in violation of Section 10(b) of the 1934 Act and Rule 10b-5 promulgated later in 1942. Although Section 10(b) was already there in 1934, it takes time for the SEC to implement. Therefore, the short-swing trading was considered at that time one of the most effective and practicable mechanism to reduce the occurrence of insider trading.

In Taiwan, when TWSEA was enacted in 1968, it patterned after the U.S. 1933 and 1934 Acts. The draft of the TWSEA borrowed the then available provisions contained in the 1933 and 1934 Acts and integrated them into a single TWSEA with certain modifications that are necessary for Taiwan's legal system and securities market. The TWSEA has an anti-fraud provision, Article 20, which is similar to Section 10(b) of the 1934 Act. However, because it was just the beginning and there were not many insider trading cases in the 1960s, the TWSEA did not have specific provision to regulate insider trading until later 1980s. After accumulated insider trading cases from 1960s to 1980s and the enacting of the 1984 and 1988 two pieces of insider trading legislation in the U.S., the TWSEA was amended in 1988 to add Article 157-1 to regulate insider trading, under which violators will incur criminal and civil liabilities. However, prior to the enacting of Article 157-1, the TWSEA borrowed the then available Section 16 of the 1934 Act and imposed

41. *Id.*

42. 15 U.S.C. §78p (b).

43. JAMES D. COX ET AL., *supra* note 11, at 813. For reference to other explanations why not direct insider trading law but short-swing trading law, see Karl Shumpei Okamoto, *Rereading Section 16(b) of the Securities Exchange Act*, 27 GA L. REV. 183 (Fall, 1992).

disgorgement liability on short-swing transactions in Article 157.

B. Definition of Short-Swing Trading

The Short-swing law does not prohibit the statutory insiders (i.e. directors, officers, and 10% shareholders under Section 16 of the 1934 Act; directors, supervisors, managers, and 10% shareholders under Article 157 of the TWSEA) from buying and selling the equity securities of the issuer, nor did it make the transactions illegal or invalid. Instead, it imposes a disgorgement liability on the statutory insiders if they purchase and sell or sell and purchase the equity securities of the issuer within the period of six months. Under the TWSEA, the definition is similar but with slight variation. Article 157 of the TWSEA considers that “obtain (or acquire) and sell” or “sell and purchase” of the issuer’s equity securities by statutory insiders falls within the definition of the short-swing trading and the profit from such transactions are subject to disgorgement. Because of the wording under the TWSEA uses “obtain or acquire” instead of “purchase or buy,” it raises an issue on whether there are any exempted transactions when interpreting “obtain or acquire.” For example, whether to acquire the securities by succession, as a gift or as a consequence of merger are subject to disgorgement? We will discuss this issue in Part V of this article.

When short-swing trading occurs, the issuer has a right to recapture the short-term trading profits from those statutory insiders who engage in such transactions. Because of the high possibility that no directors will ask the short-swing traders to disgorge the profit or bring litigation, the short-swing trading law gives shareholders a standing to sue on behalf of the issuer against the short-swing traders. Under the short-swing trading law, there is no need to prove the existence of material non-public information and that statutory insiders obtain such information and engage in securities transactions for personal profit.⁴⁴ In other words, whether there is any material non-public information and whether the statutory insiders make their trading on the basis of that information is irrelevant to the disgorgement liability.

44. According to a judgment of Taiwanese court, it confirms that the purpose of short-swing trading law is “to strengthen investors’ confidence by depriving the short-swing trading profit of corporate insiders to deter short-swing trading, and by way of mechanical application to solve the difficulty of burden of proof and to have the effect of deterring insider trading.” Taiwan Chang Hwa District Court, 90 Litigation No. 674 (Sept. 25, 2001).

C. Liability for Short-Swing Trading

When the transactions engaged by statutory insiders fall with the definition of the short-swing trading, short-swing traders are required to surrender the trading profits to the issuer. The liability is said to be an “absolute liability.”⁴⁵ In other words, once the transactions are identified to fall within the scope of short-swing trading, the statutory insiders will incur such liability unless such transactions are exempted transactions as interpreted by the competent authority. It then comes to the mathematic issue, i.e., how to calculate the amount of short-swing profits subject to disgorgement?

The purpose of short-swing trading law is to prevent the unfair use of corporate information and deter the occurrence of short-swing trading. To reach this purpose, the liability for engaging in short-swing trading is to grant the issuer a right to request the traders to disgorge the short-swing trading profits. In 1951, a judicial decision decided by the Tax Court of the United States stated that if a person who paid to the issuer according to Section 16(b) of the 1934 Act, such amount of payment is not allowed as a deduction for Federal income tax purpose.⁴⁶ The Tax Court, for the purpose of determining whether the money paid by the corporate insider to the corporation according to Section 16(b) of the 1934 Act is tax deductible, interpreted the short-swing trading law as a “prophylactic measure absolute liability.”⁴⁷ The purpose of this decision is to ensure the “deterrent effect” of the short-swing trading law.⁴⁸

45. Lawrence A. Steckman, Note: *Risk Arbitrage and Insider Trading: A Functional Analysis of the Fiduciary Concept under Rule 10B-5*, 5 *Touro L. Rev.* 121, 174 n.256 (October, 1988); *Stock Exchange Practices, Report of the Committee on Banking and Currency*, S. Rep. No. 1455, 73rd Cong., 2d Sess., 55 (1934).

46. “Allowance of the deduction in question would weaken an effective method of enforcing the sharply defined policy expressed in section 16(b) by mitigating the deterrent effect of the sanction imposed and making the net effect of the transactions profitable through the gaining of a tax advantage.” *William F. Davis, Jr. v. Commissioner of Internal Revenue*, 17 T.C. 549 (September 28, 1951).

47. *Id.*

48. In *Commissioner of Internal Revenue v. Heininger*, the Supreme Court stated that the consequence for allowing tax deduction should not “frustrate sharply defined national or state policies proscribing particular types of conduct.” *Commissioner of Internal Revenue v. Heininger*, 320 U.S. 467, 64 S.Ct. 249 (Dec. 20, 1943). The Tax Court in concluded that “the obligation imposed by the section is in the nature of a penalty and that allowance of its deduction under the circumstances of this proceeding would frustrate the public policy expressed in the

However, what is the nature of the liability under short-swing trading law? Is the disgorgement of the short-swing trading profit a fine or penalty? If not, what is it? The opinions of the Tax Court were divided. Prior to 1956, the majority opinion of the Tax Court fashioned that liability imposed by Section 16(b) of the 1934 Act was a penalty.⁴⁹ In a 1956 Tax Court opinion reconsidering its previously 1951 decision and a rule promulgated by the Internal Revenue Service (IRS) in 1961, both indicated that Section 16(b) of the 1934 Act extended the common law concept of fiduciary duty to require the insider to shift the profits to the corporation that did not render the transaction illegal nor did the payment constitute a penalty, and to allow deduction will not frustrate the public policy.⁵⁰ The SEC, as the competent authority of the 1934 Act, held the opinion that although the liability under Section 16(b) is not a penalty from criminal law's point of view, it "still falls within the functional definition of 'penalty' ... with their emphasis on the preventive as opposed to the remedial consequences of such payments."⁵¹

IV. Distinctions between Short-Swing Trading and Insider Trading Laws

The short-swing trading and insider trading law both are designed to pre-

section." William F. Davis, Jr. v. Commissioner of Internal Revenue, *supra* note 42.

49. *See* cases cited by the dissenting Justice Atkins. Laurence M. Marks v. Commissioner of Internal Revenue, 27 T.C. 464 (December 10, 1956).

50. Internal Revenue Service, Revenue Ruling, "Section 16(b) does not render the dealings of the insider unlawful or state that the amount required to be paid to the corporation constitutes a penalty. No distinction is made as to whether or not the profits were innocently derived. As distinguished from a statute which requires a wrongdoer to pay a specific amount, section 16(b) merely shifts the benefit of the insider's dealings to the corporation. It extends the common law concept of a corporate officer's or director's fiduciary duty. The purpose of the statute is to place the insider in the same position he would have occupied if he had never engaged in the stock dealings. This purpose is not frustrated by the allowance of a tax deduction for amounts paid by reason of section 16(b); but, rather, the allowance of the deduction is consistent with the purpose of the statute in returning the insider to his original position." Rev. Rul. 61-115, 1961 WL 12637 (IRS RRU), 1961-1 C.B. 46 (1961); *see also* Laurence M. Marks v. Commissioner, *supra* note 45.

51. Report of the Securities and Exchange Commission on Proposal for Amendments to the Securities Act of 1933 and the Securities Exchange Act of 1934, at 36 (August 7, 1941), *cited from* William F. Davis, Jr. v. Commissioner, *supra* note 42.

vent insider trading activities. However, the regulatory approaches are different in several aspects. We will identify several major distinctions between these two regulatory mechanisms in the following discussion.

A. Different Scopes of Persons Subject to Short-Swing Trading and Insider Trading Laws

The scope of persons subject to the short-swing trading law is narrower than that subject to insider trading law. Under the short-swing trading law, the statutory insiders are typical corporate insiders plus 10% shareholders. Corporate insiders, including directors and officers, are presumed to have access various types of confidential information from time to time. Principal shareholders are also assumed to have access confidential corporate information because of their significant ownership and their influence on corporate policies. Because there is no need to prove the possession of confidential corporate information for securities trading, the scope of persons subject to the short-swing trading law is limited to those who are presumably having the opportunities to access confidential information because of their position or large shareholding in the company. Both the TWSEA and the 1934 Act target the same group of persons for short-swing trading law. Because Taiwan's corporate structure adopts the two-tier system, there are supervisors other than the board of directors.⁵² Therefore, under the TWSEA, persons subject to short-swing trading law include directors, supervisors, managers, and 10% shareholders.

In comparison, the insider trading law aims at regulating illegal trading by persons possessing material nonpublic information. Persons subject to insider trading law include traditional corporate insiders, principal shareholders, and outsiders obtaining information from corporate insiders or because of their professional, contractual or controlling relationship with insiders or the issuer. Examples of outsiders subject to insider trading law include (1) tippees of insiders, (2) a company's attorneys, (3) external auditors, (4) underwriters, (5) outside consultants, (6) government officers. Normally, those outsiders are subject to insider trading law not merely because they possess material

52. For a public company, it may now choose to switch to a one-tier system by replacing the supervisors with an audit committee composed of at least three independent directors according to Article 14-4 added to the TWSEA in 2006.

nonpublic information but because “they have enter into a special confidential relationship in the conduct of the business of the enterprise and are given access to the information solely for corporate purposes.”⁵³

B. Different Elements for Constituting Short-Swing Trading and Insider Trading

For the purpose of imposing disgorgement liability on short-swing trading, it covers transactions of purchase and sale of the issuer’s equity securities by statutory insiders within 6-month periods. First, transactions subject to short-swing trading law include any purchase and sale or sale and purchase of the issuer’s equity securities. Second, transactions subject to disgorgement liability are those occurred within the 6-month period. Third, transactions are consummated by persons while they have the status of statutory insiders.⁵⁴

In contrast, under insider trading law, there are more elements to meet in order to convict a person for illegal insider trading. First, persons subject to insider trading law are not limited to corporate insiders. Outsiders having entered into a special contractual or fiduciary relationship with the issuer are considered as quasi-insiders and could also be subject to insider trading law. Second, plaintiff must prove the existence of material nonpublic information.⁵⁵ Whether the information is material is determined by the “materiality” test, i.e., whether all the information as a total mix is price sensitive to a

53. *Dirks v. Securities and Exchange Commission*, 463 U.S. 646, 655 n.14 (1983).

54. There has been divided opinions on whether two matched transactions must be completed when traders have the status of statutory insiders. There has been opinions that although one of the matched transactions is occurred within 6 months before he becomes or after he is no longer the statutory insider, such transaction is still subject to disgorgement. The judicial decisions and the securities regulators held that traders must be statutory insiders for both buy and sale transactions. Taiwan’s Securities and Exchange Commission, Letter (84) Taiwan-Finance-Securities (III) No. 00461 (March 2, 1995). The US regulator held that transactions occurred before one becomes the statutory insider are not subject to disgorgement but transactions occurred with 6 months after one lost the statutory insider status are still counted.

55. For discussion of the materiality of information, *see generally*, Joan Macleod Heminway, *Materiality Guidance in the Context of Insider Trading: A Call for Action*, 52 AM. U. L. REV. 1131 (Oct. 2003).

reasonable investors.⁵⁶ Third, there is a requirement for a finding of scienter.⁵⁷ When the SEC or contemporaneous traders bring an insider trading litigation, scienter is required. As interpreted by judicial decisions, the defendant must have acted with scienter, which is a “mental state embracing intent to deceive, manipulate or defraud.”⁵⁸ Four, trading on material nonpublic information must constitute fraud to establish the Rule 10b-5 liability and breach of fiduciary duty is the key element if the trader breaches his duty to the corporation or to the source of information.⁵⁹

C. Different Liabilities

In the earlier part of this article, we discuss the nature of the short-swing trading liability. As indicated by the SEC, judicial decisions, and ruling of the IRS, the nature of such liability is not a fine or penalty though functionally it might serve for the purpose to prevent unfair use of corporate information.⁶⁰ In contrast, violation of insider trading law would incur civil and criminal liabilities and in some jurisdictions administrative sanctions. Under short-swing trading law, the liability of the short-swing traders owe to the issuer and must disgorge any short-swing trading profits to the issuer. Without proving the existence of fraud or deception, there is no criminal liability for engaging in short-swing trading nor did it incur civil liability to opposite traders.

In contrast, under insider trading law, persons engaging in insider trading could incur criminal liability. Under Article 171 of the TWSEA, a person convicted for violation of insider trading law is subject to punishment with imprisonment from three to ten years and can concurrently be fined between

56. See *SEC v. Bausch & Lomb Inc.*, 565 F.2d 8, 18 (2d Cir. 1977). An information is considered material “if there is a substantial likelihood that a reasonable investor would consider it important in making his or her investment decisions.” *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438, 449 (1976).

57. See generally, Brian E. Pastuszynski et al., *Post-PSLRA Judicial Treatment of Insider Trading Allegations as a Basis for Pleading Scienter in Securities Fraud Cases*, SG091 ALI-ABA 831 (May 2-3, 2002).

58. *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 193-94 n.12 (1976).

59. Steven R. Salbu, *Tipper Credibility, Noninformational Tippee Trading, and Abstention from Trading: An Analysis of Gaps in the Insider Trading Laws*, 68 WASH. L. REV. 307, 310-311 (April, 1993).

60. See *supra* note 45-47 and accompanying text.

NT\$10 million and NT\$200 million.⁶¹ Under the 1934 Act, as amended by later legislations, including the 1984 Act, the 1988 Act and the Sarbanes-Oxley Act of 2002, the SEC may bring judicial actions to seek for civil penalties of up to three times the amount of profits realized or losses avoided.⁶² In addition, persons engaging in insider trading are subject to criminal sanction and contemporaneous traders may also sue for damages.⁶³

V. Issues Arising from Short-Swing Trading Law and Challenges on the Appropriateness of Short-Swing Trading Law

A. Statutory Short-Swing Transactions Subject to Disgorgement— What Constitutes “Acquire” or “Obtain” of Securities under the Short-Swing Trading Law

In Taiwan, transactions subject to short-swing profit disgorgement are matched in the following ways. First, obtaining or acquiring transactions are matched with sale transactions occurred later. Second, sale transactions are matched with buy transactions occurred later. Accordingly, it is important to define the scope of “obtaining” or “acquiring” of the issuer’s securities that are subject to matching for disgorgement purpose. Because of the wording under the TWSEA uses “obtain or acquire” instead of “purchase or buy,” it raises an issue on whether there are any exempted transactions when interpreting “obtain or acquire,” particularly when the acquisition of the equity securities is involuntary or is not controlled by the statutory insiders, such as acquiring the securities by succession or as a consequence of merger. Under the US law, unless it is exempted by the SEC rules, whether one transaction fall into the statutory short-swing transaction is decided by the courts. The rules could change because the courts decide the case on an ad hoc basis.

Under the short-swing trading law, there are little disputes on transactions

61. TWSEA, §171. If the illegal trading profit exceeds NT\$100 million, the insider trader is subject to punishment with imprisonment for minimum of seven years and can concurrently be fined between NT\$25 million and NT\$500 million.

62. 15 U.S.C.A. §78u-1 (a)(2).

63. *See supra* note 12~18 and accompanying text.

that are voluntarily engaged by the statutory insiders. Therefore, voluntary purchases and sales are to be matched for calculating the short-swing trading profits. However, it is more controversial for transactions that fall at the borderline. The U.S. courts have developed a number of cases allowing certain unorthodox transactions to be exempt from short-swing trading liability.⁶⁴ Unorthodox transactions are referred to the transactions in which the statutory insiders do not obtain or acquire the securities through traditional concept of purchase or sale transactions, but rather from fancier concepts of transactions, such as merger, exercise of option or convertible rights, or from employee benefit plans.⁶⁵ If we are to mechanically apply the short-swing trading law, unorthodox transactions are also subject to disgorgement of short-swing profit. However, many U.S. courts have created the so called “unorthodox transaction doctrine” to exempt certain unorthodox transactions from short-swing trading liability.⁶⁶ Although there is an unorthodox transaction doctrine, the application is limited to a small number of exceptions and some unorthodox transactions could still fall into the scope of statutory short-swing transactions and are subject to recovery.

B. Calculation of Short-Swing Profits

In the U.S., Section 16(b) does not provide the rule regarding how to calculate the short-swing profits. From the judicial decisions, the courts normally match the transactions within the six-month period and assess the maximum profit that is realized by the statutory insiders. When computing the short-swing profits, it is observed that only matched transactions showing profits will be calculated. For transactions that incur losses to statutory insiders are excluded from calculation. In other words, only profits will be calculated into the recoverable amount and losses are not allowed to offset the recoverable amount. As a result, while the statutory insiders may be required to disgorge the short-swing profit based on the computation formula, they may in reality

64. Peter G. Samuels, *Liability for Short-Swing Profits and Reporting Obligations under Section 16 of the Securities Exchange Act of 1934*, 1392 PLI/Corp 523, 562-565 (Oct. 2003).

65. For example, in the M&A context, certain acquisitions of the issuer’s equity securities are exempt from short-swing trading liability. See e.g., Rodrigo J. Howard et al., *Selected Securities Law Issues after the Merger Agreement Is Signed: Practical Guidelines*, 1122 PLI/CORP 949, 992-997 (May-June 1999).

66. *Id.* at 997-999.

sustain a loss. Although the implementation does have some deterrent effects, this is a fundamental flaw of this regime particularly when there is no showing of the existence of material nonpublic information and no potential abuse of the corporate information. This is what short-swing trading law has frequently been criticized.

In Taiwan, Article 157 of the TWSEA does not provide the guideline on how to calculate the short-swing profits either. Instead, the constructive formula for calculating the short-swing profit is provided in Article 11 of the TWSEA Enforcement Rules.⁶⁷ The calculation of short-swing profits should comply with the following rules:⁶⁸

1. If the securities belong to the same type, the profit is calculated by matching transactions of the highest selling price with the lowest purchasing price, then the second highest selling price with the second lowest purchasing price, and so on. Losses arising from those transactions will not be calculated.
2. If the securities traded subject to the disgorgement liability are not in the same type, for common stock, it is calculated by the trading price and the number of shares traded; for other types of equity securities, such as options or convertible bonds, it is calculated by the trading day's (the day that such securities was acquired or sold) closing price of the common stock and the number of shares after such option or convertible rights are exercised. The matching method is the same as stated in the previous paragraph 1.
3. Dividends deriving from those short-swing transactions are also calculated.
4. Securities trading tax and commission paid to the securities brokers can be deducted.⁶⁹

Basically, the TWSEA Enforcement Rules offers constructive calculation formula similar to that used by the U.S. courts. It is understandable that the

67. The Securities and Exchange Act Enforcement Rule (hereinafter the TWSEA Enforcement Rules) is promulgated by the securities regulator, currently the Financial Supervisory Commission, according to Article 182-1.

68. TWSEA Enforcement Rules, art. 11, para. 2.

69. TWSEA Enforcement Rules, art. 11, para. 3.

application of short-swing trading law and the calculation formula is not so friendly to statutory insiders because this is the only regulatory scheme used since 1934 and prior to illegal insider trading transactions were officially prosecuted. Nowadays, statutory insiders, obtaining material nonpublic information of the issuer and engaging in trading of the issuer's equity securities or tip others to trade, will incur criminal as well as civil liabilities. The regulatory presumption and legislative purpose are to prevent corporate insiders from taking advantage of their position in the corporation and potential opportunities to abuse corporate information and trade corporate securities for personal profit. However, the presumption is flawed for various reasons. Moreover, the trading system and regulatory system are completely different from the 1934 or 1968 when the short-swing trading law was enacted in the U.S. and in Taiwan. Currently, the trading system has been fully computerized and the information of corporate insiders of listed companies or OTC traded companies has been stored in the stock exchanges or the competent authorities. Any trading activities of corporate insiders are recorded and monitored. Corporate insiders should know that any trading of the issuer's equity securities are subject to short-swing trading profit liability and must disgorge to the issuer. For those who want to avoid being exposed to such liability will not trade with their accounts. Taiwan Stock Exchange and Greta Securities Market (GTSM or the OTC Market) have discovered this situation and issued rules to encourage whistle blowers to report up and illegal trading made by corporate insiders.⁷⁰ However, one may still ask whether the short-swing trading law has reached its goal to deter insider trading. For those short-swing profit disgorgement cases, has the law caught the right or wrong persons? It is the opinion of this article that it is time to review the appropriateness of the short-swing trading law and make necessary amendment.

C. Exemptions

Both the U.S. and Taiwan's securities regulations did provide exemptions to exempt certain types of transactions from disgorgement liability. The following lists exemptions available under the US or Taiwan's securities regulation:

70. Regarding short-swing trading, if one found corporate insiders using other person's account to make trade and report up to the Taiwan Stock Exchange, a prize will be awarded. TWSE Rules on Report up of Illegal Activities in the Securities Market, §2, para. 6.

1. An involuntary transaction in connection with a merger is not necessarily subject to the recovery of short-swing profits:
 - (1) The conversion or cancellation of securities in connection with a merger by the statutory insider is eligible for exemption.⁷¹
 - (2) The conversion in a merger of target equity securities by officers and directors of the target are eligible for the Rule 16b-3(e) exemption whether the disposition is a conversion, exchange, or cancellation of the target securities for equity, debt or cash.⁷²
 - (3) The acquisition of the acquiring company's securities by officers and directors of the acquirer through the conversion of target company's equity securities, fall into the exemption under Rule 16b-3(d).⁷³
2. According to Rule 16b-3, tax conditioned plans that satisfy the specified provisions of the Internal Revenue Code of 1986 are exempted from Section 16(b) liability.⁷⁴
3. The exercise of stock options under an Employee Stock Option Plan (ESOP) is exempted if (a) the ESOP is a written plan approved by the official meeting of the company, (b) the duration between the grant of stock option and the time of exercise is longer than 6 months, and (c) such employee stock options are not transferrable.⁷⁵
4. Acquiring equity securities because of succession.⁷⁶
5. Receiving employee stock options from the issuer is exempted.⁷⁷ However, to exercise the employee stock options to purchase shares of the

71. Securities and Exchange Commission, Skadden, Arps, Slate, Meagher & Flom LLP, No Action Letter (January 12, 1999). The exempted transactions include the disposition of target company's securities and the acquisition of acquiring company's securities.

72. Rule 16b-3(e) of the 1934 Act, 17 C.F.R. § 240.16b-3(e).

73. The exemption includes the situation when employees and directors of the target who become officers or directors of the acquiring company before or at the time of the merger. Rule 16b-3(d).

74. Justin L. Bastian et al., *Section 16 Short-Swing Trading: Selected Practical Issues and Pitfalls to Avoid*, 1443 PLI/CORP 1209, 1219-1221 (Sept.-Dec., 2004).

75. Rule 16b-6 of the 1934 Act, 17 C.F.R. § 240.16b-6.

76. Previously, the succession of shares was subject to disgorgement according to securities regulator's order. Taiwan Securities and Exchange Commission Order, Taiwan-Finance-Securities (III) No. 00461 (1995). This exemption becomes available in 2007 in Taiwan. Financial Supervisory Commission Order, Finance-Management-Securities (III) No. 0960048145 (2007).

77. Taiwan Securities and Futures Commission Order, (91) Taiwan-Finance-Securities (III) No. 172479, para. 1 (2002).

issuer is not exempted.

6. Acquiring convertible corporate securities, corporate bond with warrants from a public offering and exercising convertible rights or warrants to acquire corporate stock are exempted.⁷⁸
7. Receiving stock dividend from the issuer is exempted.⁷⁹

However, here are some examples that unorthodox transactions are not exempted and are still subject to disgorgement:

1. Purchase or sale that preceded stock dividend (or stock split), is to be matched against sale or purchase made by insider after record date for dividend distribution (or after the stock split).⁸⁰
2. Grant of stock options is considered as purchase of securities. However, the exercise of the option and receive shares is not considered as a purchase for the purpose of short-swing trading.⁸¹

Although the securities regulators of both countries do provide exemptions to allow certain type of transactions exempted from disgorgement liability, it is necessary to mention that other than the exempted transactions, “good faith” is not a defense for escaping the disgorgement liability.⁸² When short-swing trading law was enacted, it aimed at preventing any possibilities for statutory insiders to unfairly use their position to trade on the equity securities of their own company. Therefore, unless it is explicitly exempted by securities regulation, no defense or excuse is acceptable.

78. Taiwan Securities and Futures Commission Order, (91) Taiwan-Finance-Securities (III) No. 172479, para. 2 (2002).

79. Taiwan Securities and Exchange Commission Order, Taiwan-Finance-Securities (II) No. 24094 (April 27, 1989).

80. Isadore BLAU, a stockholder of Air-Way Industries, Inc., suing on behalf of himself and all other stockholders similarly situated and on behalf and in the right of Air-Way Industries, Inc., Plaintiff-Appellee-Appellant, v. Edward LAMB and Edward Lamb Enterprises, Inc., Defendants-Appellants-Appellees. 363 F.2d 507 (June 27, 1966), *certiorari* denied 87 S.Ct. 707 (January 9, 1967).

81. Rules 16b-6(a)&(b); Ira M. Bratt, *New Confiscation Rules for Insider Short Swing Trading Profits*, 19 WESTCHESTER B.J. 43 (Winter, 1992).

82. In a judicial decision, a Taiwan’s court indicated that the legislative intent for the short-swing trading law is to mechanically apply the provision. Whether the traders are intentional, negligent, or in good faith in making such trading is irrelevant to the establishment of the disgorgement liability. Taiwan Taipei District Court, 90 Litigation 785 (Apr. 25, 2001).

VI. Conclusion: Recommendation on Taiwan's Short-Swing Trading Law

A. Long-Term Goal: Repeal of the Short-Swing Trading Law

While recognizing the justifiable regulatory functions of the short-swing trading law in preventing unfair use of corporate information for personal profits, it is also important not to overlook the existence of conflicting policies and issues arising from implementing the short-swing trading law. For the long-term goal, this article recommends the repeal of the short-swing trading law for the following reasons and conditions.

Firstly, in the emphasis of corporate governance by corporate and securities regulators encouraging the increase of the shareholding of directors and officers to have their interests in line with those of shareholders, it becomes more controversial on imposing the short-swing trading law. The TWSEA imposes minimum shareholding requirements on both directors and supervisors to own a prescribed percentage of the outstanding shares.⁸³ Under the authorization of the TWSEA, the competent authority promulgates rules to set the minimum shareholding percentages on the directors as a whole and supervisors as a whole.⁸⁴ The percentages vary depending on the size of the paid-in capital of each company.⁸⁵ While imposing the minimum shareholding requirement on directors and supervisors, the policy cannot require them to raise their stake in the corporation without providing them opportunities to freely adjust their shareholding for *bona fide* financing purpose. At minimum, the transactions for the purpose of satisfying the minimum shareholding re-

83. TWSEA, §26, para. 1.

84. TWSEA, §26, para. 2; Rules and Review Procedures for Director and Supervisor Share Ownership Ratios at Public Companies, §2.

85. Article 2 of the Rules and Review Procedures for Director and Supervisor Share Ownership Ratios at Public Companies sets forth the minimum shareholding percentage that directors as a whole and supervisors as a whole must own. The following provides three examples. (1) If the paid-in capital of the company is less than NT\$300 million, shares owned by all directors must be equal or more than 15% of the outstanding shares and shares owned by all supervisors must be 1.5% or more of the outstanding shares. (2) If the paid-in capital of the company is between NT\$300 million and NT\$1 billion, the total shares owned by all directors and all supervisors are 10% and 1% respectively. (3) If the paid-in capital of the company is between NT\$1 billion and NT\$2 billion, the total shares owned by all directors and all supervisors are 10% and 1% respectively.

quirement should be exempted.

Secondly, because there is no need to prove that statutory insiders possess material nonpublic corporate information in short-swing trading, when they consummate statutory transactions, they are subject to disgorgement liability to disgorge the “constructive short-swing profits” to the company disregarding their state of mind whether they are in reality innocent or bona fide and whether in reality they suffer a loss.⁸⁶ Because there is a minimum 6-month holding requirement in order not to be subject to disgorgement liability, it is possible and there are cases that the statutory insiders incur disgorgement liability because of miscalculation of the expiration day of the 6-month period.

Thirdly, it creates economic waste to regulate the short-swing trading because it increases the cost for regulators and regulated statutory insiders to comply with such law but with limited effect.⁸⁷ The regulatory regime should not impose unduly or unnecessary burdens or obligations on the management. The management should devote their time in managing the corporation and try to maximize the profits for shareholders and take care of the interests of the stakeholders. It is not appropriate to assume that officers, directors, and principal shareholders will misuse or unfair use of the corporate information for personal profits.

Fourthly, the litigations for the recovery of short-swing profits are not efficiently carried out by the issuer. In practice, the issuer rarely brings a short-swing trading litigation against the statutory insiders because it must be brought by directors or supervisors of the issuer. Although the law does provide a right for shareholders to sue on behalf of the issuer, there is no incentive for shareholders to bring such litigation. Therefore, Taiwan enacted the Securities and Futures Investors Protection Act in July 2002 and established the Securities and Futures Investors Protection Center (SFIPC), an NPO and NGO, in January 2003. The SFIPC owns 1000 shares of each publicly traded corporation.⁸⁸ Currently, the litigations for the disgorgement of short-swing profits are brought by the SFIPC.⁸⁹ The SFIPC handled 5,969 short-

86. For the purpose of calculating short-swing profits, Article 11 of the TWSEA Enforcement Rules set forth the constructive formula. *See supra* notes 63~65 and accompanying text.

87. For discussion of the limited effectiveness of short-swing trading, *see* Jesse M. Fried, *Reducing The Profitability of Corporate Insider Trading through Pretrading Disclosure*, 71 S. CAL. L. REV. 303, 343 (January 1998).

88. Securities and Futures Investors Protection Act [hereinafter SFIPA] §19.

89. Organizational Rules of the Securities and Futures Investors Protection Center §4.

swing profit disgorgement cases for the amount of more than NT\$3 billion to be disgorged and NT\$ 1.9 billion actually disgorged from 1985 to 2010.⁹⁰ (See Appendix I) Therefore, this has increased the expense and workload of the SFIPC. Although the SFIPC has done an excellent job in enforcing short-swing trading litigation, there is still a consequential issue on how to enforce the short-swing trader to disgorge the profits to the corporation after a judgment is rendered in favor of the SFIPC. Who has the obligation to ensure that short-swing profit has been disgorged to the corporation? Will there be any report-up obligation or will there be any sanction for non-compliance? These remain the unsolved issues.

Fifthly, the short-swing trading law is a trap that may in reality punishes more innocent and careless statutory insiders. Because the short-swing trading law is relatively clear and is mechanically applied, the statutory insiders may escape the liability simply to wait for 6 month. Therefore, several scholars have expressed their doubts on the usefulness of the short-swing trading law to prevent the potential abuse of the statutory insiders' position to profit from short-swing trading and urged to repeal.⁹¹

Sixthly, the short-swing trading law is likely to punish the statutory insiders trading on public information. Short-swing trading law was enacted to prevent the unfair use of information which may be obtained by the statutory insider by reason of his relationship to the issuer.⁹² However, this initial legislative intent may in real world discipline statutory insiders who trade base on public information but the transactions fall within the six-month period. For example, a manager who buys the corporate stock on May 3rd after the company has released its 1st quarter financial report on April 30, and sells the stock on November 1st after the 3rd Quarter Financial report is

90. The data of short-swing disgorgement cases are available at <http://www.sfipc.org.tw/main.asp>.

91. See Marleen A. O'Connor, *Toward a More Efficient Deterrence of Insider Trading: The Repeal of Section 16(b)*, 58 *FORDHAM L. REV.* 309 (1989); S.S. Samuelson, *The Prevention of Insider Trading: A Proposal for Revising Section 16 of the Securities Exchange Act of 1934*, 25 *HARV. J. ON LEGIS.* 511, 522-28 (1988).

92. In *Reliance Electric Company v. Emerson Electric Company*, the Supreme Court observed that many federal courts had interpreted Section 16 of the 1934 Act and recognized that "the only method Congress deemed effective to curb the evils of insider trading was a flat rule taking the profits out of a class of transactions in which the possibility of abuse was believed to be intolerably great." *Reliance Electric Company v. Emerson Electric Company*, 404 U.S. 418, 422 (1972).

released on October 30th. Although the manager trades the corporate stock based on the publicly available financial reports, he is subject to short-swing trading disgorgement liability because the buy and sell transactions fall within 6 month.

However, while we see many reasons that short-swing trading law should be repealed in the long run, the current market condition and the enforcement of insider trading law still need much improvement. For example, it has been criticized that the conviction ratio for insider trading cases is still very low.⁹³ However, when the conviction ratio is increased as the former Chairman of the Financial Supervisory Commission expected to be 100 percent, we may then consider the repeal of short-swing trading law. Therefore, though the short-swing trading law faces many challenges and criticisms, at this moment, this law shall not easily and immediately be repealed without meeting the following conditions:

First of all, the regulatory environment and techniques for monitoring and investigating insider trading must be improved to a certain degree so that illegal insider trading will be effectively prosecuted and the public confidence on the fair play of the securities market can be restored or maintained. The increase of the conviction ratio will be a signal for the improvement and maturity of the insider trading enforcement. As mentioned by the former Chairman of the FSC, the competent authority has more experts in detecting insider trading and collecting evidence. Currently, the most insider cases are forwarded by the FSC to the Prosecutors' Office and prosecutors will conduct further investigation and determine whether to prosecute. The reasons for the low conviction ratio could arise from the different interpretation of the insider trading law or different view regarding whether there is sufficient evidence. One way for the improvement of the insider trading enforcement is increase the number of prosecutors as onsite staff of the FSC and work closely with the Prosecutors' Office in prosecuting insider trading cases.

Secondly, disclosure requirements on statutory insiders must be strictly enforced. The disclosure of shareholding of statutory insiders provides a record for the competent authority or shareholders to monitor whether there involves any illegal trading. Disclosure of this information also provides the market to

93. In 2008, one legislator questioned the competent authority why only 6 out 196 prosecuted insider trading cases defendant were convicted at the district court level in the past 8 years. The conviction ratio is only 3%. *Possessing Inside Information, Prohibiting Trading*, Economic Daily News [Taiwan], at A3 (Nov. 27, 2008).

watch and analyze the changes or statutory insiders' shareholding and trading patterns. If there involves material non-public information, untrue disclosure, and other fraudulent activities, such record provide a basis for further investigation. To be sure, there should be adequate administrative penalties for failing to comply with the disclosure requirements.

Thirdly, it is highly recommended to impose a pre-trading disclosure obligation on statutory corporate insiders and the use of real-name trading system. The pre-trading disclosure will allow investors as well as the competent to trace and detect whether the trading involve any illegal insider trading. There has been suggestion that pre-trading disclosure can reduce the profitability from corporate insider trading.⁹⁴ In addition, every trader can use his/her account only. If corporate insider uses other person's account to trade, this trading should be subject to short-swing trading law and this is one of the very few situation that short-swing trading law should apply.

B. Modification of the Current Short-Swing Trading Law

Although for the long run, it is recommended that short-swing trading law be abolished, this article recommends several modifications to the short-swing trading law while it is still in force to increase the justification of this regulatory mechanism and in the mean time not to undermine its regulatory function. Moreover, from the evolution of short swing trading law and insider trading law, it is perceived that the former was in existence when 1934 Act was enacted and when TWSEA was enacted in 1968. Insider trading law developed later but with more theoretical basis. The goals of both laws are to regulate insider's trading activities to prevent them from unfairly using corporate information and prevent the phenomenon of information asymmetry. While insider trading is developing into a more mature stage, it is necessary to review the appropriateness of the content of short-swing trading law. Here are several recommended modifications to the short-swing trading law in Taiwan:

First, as recommended, prompt and full disclosure for the shareholding and its changes by the statutory insiders must be strictly enforced. Currently, the statutory insiders of public corporation are required to file notification to

94. For discussion of the pre-trading disclosure, *see generally*, Fried, *supra* note 83, at 348-92.

the company of any change of their shareholding by the 5th day of the next month and the company will file with the competent authority by the 15th day.⁹⁵ Failure to comply such requirements shall subject the statutory insiders to administrative fine in the amount between NT\$240,000 to NT\$2,400,000.⁹⁶ In addition, statutory insiders shall comply with the disclosure requirement and select one of the following means when transferring their shares: (1) by way of public secondary offering; (2) file with the competent authority at least three days prior to the sale of stock through TWSE or GreTai Securities Market (daily sale of less than 10,000 shares is exempted); (3) file with competent authority and transfer shares to designated person within three days.⁹⁷ Currently, the information of statutory insiders' filing of share transfer is available on the Market Observation Post System (MOPS).⁹⁸ It is recommended that pre-trading filing should include trading of less than 10,000 shares because to sell 10,000 everyday can accumulate to a large number of shares. Because the filing on the MOPS is easy and is immediately available to the public, the disclosure should include the pre-trading filing and filing immediately after the actual trading. The transaction need to be promptly disclosed including the debt and equity securities of the publicly traded corporation as well as the derivative securities, stock options, stock futures, etc. This can provide a record for tracing whether there is insider trading and the competent authority can consider exempting bona fide trading from disgorgement liability. However, failure to comply with the disclosure requirement or to trade with other person's account will deprive a statutory insider from asserting that he is innocent or *bona fide* and cannot be excused from disgorgement liability. It is important to note that this article does not promote the radically repeal short-swing trading liability. Instead, innocent trading should be exempt from liability if all of the suggested conditions are satisfied.

Secondly, a clear and concise rule or guidance on what types of transactions are exempted from short-swing trading liability must be established. The U.S. SEC promulgated Rule 16b-3 exemption specifically for

95. TWSEA, §25.

96. TWSEA, §178, para. 1, item 2.

97. TWSEA, §22-2, para. 1.

98. The Market Observation Post System is maintained by the Taiwan Stock Exchange. The MOPS website is <http://mops.twse.com.tw/mops/web/index> (Chinese) or http://emops.twse.com.tw/emops_all.htm (English).

the interpretation of what kind of transactions will not be subject to short-swing disgorgement liability. It is necessary to note that transactions of statutory insiders exempted from short-swing trading liability are not limited to transactions listed under Rule 16b-3. There are other situations that transactions of statutory insiders are exempted.⁹⁹ In the past, Taiwan's securities regulator issues administrative orders in solving the issues come to its attention. It is strongly suggested that the competent authority establish a systematic ruling system and for the purpose of short-swing trading to review the consistency of its orders and observe the development of the securities and futures markets with regard to what types of transactions are exempted and what are not.

Thirdly, mechanical application of short-swing trading law may cause harsh result in many occasions. It is advisable that Taiwan's securities regulator adopts the "unorthodox transaction doctrine" to exempt certain unorthodox transactions that "do not present potential for speculative abuse" of corporate information.¹⁰⁰ It is urged that the securities regulator should create a list of exempted transactions to exempt transactions that do not defeat the purpose of short-swing trading law. Additionally, the court shall have the discretion to decide whether an unorthodox transaction that does not have the potential threat on misuse of corporate information should be exempted. This will cure the problem of mechanical application.

Fourthly, as discussed earlier, in Taiwan the litigation for the disgorgement of short-swing profit is brought by the SFIPC.¹⁰¹ Although the SFIPC can bring the litigation for the corporation, the consequential issue is how to enforce the disgorgement after the judgment is rendered. It is therefore suggested that a reporting obligation must be created to make sure that the

99. For example, insiders exempted from Section 16(a) reporting requirement are exempt from Section 16(b) liability. Peter G. Samuels, *Liability for Short-Swing Profits and Reporting Obligations under Section 16 of the Securities Exchange Act of 1934*, 1271 PLI/CORP 621, 659 (2001).

100. Samuel Wolff, *Section 16 in Transactional Practice: Levy, Groups and the Proposed Rules*, 32 No. 3 SECURITIES REGULATION LAW JOURNAL 1 (Fall 2004).

101. When insider of a listed company engages in short-swing trading and that company fails to request the insider to disgorge the short-swing trading profits to the company, the SFIPC, being a shareholder, may request the company to exercise such right or to bring a derivative suit to enforce the disgorgement. TWSEA, §157. From 1994 to first half of 2007, the SFIPC and its predecessor (Investor Protection Center of the Securities and Futures Institute) brought 4814 cases of short-swing trading litigation.

short-swing traders has disgorged the fund to the issuer. A possible solution is to require the board of directors or supervisors or the legal compliance officer to report up to the securities regulator. The regulator can also seriously consider the mechanism employed by the US SEC since 1991, i.e., to impose reporting obligation on the issuer for non-compliance of statutory insiders (Item 405 or Regulation S-K). The issuer is required to disclose in the annual report any con-compliance of the statutory insiders, including number of late filing, the identity of the insiders and detail information regarding the non-compliance.¹⁰² To ensure the corporate insider has disgorged the short-swing profit to the corporation, it is suggested that the TWSEA imposes a reporting obligation on the issuer to report the enforcement of the court order to recover the disgorgement of short-swing profit from corporate insider and any non-compliance to the competent authority. It is suggested that failing to comply with this reporting requirement shall subject the issuer and its responsible person to administrative fine.

Appendix I Short-Swing Cases Handled by the SFIPC¹⁰³

Year	Cases	Short-Swing Profit to be Disgorged	Closed Cases	Total Amount Disgorged
1994	84	80,270,024	84	77,717,537
1995	186	83,820,842	186	73,178,590
1996	215	172,609,117	215	153,304,443
1997	420	265,703,236	418	169,081,856
1998	353	986,116,196	347	111,296,617
1999	416	224,661,201	416	188,881,366
2000	441	233,376,966	439	185,195,578
2001	321	83,974,981	321	82,212,818
2002	351	106,453,696	351	105,064,181
2003	502	51,474,426	502	51,035,665
2004	635	87,497,860	632	80,542,811
2005	360	57,373,111	360	57,373,111
2006	325	187,959,260	323	184,542,872

102. Peter G. Samuels, *Liability for Short-Swing Profits and Reporting Obligations under Section 16 of the Securities Exchange Act of 1934*, 1513 PLI/CORP 493, 537-39 (2005).

103. Information from Securities and Futures Investors Protection Center, TAIWAN

2007	391	109,236,112	389	107,542,556
2008	338	86,720,877	335	84,989,539
2009	313	102,153,563	312	102,138,774
2010	318	98,782,303	317	98,542,112
TOTAL	5,969	3,018,183,771	5,947	1,912,640,426

(Source: Information from Securities and Futures Investors Protection Center, TAIWAN)

Appendix II Taiwan’s Short-Swing Trading and Insider Trading Provisions under the TWSEA

Note: The following provisions were part of the Securities and Exchange Act of Taiwan. The translations were made by Winkler Partners (From 1 June 2001) and TSAR & TSAI LAW FIRM (Before 31 May 2001). The Chinese version of the TWSEA is available at <http://www.selaw.com.tw/Scripts/Query4B.asp?FullDoc=所有條文&Lcode=G0100001>, and the English versions of the TWSEA is available at <http://eng.selaw.com.tw/FLAWDAT0201.asp>.

Article 157 (Disgorgement of Short-Swing Trading Profits)

In the event that any director, supervisor, managerial officer, or shareholder holding more than ten percent of the shares of a company sells the listed securities within six months after its acquisition, or repurchase the securities within six months after its sale, the company shall claim for the disgorgement of any profit realized from the sale and purchase.

If the board of directors or the supervisors of the company fail to exercise the right of claim for disgorgement under the preceding paragraph on behalf of the company, its shareholders may request the directors or the supervisors to exercise the right of claim within thirty days; upon the expiration of such period, if no action has been taken, such requesting shareholders shall have the right to claim for disgorgement on behalf of the company.

The directors and supervisors shall be jointly and severally liable for damages suffered by the company as a result of their failure to exercise the claim provided under paragraph 1 of this Article.

The right of claim specified in paragraph 1 of this Article shall be extinguished if not exercised within two years after the date on which the profit is realized.

The provisions of paragraph 3 of Article 22-2 hereof shall apply mutatis mutandis to paragraph 1 of this Article.

This Article shall apply mutatis mutandis to other securities with the nature

of equity shares issued by a company.

Article 157-1 (Prohibition of Insider Trading)

Upon learning any information that will have a material impact on the price of the securities of the issuing company, and prior to the public disclosure of such information or within 12 hours after its public disclosure, the following persons shall not purchase or sell shares of the company that are listed on an exchange or an over-the-counter market, or any other equity-type security of the company:

1. a director, supervisor, and/or managerial officer of the company, and/or a natural person designated to exercise powers as representative pursuant to Article 27, paragraph 1 of the Company Act.
2. shareholders holding more than ten percent of the shares of the company.
3. any person who has learned the information by reason of occupational or controlling relationship.
4. a person who, though no longer among those listed in [one of] the preceding three subparagraphs, has only lost such status within the last six months.
5. any person who has learned the information from any of the persons named in the preceding four subparagraphs.

Persons in violation of the provisions of the preceding paragraph shall be held liable, to trading counterparts who on the day of the violation undertook the opposite-side trade with bona fide intent, for damages in the amount of the difference between the buy or sell price and the average closing price for ten business days after the date of public disclosure; the court may also, upon the request of the counterpart trading in good faith, treble the damages payable by the said violators should the violation be of a severe nature. The court may reduce the damages where the violation is minor.

The persons referred to in subparagraph 5 of paragraph 1 shall be held jointly and severally liable with the persons referred to in subparagraphs 1 through 4 of paragraph 1 who provided the information for the damages referred to in the preceding paragraph. However, where the persons referred to in subparagraphs 1 through 4 of paragraph 1 who provided the information had reasonable cause to believe the information had already been publicly disclosed, they shall not be liable for damages.

The phrase “information that will have a material impact on the price of the securities” in paragraph 1 shall mean information relating to the finances or businesses of the company, or the supply and demand of such securities on

the market, or tender offer of such securities, that will have a material impact on its price, or any other information that would have a material impact on the investment decision of a reasonably prudent investor. Regulations governing the scope of the information, the means of its disclosure and related matters shall be prescribed by the Competent Authority.

The provisions of paragraph 3 of Article 22-2 shall apply *mutatis mutandis* to subparagraphs 1 and 2 of paragraph 1 of this Article; the same shall apply with respect to those who have lost the identity [set out in those provisions] for a period of less than a full six months. The provisions of paragraph 4 of Article 20 shall apply *mutatis mutandis* to the trading counterpart referred to in paragraph 2 of this Article.

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