INSIDER TRADING IN THE PHILIPPINES: CONSTITUTIONAL AND OTHER LEGAL ISSUES ON IMPOSING CIVIL AND CRIMINAL LIABILITY FOR SHORT-SWING PROFITS AND INSIDER TRADING VIOLATIONS*

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ABSTRACT

As of this writing, the Supreme Court has yet to resolve and decide on the merits of a case involving insider trading. It is submitted that this strongly indicates that there is great difficulty in implementing and enforcing prevailing laws and regulations regarding the matter. In this article, the authors present an analysis of the sufficiency and enforceability of key provisions of Republic Act No. 8799, or the Securities Regulation Code, on insider trading, as well as other relevant rules and regulations promulgated by government regulatory agencies. The article, in particular, examines the law and its related rules and regulations in relation to their declared purpose of promoting investor confidence in the Philippines. The article concludes with recommendations of key measures, both legislative and administrative in nature, that may be implemented to ensure the effective realization of the declared policy of the State.

I. INTRODUCTION

The Securities Regulation Code[1] ("SRC") was enacted to promote the state policy of minimizing, if not totally eliminating, insider trading and other fraudulent or manipulative devices and practices that create distortions in the free market.[2] To prevent insiders—particularly, officers, directors, or controlling stockholders—from benefiting from the unfair use of information obtained by

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[1] Rep. Act No. 8799 (2000).

[2] § 2.

reason of their close relationship and dealings with a corporation, the SRC proscribes short-swing profits under Section 23.2 and insider trading under Section 27. The validity and enforceability of these provisions, however, remain untested in Philippine courts because the Securities and Exchange Commission (SEC)—the government agency tasked to implement the SRC—has not yet been able to obtain a single conviction against charged insiders.

History has proven that abuse of insider information occurs in the Philippine stock market and has prejudiced the public in several instances. This paper posits that certain flaws in the SRC prevent the SEC and the public from making insiders accountable, contrary to the very state policy that the law seeks to promote.

In discussing the issues preventing the prosecution of insider trading violations in the Philippines, reference to the United States context may prove to be prudent since US laws comprise the basis of most of the provisions of the SRC.

Three essential issues in relation to the provisions on short-swing profits and insider trading are to be discussed herein: (1) the constitutionality of the presumption of insider trading against insiders who transact after material nonpublic information came into existence, but prior to the dissemination of such information to the public; (2) the effect of privacy laws on the power of the SEC to obtain evidence against insiders; and lastly, (3) the sufficiency of civil remedies for the recovery of profits from insider trading that are available to the SEC and investors who are prejudiced by the insider's abuse of information.

II. HISTORY OF INSIDER TRADING IN THE PHILIPPINES

The Manila Stock Exchange, the Philippines' first national stock exchange, was established in 1927. In 1963, another exchange, the Makati Stock Exchange, started operations. Both exchanges traded listed securities until the respective licenses of the Manila and the Makati Stock Exchanges were cancelled and the trading of both exchanges was transferred to the Philippine Stock Exchange (PSE) in 1994.[3] At present, 259 listed equity securities are being traded with the PSE.

The Philippine stock market, despite being in existence for more than 85 years, is quite small relative to more advanced markets. In contrast, there are

[3] Philippine Stock Exchange, *History*, *at* http://www.pse.com.ph/corporate/home.html.

6,800[4] and 2,800[5] equity securities listed with the Hong Kong Exchange and Clearing Limited and the New York Stock Exchange, respectively. Given that the Philippine stock market is small and most large Philippine corporations are owned and controlled by a few wealthy families, often with interlocking directors, the possibility of insider trading is apparent.

The first law promulgated to regulate the stock market was Commonwealth Act No. 83 or the Securities Act of 1936, which was enacted on October 26, 1936. As a measure to address and penalize fraud and various forms of excesses in the stock market, the Act established the SEC[6] and prescribed rules on the registration of securities, brokers, dealers, salesmen,[7] and exchanges.[8] Under the Act, "any person who willfully and knowingly makes, or causes to be made, any statement in any application, report, or document required to be filed [...] which statement is false or misleading with respect to any material fact"[9] shall be penalized.

However, despite its known purpose, the Act did not contain any specific provisions on insider trading. This is ironic considering that a landmark case on insider trading in the US, *Strong v. Repide*,[10] originated from a Philippine Court of First Instance. The case arose from the sale by a shareholder of shares in the Philippine Sugar Estates Development Company to one of the directors of the company. The defendant director, while negotiating the purchase of the plaintiff's stock, was simultaneously negotiating the sale of corporate land assets to the Philippine government. The director concealed the information about the negotiations and, as a result, was able to obtain the stock from the stockholder for just one-tenth of its actual value. The US Supreme Court avoided the purchase, holding that, although the director may not be under the obligation of a fiduciary nature to disclose to a stockholder his knowledge affecting the value of the shares, such duty existed by reason of the special circumstance that he concealed his exclusive knowledge of the impending sale of friar lands to the government from the stockholder. The "special-facts" rule was sustained in succeeding cases citing *Strong v. Repide.*

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[4] Hong Kong Exchange and Clearing Limited, *Daily Quotation, available at* http://www.hkex.com.hk/eng/stat/smstat/dayquot/qtn.asp.

[5] New York Stock Exchange, *Frequently Asked Questions, available at* http://www.nyse.com/content/faqs/1050241764950.html.

[6] Com. Act No. 83, § 3 (1936).

[7] §§ 14-15.

[8] §§ 16-28.

[9] § 40.

[10] 213 U.S. 419 (1909).

On January 29, 1973, the SEC issued the *Rules Requiring Disclosure of Material Facts by Corporations whose Securities are Listed in any Stock Exchange or Registered/Licensed Under the Revised Securities Act.* This required the full disclosure of material facts that are of interest to investors. In this set of rules, "material fact" was explained as that which "induces or tends to induce or otherwise affect the sale or purchase of its securities."[11]

The insider trading provision was introduced in the Philippines by way of Batas Pambansa Blg. 178, or the Revised Securities Act, which was signed into law on February 23, 1982. It was the law in effect when the first case on insider trading that reached the Philippine Supreme Court was filed, *SEC v. Interport Resources Corp.*[12] In that case, the SEC made a finding that the directors violated the insider trading provisions of the Revised Securities Act, i.e. Sections 30[13] and 36,[14] when they heavily traded Interport Resources Corp. shares

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[11] SEC v. Interport Resources Corp., G.R. No. 135808, 567 SCRA 354, Oct. 6, 2008.

[12] *Id.*

[13] "Section. 30. *Insider's duty to disclose when trading.* – (a) It shall be unlawful for an insider to sell or buy a security of the issuer, if he knows a fact of special significance with respect to the issuer or the security that is not generally available, unless (1) the insider proves that the fact is generally available or (2) if the other party to the transaction (or his agent) is identified, (a) the insider proves that the other party knows it, or (b) that other party in fact knows it from the insider or otherwise.

(b) 'Insider' means (1) the issuer, (2) a director or officer of, or a person controlling, controlled by, or under common control with, the issuer, (3) a person whose relationship or former relationship to the issuer gives or gave him access to a fact of special significance about the issuer or the security that is not generally available, or (4) a person who learns such a fact from any of the foregoing insiders as defined in this subsection, with knowledge that the person from whom he learns the fact is such an insider.

(c) A fact is 'of special significance' if (a) in addition to being material it would be likely, on being made generally available, to affect the market price of a security to a significant extent, or (b) a reasonable person would consider it especially important under the circumstances in determining his course of action in the light of such factors as the degree of its specificity, the extent of its difference from information generally available previously, and its nature and reliability.

(d) This section shall apply to an insider as defined in subsection (b) (3) hereof only to the extent that he knows of a fact of special significance by virtue of his being an insider."

[14] "Section 36. *Directors, officers and principal stockholders.* – (a) Every person who is directly or indirectly the beneficial owner of more than ten per centum of any [class] of any equity security which is registered pursuant to this Act, or who is [a] *director or an officer* of the issuer of such security, shall file, at the time of the registration of such security on a securities exchange or by the effective date of a registration statement or within ten days after he becomes such a beneficial owner, director or officer, a statement with the Commission and, if such security is registered on a securities exchange, also with the exchange, of the amount of all equity securities of such issuer of which he is the beneficial owner, and within ten days after the close of each calendar month thereafter, if there has been a change in such ownership during such month, shall file with the Commission, and if such security is registered on a securities exchange, shall also file

utilizing material insider information on the approval of the purchase of a corporation which would assume a five-year power-purchase contract with the National Power Corp. The issue, elevated to the Supreme Court in 2008, however, was not whether the directors were guilty of insider trading, but whether Sections 30 and 36 of the Revised Securities Act required the enactment of implementing rules to make them binding and effective. The Supreme Court ruled that the lack of ambiguity in the said provisions rendered implementing rules unnecessary and proceeded to discuss the elements of insider trading, without making any ruling on whether any violation was committed.

The BW Resources Corp. shares controversy that occurred in the years 1999 and 2000 caused the passage of the SRC.[15] Dante Tan was a major stockholder of BW Resources Corp., which announced its intention to put up several casinos, to be managed by Stanley Ho, a casino mogul from Macau. Tan heavily traded BW shares causing market prices to increase from PHP 2 to PHP 107 per share. When the plan did not push through due to opposition from various sectors, market prices suddenly dropped, which the public perceived to have caused the stock market crash. Although the case against Dante Tan[16] did not prosper as the Supreme Court ruled in favor of Tan's Demurrer to Evidence, market manipulation and insider trading gained public attention, leading to the passage of stringent provisions in the SRC.

III. THE DEVELOPMENT OF INSIDER TRADING LAWS IN THE UNITED STATES

The enactment of the US Securities Exchange Act of 1933 and 1934 was a result of numerous cases involving abuse of confidential information by insiders that were litigated in the US courts. This is in sharp contrast to the situation in the Philippines, where a dearth in explicit rules and applicable jurisprudence prevails despite the enactment of the SRC in 2000.

The insider trading provisions in the SRC were based on the US Securities Exchange Acts of 1933 and 1934, which addressed insider trading both directly[17] and indirectly.[18] These laws prohibit the unfair use of insider

with the exchange, a statement indicating his ownership at the close of the calendar month and such changes in his ownership as have occurred during such calendar month."

[15] Financemanila, Flashback: the BW Controversy, *at* http://www.financemanila.net/2008/07/flashback-the-bw-controversy.

[16] People v. Tan, G.R. No. 167526, 625 SCRA 388, Jul. 26, 2010.

[17] 15 U.S.C. § 78p (b).

[18] 15 U.S.C. § 78j (b).

information by directors, officers, and other insiders, making two acts unlawful, namely: (1) gaining short-swing profits, and (2) insider trading. The same prohibitions were adopted in the SRC.

Court decisions varied in applying common law fraud to insider trading, particularly as regards the first element. Two major doctrines were formulated based on the rulings of the courts, which were later known to be the *majority rule* and the *minority rule.* The majority rule entailed that the insider had no obligation to disclose nonpublic information, so intentional misrepresentation had to be proved to hold him liable. The minority rule, on the other hand, created a fiduciary duty between the insider and the shareholders such that non-disclosure would be a violation of this duty amounting to fraud.

In 1909, the US Supreme Court established the "special-facts rule" in *Strong v. Repide,* which entailed that, although the director may not be under the obligation of a fiduciary nature to disclose to a shareholder his knowledge affecting the value of shares, such duty may exist by reason of special circumstances showing that the director unfairly took advantage of the shareholder.[19]

After the passage of the US Securities Exchange Act, three general theories were used in interpreting insider trading liability under SEC Rule 10(b): (1) the classical theory, (2) the tipper-tippee theory, and (3) the misappropriation theory.[20]

Under the *classical theory,* the applicability of SEC Rule 10(b) was strictly limited to insiders who obtained confidential information by reason of their position with a particular corporation. They, therefore, had the fiduciary duty to disclose the information to the public or abstain from trading to avoid taking unfair advantage of uninformed stockholders. In the 1980 case of *Chiarella v. US,*[21] the accused was an employee of a financial printer engaged by certain corporations to print corporate takeover bids. The accused deduced the identities of the target corporations and without disclosing the information to the public, bought shares in the same with the expectation of selling them at a profit when the stock market prices would rise after the takeover plans were made public. The US Supreme Court ruled that such conduct did not constitute a violation of SEC Rule 10(b) because the liability under the provision does not

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[19] HENRY MANNE, INSIDER TRADING AND THE STOCK MARKET 17-23 (1966).

[20] Bradley Bondi & Steven Lofchie, *The Law of Insider Trading: Legal Theories, Common Defenses and Best Practices for Ensuring Compliance,* 8 N.Y.U. J. L. & BUS. 151 (2012).

[21] 445 U.S. 222, 100 S. Ct. 1108, 63 L. Ed. 2d 348 (1980).

arise from the mere possession of nonpublic market information, but is premised upon an affirmative duty to disclose the information. The accused had no such duty because he was not a corporate insider and did not receive the confidential information from the target corporations or from any of its insiders. It was also held that no duty arose from accused's relationship with the sellers of the target corporations' securities, for he had no prior dealings with them, was not their agent, was not a fiduciary, and was not a person in whom the sellers had placed their trust and confidence.

The *tipper-tippee theory,* on the other hand, was used in resolving the 1982 case of *Dirks v. Securities and Exchange Commission.*[22] The accused, an officer of a broker-dealer, became a "tippee" when he received information from an insider—the "tipper"—with regard to fraudulent transactions in the issuing corporation. He relayed this information to his clients, who in turn sold their shares in the issuing corporation, causing the stock prices to drop considerably. The US Supreme Court ruled that a tippee can only be held liable for insider trading under SEC Rule 10(b), if he received the information improperly, i.e. that the tipper-insider breached his duty under the classical theory and disclosed the corporate information for the improper purpose of exploiting it for personal gain. Another element is that the tippee knows or should know that there has been a breach. In this case, the tipper was motivated by a desire to expose the fraudulent transactions in the issuing company. Hence, in the absence of a breach of duty to shareholders by the insiders-tippers, there was no derivative breach by the accused.

Finally, under the *misappropriation theory,* the US Supreme Court, in deciding the 1997 case of *US v. O'Hagan,*[23] ruled that an outsider may be held liable under SEC Rule 10(b) when he misappropriates confidential information for securities trading purposes, in breach of a duty owed to the source of the information. Such liability is premised on the breach of the outsider's fiduciary duty to those who entrusted him with access to the confidential information. The classical theory, in effect, was made to apply not only to officers, directors, and other permanent insiders of a corporation, but also to attorneys, accountants, consultants, and others who temporarily become fiduciaries of a corporation.

The misappropriation theory presently applies in both the US and the Philippines. The US SEC amended Rule 10(b) in October 23, 2000 to

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[22] 463 U.S. 646 (1983).

[23] 521 U.S. 642, 117 S. Ct. 2199 (1997).

incorporate the theory, while the Philippines adopted it in Section 27 of the SRC.

IV. INSIDER TRADING LAWS IN THE PHILIPPINES

The SEC issued the Amended Implementing Rules and Regulations of the SRC on December 30, 2003. However, the Rules, aside from extending insider-trading liability under Section 27 to registered persons—i.e. broker-dealers, licensed salesmen, and associated persons[24]—are bereft of any provision with regard to the offenses involving short-swing profits and insider trading. The elements of the offenses are, therefore, solely based on the provisions of the SRC, namely Sections 23.2 and 27.

A. Short-Swing Profits

To prevent officers and directors from gaining from the short-range market effects of corporate news or events, normally known to them before announcements are made to the public, they are prohibited from buying and selling the shares of the corporation within a period of six months.[25] Under Section 23.2 of the SRC, insiders are prohibited from making short-swing profits, irrespective of intent to abuse confidential information on the issuer. As long as the following elements are present, an insider may be held liable:

1. There is a "purchase and sale" or "sale and purchase" of equity security of the issuer within any period of less than six months.

2. The person who purchased or sold or sold and purchased the securities has a relationship with the issuer by being (a) the beneficial owner of more than 10% of any class of the any of its equity security, provided that he is such both at the time of the purchase and sale, or the sale and purchase; its (b) director; or (c) officer.

3. The person is not a dealer holding such securities in an investment account in the ordinary course of his business and incident to the establishment or maintenance by him of a primary or secondary market for such security.

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[24] Amended Implementing Rules and Regulations of the Securities Regulation Code, SRC Rule 30.2 (B)(vi)(3) (2004).

[25] LOUIS LOSS, MULTINATIONAL APPROACHES – CORPORATE INSIDERS 17 (1975).

4. Such security was not (a) acquired in good faith and (b) in connection with a debt previously contracted.

5. Profit is realized from the purchase and sale or sale and purchase.[26]

B. Insider Trading

Insider trading is the trading of a corporation's stock or other securities (e.g. bonds or stock options) by individuals with potential access to material nonpublic information about such corporation.[27] It involves trading by those in a position to use privileged information about factors affecting the market value of securities before that information is made known to outside investors and the general public.[28]

Under Section 27 of the SRC, the following acts by insiders, while in possession of material nonpublic information, are unlawful:

1. To sell or buy a security of the issuer (*insider trading per se*); and

2. To communicate material nonpublic information about the issuer or the security to any person knowing or having reason to believe that such person will likely buy or sell a security of the issuer while in possession of such information (*unlawful tipping*).

In *insider trading per se* the following elements must concur:

1. An insider sells or buys a security of the issuer while in possession of material nonpublic information with respect to the issuer of the security.

2. The insider fails to prove that:

    a. That the information was not gained from his relationship with the issuer; or

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[26] Rep. Act No. 8799, § 23 (2000).

[27] EFREN VINCENT DIZON, SECURITIES REGULATION CODE 182 (2011).

[28] INGO WALTER, THE SECRET MONEY MARKET: INSIDE THE DARK WORLD OF TAX EVASION, FINANCIAL FRAUD, INSIDER TRADING, MONEY LAUNDERING, AND CAPITAL FLIGHT 100 (1990).

b. If the other party selling to or buying from the insider (or his agent) is identified, (i) that he disclosed the information to the other party, or (ii) that he had reason to believe that the other party otherwise is also in possession of the information.[29]

The purchase or sale covered by *insider trading per se* is that made by the insider, or such insider's spouse or relatives by affinity or consanguinity within the second degree, legitimate or common-law.[30]

The SRC defines "insider" as (a) the issuer; (b) a director or officer (or any person performing similar functions) of the issuer or a person controlling the issuer; (c) a person whose relationship or former relationship to the issuer gives or gave him access to material information about the issuer or the security that not generally available to the public; (d) a government employee, director, or officer of an exchange, clearing agency and/or self-regulatory organization who has access to material information about an issuer or a security that is not generally available to the public; or (e) a person who learns such information by a communication from any forgoing insiders.[31] In addition, the SRC provides that once the insider commits unlawful tipping, the "tippee" by virtue of the communication, likewise becomes an insider.[32]

Information is defined as "material nonpublic" if: (a) it has not been generally disclosed to the public and would likely affect the market price of the security after being disseminated to the public and the lapse of a reasonable time for the market to absorb the information; or (b) would be considered by a reasonable person important under the circumstances in determining his course of action whether to buy, sell or hold a security.[33]

A presumption was created by the SRC as proof that the sale or purchase was made *while in possession of the material nonpublic information.* Section 27.1 provides that the sale or purchase by the insider or his relative shall be presumed to have been effected while in possession of material nonpublic information if transacted after such information came into existence, but prior to the dissemination of such information to the public and the lapse of a reasonable time for market to absorb such information. To rebut this

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[29] Rep. Act No. 8799, § 27.1 (2000).
[30] § 27.1.
[31] § 3.8.
[32] § 27.3.
[33] § 27.2.

presumption, the insider must prove "that he was not aware of the material nonpublic information at the time of the purchase or sale."[34]

V. CONSTITUTIONALITY OF THE STATUTORY PRESUMPTION OF INSIDER TRADING

A. Statutory Criminal Presumptions in the Philippines

Statutory criminal presumptions were developed to aid prosecutors in building their cases in circumstances where they would otherwise be unable, or find it difficult, to do so.[35] Presumptions aid reasoning and argumentation, assuming the truth of some facts upon proof of other facts. Presumptions are created based on general human experience, or probability of any kind, or merely on policy and convenience.[36]

An expected and, in fact, often-raised criticism against these legislatively-created presumptions in the Philippines is that they may violate other fundamental statutory and constitutional principles such as the presumption of innocence[37] and the reasonable doubt standard[38] in criminal cases.

A look at pertinent Philippine laws and jurisprudence would reveal that the creation of statutory criminal presumption—though broad and generally within the prerogative of Congress—is not without limitations.

For instance, the Anti-Fencing Law of 1979 made buying, receiving, possession, keeping, acquisition, concealment, and sale or disposition of stolen properties unlawful.[39] The elements of "fencing" under this law are: (1) a robbery or theft has been committed; (2) the accused, who took no part in the robbery or theft, "buys, receives, possesses, keeps, acquires, conceals, sells or disposes, or buys and sells, or in any manner deals in any article or object taken" during that robbery or theft; (3) he knows or should have known that the thing was derived from that crime; and (4) he intends by the deal he makes to gain for

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[34] § 27.1.

[35] N. Huntley Holland & Harvey Chamberlin, *Statutory Criminal Presumptions: Proof Beyond a Reasonable Doubt?*, 7 VAL. U. L. REV. 148 (1973).

[36] *Id.*, *citing* J. THAYER, A PRELIMINARY TREATISE ON EVIDENCE AT THE COMMON LAW 314 (1898).

[37] CONST. art. III, § 14 (2).

[38] RULES OF COURT, Rule 133, § 2.

[39] Pres. Dec. No. 1612, § 2 (1979).

himself or for another.[40] Under the law, the third element is presumed from the fact that the accused has possession of the thing stolen.[41]

This presumption was made an issue in *Dizon-Pamintuan v. People*.[42] In this case, the accused was charged with the violation of the Anti-Fencing Law in willfully, unlawfully and knowingly buying and keeping in her possession and/or selling or disposing of one set of earrings, a ring studded with diamonds in a triangular style, one set of diamond-studded earrings, and one diamond-studded crucifix, valued at PHP 105,000 in total, which she knew or should have known to have been derived from the crime of robbery committed by another person.

The first, second, and fourth elements of fencing were duly established. It was sufficiently proven by evidence presented by the prosecution that a robbery was committed in the house of the private complainants. The items were later seen displayed for sale at a stall tended to by the accused. The Court noted that the public display of the articles for sale clearly manifested intent to gain on the part of the accused.

An issue resolved by the Court then was whether the prosecution proved the existence of the third element: that the accused knew or should have known that the items recovered from her were the proceeds of the crime of robbery or theft. The Court ruled that the third element of *knowledge* is presumed from the proven fact of *possession*. The Court, citing *US v. Luling*,[43] further stated that "the presumption is reasonable for no other natural or logical inference can arise from the established fact of her possession of the proceeds of the crime of robbery or theft."

In another case, *People v. Mingoa*,[44] the accused was charged with malversation of public funds—punishable under the Revised Penal Code[45]—

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[40] Dimat v. People, G.R. No. 181184, 664 SCRA 220, 222, Jan. 25, 2012, *citing* Tan v. People, G.R. No. 134298, 313 SCRA 220, 229, Aug. 26, 1999.

[41] Pres. Dec. No. 1612, § 5 (1979).

[42] G.R. No. 111426, 234 SCRA 63, Jul. 11, 1994.

[43] 34 Phil. 725 (1916).

[44] 92 Phil. 856 (1953).

[45] REV. PEN. CODE, art. 217. "*Malversation of public funds or property; Presumption of malversation.* — Any public officer who, by reason of the duties of his office, is accountable for public funds or property, shall appropriate the same or shall take or misappropriate or shall consent, through abandonment or negligence, shall permit any other person to take such public funds, or property, wholly or partially, or shall otherwise be guilty of the misappropriation or malversation of such funds or property, shall suffer:

1. The penalty of prision correccional in its medium and maximum periods, if the amount involved in the misappropriation or malversation does not exceed two hundred pesos.

having been found short in his accounts as officer-in-charge of the office of the municipal treasurer and unable to produce the missing funds, amounting to PHP 3,938, upon demand by the provincial auditor. He explained to the examining officer that some days before, he had, by mistake, put the money in a large envelope which he took with him to a show, and that he forgot it on his seat and was no longer there when he returned. He did not, however, testify in court or present any evidence in his favor.

The accused contended that in the absence of direct evidence of actual misappropriation, the trial court convicted him based on mere presumptions—that is, presumptions of criminal intent in losing the money under the circumstances alleged and presumptions of guilt from the mere fact that he failed, upon demand, to produce the sum lacking. The first presumption was held to be irrelevant, but as to the second, the same was authorized by Article 217 of the Revised Penal Code.

In said decision, the Supreme Court stated that in a long line of cases,[46] the Court has adopted the view that:

> [T]he legislature may enact that when certain facts have been proven they shall be *prima facie* evidence of the existence of the guilt of the accused and shift the burden of proof provided there be rational connection between that facts proven and the ultimate fact presumed so that the inference of the one from proof of the others is not unreasonable and arbitrary because of lack of connection between the two in common experience.[47]

The *presumed fact* is that the officer embezzled the funds or property entrusted to his custody, and the presumption is made to arise from the *proven fact* that he received them and yet failed to have them forthcoming upon proper demand. The Court held:

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2. The penalty of prision mayor in its minimum and medium periods, if the amount involved is more than two hundred pesos but does not exceed six thousand pesos.

3. The penalty of prision mayor in its maximum period to reclusion temporal in its minimum period, if the amount involved is more than six thousand pesos but is less than twelve thousand pesos.

4. The penalty of reclusion temporal, in its medium and maximum periods, if the amount involved is more than twelve thousand pesos but is less than twenty-two thousand pesos. If the amount exceeds the latter, the penalty shall be reclusion temporal in its maximum period to reclusion perpetua."

[46] US v. Tria, 17 Phil. 303 (1910); US v. Luling, 34 Phil. 725 (1916); People v. Merilo, G.R. No. 3489, Jun. 28, 1951.

[47] People v. Mingoa, 92 Phil. 856, 859 (1953).

> [T]he fact presumed is but a natural inference from the fact proved, so that it cannot be said that there is no rational connection between the two. Furthermore, the statute establishes only a *prima facie* presumption, thus giving the accused an opportunity to present evidence to rebut it. The presumption is reasonable and will stand the test of validity laid down in the above citations.[48]

Thus, the insider trading provisions, being penal in nature, should likewise stand the same test of validity.

B. Statutory Presumptions in the Insider Trading Provision

In an international securities law conference on insider trading in which the US and certain European countries participated in 1975, the use of statutory presumptions in insider trading provisions was discussed with disfavor.[49] This, perhaps, is because such use goes against the original conception of insider trading liability as common law fraud, where intentional misrepresentation or *scienter* was an essential element. The use of statutory presumptions effectively makes proof of such intentional misrepresentation unnecessary.

Professor Loss, who served as Associate General Counsel for the US SEC, opined that criminal sanctions should not be used as a financial regulatory tool, and should only be pursued in egregious cases of abuse of confidential information.[50] This must be balanced, however, with the inevitable difficulty of proving actual misuse of material nonpublic information. An insider can always claim that he traded not on such information, but on his own analysis of the price movements in the stock market. For this reason, it is the extent of the presumptions, such that it does not violate the constitutional right to be presumed innocent and the reasonable doubt standard in criminal cases, which must be considered.

In cases of short-swing profits, the presumption is that an insider who trades within a six-month period does so to take advantage of confidential corporate news. There is only one instance in which an insider can avoid liability. The Philippines adopted the defense in the US Securities Exchange Act of 1934, i.e. unless the insider acquired such security in good faith and in connection with a debt previously contracted.[51] The insiders are, therefore, fairly apprised of the prohibited act and can raise a defense that can be proved. Although Section 23.2

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48 *Id.*

49 LOSS, *supra* note 25, at 88, 95, 222, 241.

50 *Id.* at 222.

51 Rep. Act No. 8799, § 23.2 (2000).

of the SRC has not, as of this writing, been held unconstitutional, two legal issues that may affect the interpretation and validity of this provision are worth discussing, namely: (1) the definitions of "purchase" and "sale," and (2) the standard for the defense of "unless such security was acquired in good faith in connection with a debt previously contracted."

As to the first, the definition of "purchase" in the US Code includes any contract to buy or *otherwise acquire* and "sale," any contract to sell or *otherwise dispose such shares.*[52] Thus, an agreement for exchange of stock at a future time would be considered as a purchase or sale for the purpose of determining an insider's liability for short-swing profits. There is no similar definition in the SRC or its Implementing Rules and Regulations. It is, then, arguable whether or not an acquisition or disposition of shares pursuant to an "Agreement for Exchange of Stock" is covered by Section 23 (b) of the SRC. In the US case of *Booth v. Varian Associates*,[53] the agreement entered into in 1959 was for Booth to give his Bomac shares to Varian Associates in exchange for shares of the latter. The number of Varian shares would be that totaling a value of USD 2,000,000 based on the closing price on June 28, 1962. Booth sold the Varian shares within six months after the exchange. In rejecting Booth's argument that the "purchase date" was in 1959 and not in 1962, the US Court of Appeals First Circuit ruled:

> On the other hand, the assumption of June 1962 as the date of "purchase" would be more consonant with the statute. For one thing, only on that date did the insiders know the amount of how much stock they were to receive and the price of each share, generally critical information for those whose potential profit from speculation is based upon an advantageous sale. Second, from an investment standpoint, appellants had no position in Varian during the three and one-half years interval between January 1959 and June 1962. Their investment position did not arise until the exchange ratio was fixed, no earlier than the close of the stock market on June 28, 1962. When they sold on the market later in 1962, their profits, in point of fact, were attributable to only a short term investment in appellee's stock. Third, a "purchase" made on June 28, 1962, followed by a sale within six months will be easily susceptible to enforcement.[54]

The same issue may arise in cases wherein securities are acquired by the exercise of stock options; such as in the case of corporate officers who are given incentives in the form of stock options and sell the shares within six months from the date of exercise, or a stockholder's conversion of preferred shares to

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[52] 15 U.S.C. §§ 78c (a) (13)-(14).

[53] 334 F.2d 1 (1st Cir. 1964).

[54] *Id.*

common shares. In the case of stock options, the date of purchase may also be an issue. Generally, the date of acquisition is the date of exercise, but it may likewise be argued that it should be the date of grant or the date when the options are exercisable.[55]

It may be unfair to apply these rulings in the Philippines at present because of the lack of similar definitions of "purchase" or "sale" in the SRC. However, the danger that insiders may take advantage of this situation is apparent and, as such, amendments in the law and rules may be necessary.

Second, as to the defense that the shares were acquired in good faith in connection with a debt previously contracted, *Rheem Manufacturing v. R.S. Rheem*[56] is a case wherein the exemption was held to be applicable by the US Court of Appeals. Rheem was a director of the company and was entitled to his share in the company's retirement fund. He made arrangements for shares of stock in the company to be issued in his favor instead of receiving cash. He then pledged the securities to a bank, which later liquidated such shares. The bank ordered the liquidation within six months from the issuance of the shares. The US Court of Appeals Ninth Circuit ruled that Rheem acquired the said shares in good faith in connection with a debt previously contracted between Rheem and the company, ruling that:

> Here there was an obligation to pay a fixed sum certainly and at all events, existing prior to and apart from the settlement of the obligation by the transfer of stock, which we are persuaded determines the existence of "a debt previously contracted" within the meaning of the statute. This phrase is thus complementary to the requirement of good faith. It gives further assurance that inadvertent profits at the expense of unconsulted shareholders will not be made on a regularly recurring basis, as would be the case with many otherwise uncontrolled bonus and option plans. Yet, it makes possible the one-shot settlement of matured debts in any manner the parties in good faith may choose.[57]

The same standard may be used in case a violation involving short-swing profits is filed before the Philippine courts.

In case of insider trading, the statutory presumption that the insider unfairly used material nonpublic information is rebuttable, but the

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[55] HAROLD BLOOMENTHAL, SECURITIES LAW 376 (1966).
[56] 295 F.2d 473 (1961).
[57] *Id.*

constitutionality of such is questionable. The crux of the prohibition under Section 27 of the SRC is the buying or selling of securities by an insider while in possession of material nonpublic information. A rebuttable presumption of the element of "while in possession of material nonpublic information" is established if the insider transacted after such information came into existence, but prior to dissemination of such information to the public and the lapse of a reasonable time for the market to absorb such information.

A reading of the provision would suggest that the mere existence of material nonpublic information gives rise to a statutory presumption as to the two elements of the offense: (1) that the director, officer, or controlling shareholder of the issuer *was aware* of the material nonpublic information; and (2) that he bought or sold the securities *while in possession* of such information. As a result, there would be no necessity on the part of the SEC to prove that the insider was, in fact, "aware" of such information. How an insider rebuts the presumption would depend on whether or not he was aware of the material nonpublic information.

If an insider was, in fact, aware of the material nonpublic information at the time of transaction, the provision may be constitutional as to him. He may raise a valid defense that the information was not gained by virtue of his relationship with the issuing corporation,[58] or that the other party he transacted with was likewise in possession of such information.[59]

However, if an insider was not aware of any material nonpublic information, these defenses are inapplicable. The only defense available to him is to prove that he was not aware of such information. The difficulty or even impossibility of proving a negative fact, lack of awareness, renders the presumption unconstitutional. The burden is shifted to the insider to prove his innocence.

As a defense, an insider may allege that, by the nature of his position in the corporation, he had no access to the nonpublic information. The law, however, does not provide that such defense is adequate to rebut the presumption. Moreover, it should be the burden of the prosecution to establish possession by the insider of the nonpublic information—either by direct evidence that the latter had knowledge, or that by reason of his functions in the company, he could not have been unaware of the information—and not the other way around.

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[58] Rep. Act No. 8799, § 27.1 (a) (2000).
[59] § 27.1 (b).

If the insider would have had access to the nonpublic information, but, in fact, did not have knowledge of the same, he may allege that he was not aware of such information. This, however, is easier said than proved. If an officer, for instance, was on leave from his position and on vacation in another country at the time he traded the shares, would this be sufficient to establish that he was not aware of the material nonpublic information at the time of the transaction? He might have received the information from an employee through a phone call or an email and traded on the basis of such. Would the SEC be justified to presume that the insider received the information by any means if the latter was not physically present in the Philippines? On the other hand, if the insider was, in fact, not aware of the information and traded his shares in good faith, would he likewise need to prove that no such correspondence occurred in order to rebut the presumption?

Since the SEC need not prove that the insider was, in fact, in possession of such information, the latter, even if he never intended to commit an offense, is presumed guilty under a law that does not provide for a valid defense.

This presumption is made even more potent by the provision that treats the trades of the insider's spouse or relatives by affinity or consanguinity within the second degree, legitimate or common-law, as the insider's own transactions. A reading of the provision would suggest that it is not enough that the insider is not aware of the information because it is the purchaser or seller, i.e. the spouse or relative, who must lack awareness. To rebut the presumption against the insider, his spouse or relative would likewise need to prove that they were not aware of the information when the transaction was made.

In the US, the prohibited act is the purchase or sale of a security of any issuer "on the basis of" material nonpublic information. The insider trades "on the basis of" material nonpublic information if the insider was aware of the same when he made the purchase or sale.[60] It is, therefore, the duty of the US SEC to present evidence to prove that the insider was, in fact, aware of such information. The presumption is limited to the insider's "use" of the nonpublic information, which was proved to be in his possession. This was the ruling of the US Court of Appeals in *Securities and Exchange Commission v. Adler* wherein it was held that:

> We believe that the use test best comports with precedent and Congressional intent, and that mere knowing possession—i.e. proof

[60] General Rules and Regulations, Securities Exchange Act of 1934, § 240.10b5-1.

> that an insider traded while in possession of material nonpublic information—is not a per se violation. *However, when an insider trades while in possession of material non-public information, a strong inference arises that such information was used by the insider in trading.* The insider can attempt to rebut the inference by adducing evidence that there was no causal connection between the information and the trade—i.e. that the information was not used. The factfinder would then weigh all of the evidence and make a finding of fact as to whether the material non-public information was used.[61] (Emphasis supplied.)

It is posited herein that the statutory presumption in the Philippines should be modified. It should be clear in the law that possession of material nonpublic information is an essential element of the offense that needs to be proved by clear and sufficient evidence, i.e. by the presentation of documents or testimonies proving that the insider was, in fact, aware of and in possession of the information. Or, at the very least, it must be proved that by reason of his functions on the company, he could not have been unaware of such information. It is only from this established fact from which an insider's abuse of such information should be presumed.

Another issue that may affect the constitutionality of Section 27 is the vagueness of the element of the offense that the information abused by the insider is nonpublic. Under the SRC, information is nonpublic when (1) it has not been generally disclosed to the public, and (2) there is lapse of a reasonable time for the market to absorb the information.[62]

In *Securities and Exchange Commission v. Interport Resources Corp.*, the Supreme Court ruled that material information is nonpublic when it is not "generally available," which was defined as:

> *Generally Available* – Section 30 of the Revised Securities Act allows the insider the defense that in a transaction of securities, where the insider is in possession of facts of special significance, such information is "generally available" to the public. *Whether information found in a newspaper, a specialized magazine, or any cyberspace media be sufficient for the term "generally available" is a matter which may be adjudged given the particular circumstances of the case.* The standards cannot remain at a standstill. A medium, which is widely used today was, at some previous point in time, inaccessible to most. Furthermore, it would be difficult to approximate how the rules may be applied to the instant case, where investigation has not even been started. Respondents failed to allege

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[61] 137 F.3d 1325, 1338 (11th Cir. 1998).

[62] Rep. Act No. 8799, § 27.2 (2000).

that the negotiations of their agreement with GHB were made known to the public through any form of media for there to be a proper appreciation of the issue presented.[63] (Emphasis supplied)

The Revised Securities Act was in still in effect when the cause of action in this case arose. If this definition is held to be applicable to the term "generally disclosed to the public" under Section 27 of the SRC, then a standard should be set as to which media can be held to be far-reaching enough for the information to be generally available or disclosed to the public.

Would there be a need to set up an official SEC website for such information, or would a simple post in a social networking site suffice to make it public? Although it is true that the issue can be resolved by the courts given the particular circumstances of each case, this will not protect insiders from possible prosecution. An insider's judgment as to this matter may—and will most likely—differ from that of the SEC.

In the US, its SEC did not define "nonpublic" in its Implementing Rules, but instead relied on the existing definition in case law. Case law, however, is vague as to what constitutes sufficient disclosure to make certain information public.[64] In *Securities and Exchange Commission v. Texas Gulf Sulfur Co.*, the US Court of Appeals Second Circuit ruled that information became public when it appeared on the Dow Jones broad tape, and not when a press conference was held.[65] In *DuPont Forgan, Inc. v. Arnold Bernhard & Co.*, it was held that the publication in Reuter Financial Report rendered the information public, even if it was not published in the Wall Street Journal until three days after.[66]

In the Philippines, the SEC may require the PSE to provide for a similar announcement feature in the trading platform. However, since most individual investors do not have access to such platform and, generally, transact by way of brokers, other modes may complement this system, such as announcements through an official website.

Even more problematic is the definition of "lapse of a reasonable time for the market to absorb the information." There is no mention of this phrase in

[63] G.R. No. 135808, 567 SCRA 354, 386-387, Oct. 6, 2008.
[64] US Securities and Exchange Comm'n, *Selective Disclosure and Insider Trading, at* http://www.sec.gov/rules/final/33-7881.htm.
[65] Robert Prentice, *The Internet and Its Challenges for the Future of Insider Trading Regulation*, 12 HARV. J. L. & TECH. 263, 272 (1999).
[66] *Id.* at 273.

the implementing rules of the SRC. How would the amount of reasonable time to absorb such information be set?

The same problem still exists in the US. Although this requirement is not found in US laws or rules, case law provides that it is not enough that the information is disseminated; the market should likewise have the opportunity to absorb it.[67] Supreme Court rulings vary as to the amount of time after disclosure which would be sufficient for market absorption—ranging from 15 minutes after its appearance on the broad tape, to nine days after a press conference.[68]

To prevent this problematic situation in the Philippines, the SEC is in the best position to determine how much time would be sufficient for the Philippine investing public to absorb material information. It could be a definite number of days, such as two full trading days, or a particular standard to determine such time. For instance, Professor Prentice discussed the most widely accepted form of Efficient Market Hypothesis, which may be used as a standard:

> It seems apparent only in the absence of evidence that the information has been incorporated into the issuer's stock price should there be a detailed analysis of whether there has been adequate dissemination and time or absorption. If the market price has fully incorporated the information and reflected it in a change in the company's stock price, the information should be viewed as "public"—end of inquiry.[69]

In such case, the insiders would be able to gauge when their liability to disclose or abstain from trading arises.

VI. THE EFFECT OF PHILIPPINE PRIVACY LAWS ON THE POWER OF THE SEC TO PROSECUTE CASES

A. Monitoring and Investigation of Suspicious Trading

The SEC is the quasi-judicial agency of the government tasked to implement the policy set forth in the SRC. All cases on insider trading filed with the Philippine courts are initiated by the SEC. The PSE, however, has the capacity to gather data and monitor trades, which may lead to the investigation of possible violations of insider trading. The PSE has a computerized trading

[67] *Id.* at 269.
[68] *Id.* at 276.
[69] *Id.* at 278.

platform that must be utilized by stockbrokers in entering into transactions for themselves or on behalf of their clients. All trades, therefore, are reflected in the said system in the name of the broker through whom the investor coursed his trades.

In cases of insider trading, investigations are usually prompted by unusual changes in the market prices or the volume of trades in relation to a certain security. In the absence of any complaint or tip from an investor or any other person or a market crash, as in the case of the BW shares, investigations of insider trading are usually initiated after surveillance conducted by the Surveillance Department of the PSE. In case violations are proven to have been committed, sanctions are imposed by the Market Regulation Department ("MRD").[70] In February 2012, the SEC approved the application of the Capital Markets Integrity Corporation ("CMIC"), an independent entity, to operate as self-regulatory organization ("SRO") and to take over the regulatory function of the PSE.

In relation to any investigation of an activity that the CMIC wants to pursue, stockbrokers may be required to submit information to aid such investigation.[71] If the broker fails to justify why it should not be held liable for violations of the SRC and the PSE Rules, the CMIC may impose fines and other penalties, in accordance with the rules issued by the PSE and the CMIC.[72] In order for any administrative, civil, or criminal liability under the SRC to be enforced against the stockbrokers and its officers and traders, or investors, the investigation will have to be forwarded to the SEC.

The SEC's Compliance and Enforcement Division conducts monitoring and surveillance of unusual trading activities. It may either initiate the investigation by gathering information from the PSE and the brokers, or pursue the findings initially made by the CMIC.

The criminal liability for short-swing profits and insider trading violations are provided for in the SRC:

> SEC. 73. Penalties. - Any person *who violates any of the provisions of this Code*, or the rules and regulations promulgated by the Commission under authority thereof, or any person who, in a registration statement filed under this Code, makes any untrue statement of a material fact *or*

[70] Philippine Stock Exchange Compliance & Surveillance Rules, art. IX, § 1.
[71] Capital Markets Integrity Corporation Rules, art. II, § 2 (2012).
[72] Art. XII, § 1.

> *omits to state any material fact required to be stated therein or necessary to make the statements therein not misleading*, shall, upon conviction, suffer a fine of not less than Fifty thousand pesos (P50,000.00) nor more than Five million pesos (P5,000,000.00) or imprisonment of not less than seven (7) years nor more than twenty- one (21) years, or both in the discretion of the court. If the offender is a corporation, partnership or association or other juridical entity, the penalty may in the discretion of the court be imposed upon such juridical entity and upon the officer or officers of the corporation, partnership, association or entity responsible for the violation, and if such officer is an alien, he shall in addition to the penalties prescribed, be deported without further proceedings after service of sentence. (Emphasis supplied.)

In the case of short-swing profits, the evidence gathered by the SEC would be adequate to prosecute a case. The SEC only needs to prove that the violator is an insider and that he bought and sold shares of the corporation within a six-month period. In case of insider trading, however, the sufficiency of the information gathered by the SEC would depend on the interpretation of Section 27.

If the presumption is that an insider used nonpublic material information by simply proving that such insider transacted after such information came into existence, but prior to the dissemination of such information to the public and the lapse of a reasonable time for the market to absorb the same, then the evidence gathered by the SEC would likewise suffice. However, if Section 27 is interpreted in favor of the constitutional right of the accused to be presumed innocent, then the SEC would need to prove by sufficient evidence that the insider had been, in fact, aware of such information at the time of transaction, similar to how the US SEC prosecutes insider trading cases.

In the Philippines, prosecution of insider trading cases may be made difficult by existing laws that protect privacy. Insiders and their accomplices need and, in fact, use privacy and financial secrecy laws to cover their tracks.[73] The right to privacy is a fundamental right, finding basis in the 1987 Constitution.[74] From such constitutional provision, other laws were enacted to afford more specific protections. Three laws that may hinder the SEC's power to prove that an insider was in possession of material nonpublic information and used it in violation of the SRC are the Anti-Wire-Tapping Law,[75] the Philippine

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[73] WALTER, *supra* note 28, at 106.
[74] art. III, § 2.
[75] Rep. Act No. 4200 (1965).

Law on Secrecy of Bank Deposits,[76] and the newly-enacted Data Privacy Act of 2012.[77]

In the US, telephone and bank records and personnel files are good sources of information in the conduct of insider trading investigations.[78] For instance, in the infamous insider trading case involving Boesky, Levine, and several other Wall Street personalities,[79] a probable arrangement between Boesky and the government may have been in place, which permitted the latter to record the business conversations of the former, which later led to the resolution of the case and the eventual conviction of the charged parties.[80] Without the recorded conversations, the other available evidence would have largely been circumstantial.

In the Philippines, the Anti-Wire-Tapping Law makes it unlawful for any person to tape or record any private conversation without the consent of all parties.[81] Moreover, the law prevents the use of taped conversations as evidence in litigation.[82] Although the law provides for exceptions,[83] the investigation and prosecution of insider trading cases is not among them. An amendment of the Anti-Wire Tapping Law may be necessary to enable the SEC to conduct thorough investigations that will include looking into telephone conversations between insiders, tippees, and other parties.

Bank secrecy laws may also hinder the process of gathering evidence. In the U.S. case involving Nahum Vaskevitch,[84] Swiss authorities granted an asset freeze, in the absence of which there would have been a reasonable likelihood that the subject funds would be secretly moved out of the U.S. to deprive its courts of jurisdiction, to the effect that no funds would be found to satisfy any final judgments in favor of the State.

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[76] Rep. Act No. 1405 (1955).

[77] Rep. Act No. 10173 (2012).

[78] L. Hilton Foster, *Securities and Exchange Commission - sources of information*, *at* http://www.sec.gov/about/offices/oia/oia_enforce/foster.pdf.

[79] Ivan F. Boesky, Dennis B. Levine, and Martin A. Siegel.

[80] James Sterngold, *Boesky Sentenced to 3 Years in Jail in Insider Scandal,* The New York Times, Dec. 19, 1987, *available at* http://www.nytimes.com/1987/12/19/business/boesky-sentenced-to-3-years-in-jail-in-insider-scandal.html?pagewanted=all&src=pm.

[81] Rep. Act No. 4200, § 1 (1965).

[82] §§ 1, 4.

[83] § 3.

[84] Securities and Exchange Comm'n v. Vaskevitch, 657 F.Supp. 312 (1987).

In the Philippines, if the SEC requests pertinent account information from banks in relation to suspicious transactions monitored and reported by the PSE, the Philippine Law on Secrecy of Bank Deposits will probably be invoked. The law treats all deposit accounts with banks as confidential in nature and only subject to examination with the consent of the depositor or upon a court order in certain circumstances.[85]

Lastly, the US SEC has opined that personnel files, which may be obtained from various sources such as employers and schools, may provide information that will *uncover connections between insiders and traders.*[86] However, this may not be feasible in the Philippines given the recent enactment of the Data Privacy Act of 2012, which makes retrieval and use of personnel files difficult, if not impossible, unless the person concerned gives his consent to such retrieval and use.[87]

VII. SUFFICIENCY OF CIVIL REMEDIES AVAILABLE TO THE SEC AND INVESTORS

A. The Right to Private Cause of Action

Undoubtedly, aside from—or even more than—the government, the issuing corporation, the shareholder who transacted with the insider, or the public, in general, would suffer from insider trading or short-swing profit transactions and, therefore, would be interested in filing an action against an offender.

In the case of short-swing profits, the SRC provides for a private cause of action to make the insider disgorge his profits. The issuing corporation may file a civil suit before the Regional Trial Court to recover any short-swing profits realized by the insider. In case the issuer refuses to file such action, any shareholder of the issuing corporation may file the action in the name and on behalf of the issuer "if the issuer shall fail or refuse to bring such suit within sixty (60) days after request or shall fail diligently to prosecute the same thereafter, but no such suit shall be brought more than two (2) years after the date such profit was realized."[88] In such case, the cause of action inures to the benefit of the corporation and not the stockholders or investors. Perhaps the reason for this is that in short-swing profit violations, the materiality of

[85] Rep. Act No. 1405, §§ 2, 3 (1955).
[86] Foster, *supra* note 78.
[87] Rep. Act No. 10173, §§ 3, 11, 12 (2012).
[88] § 23.2.

information is not an element of the offense. It merely prevents the unfair use by an insider of information obtained by him as an insider, whether or not such information is material. If the information were not material, it would likely not affect the market price of the security or be considered by a reasonable person as important in deciding to buy or sell the shares. Thus, it is the issuing corporation itself that is prejudiced by the insider's action, and not the investing public.

In the case of insider trading, the SRC provides that an investor who traded shares contemporaneously with the insider has the right to file a civil suit for damages.[89] The amount of damages shall not exceed triple the amount of the transaction, plus actual damages.[90] In the case of unlawful tipping, the tippee shall be jointly and severally liable with the insider-tipper.[91] The insider may avoid civil liability by proving that the plaintiff-investor knew the information or would have traded the shares at the same price regardless of disclosure.[92]

It may be argued that an implied private cause of action under Section 27 of the SRC may likewise be invoked, in relation to Articles 19, 20 and 21 of the Civil Code, although no such case has yet been filed in court. It is posited herein that the other remedies made available to investors in the U.S. should be considered, and that if found to be appropriate in order to protect the Philippine investing public, should be incorporated into the SRC.

In the US, the private cause of action pursued by an investor prejudiced by insider trading generally depends on whether the purchase or sale of shares was a face-to-face transaction or an anonymous open-market transaction.[93]

In the case of a face-to-face transaction, the implied right to a private cause of action under SEC Rule 10(b) would be an appropriate remedy because the element of loss causation can be proved. The Private Securities Litigation Reform Act of 1995 was enacted, providing that in any private action, the plaintiff-shareholder shall have the burden of proving that the act or omission of the defendant caused the loss for which the plaintiff seeks to recover damages.[94] The transaction is viewed as a contract; thus, the remedy of rescission and damages is provided for. This is more favorable to the investor because the

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[89] § 61.
[90] § 63.
[91] § 61.2.
[92] §§ 61, 63.1.
[93] LOSS, *supra* note 25, at 105.
[94] 15 U.S.C. § 78u–4 (b) (4).

damages to be recovered shall not be subject to the offsetting of damages paid to the US SEC under the US law on the remedy for contemporaneous traders, to be discussed below.

In the case of anonymous open-market transactions, a case may be filed on the basis of a private cause of action or as a derivative action as provided for in case law. The US Securities Exchange Act of 1934 was amended in 1988 to include a provision granting an express private right of action to contemporaneous traders.[95] This was adopted in the SRC except as to the computation of damages that the investor may recover. As to the remedy of a derivative suit, the Delaware Supreme Court ruled that such remedy was available to shareholders on behalf of the issuing corporation. In the 2011 case of *Kahn v. Kohlberg Kravis Roberts & Co., L.P.*,[96] it was held that the existence of harm to the corporation was not an element for a disgorgement equitable remedy to be available. The Court therein ruled that the focus of the prohibition against insider trading was to prevent a fiduciary wrongdoer from being unjustly enriched, and that there was no basis in case law to require such element. Although with a different justification, the same conclusion was reached by P. A. R. Brown and Nicholas S. Wilson, former officers of the Department of Trade in the United Kingdom: that insider trading may be viewed as the misuse by an insider of the intellectual property of a corporation. Since it is not the loss of the corporation that is compensated, but the improper use of the property of such corporation, a cause of action arises in its favor.[97]

In addition, there is the view that the implied right to private cause of action under SEC Rule 10(b) would also be an appropriate remedy in anonymous open-market transactions. In 1974, the US Court of Appeals Second Circuit ruled in *Shapiro v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*[98] that "the proper test to determine whether causation in fact has been established in a non-disclosure case is 'whether the plaintiff would have been influenced to act differently than he did act if the defendant had disclosed to him the undisclosed fact.'" In effect, even a contemporaneous trader could pursue the remedy because the loss causation need not be direct.[99]

Congress would need to determine if such remedies should be made available in the Philippines. In case remedies such as a suit for rescission and

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[95] 15 U.S.C. § 78t–1 (a).

[96] 23 A.3d 831, 842 (Del. 2011).

[97] LOSS, *supra* note 25, at 92, 170.

[98] 495 F.2d 228 (1974).

[99] Note, *Private Causes of Action for Option Investors Under the SEC Rule 10b-5: A Policy, Doctrinal, and Economic Analysis*, 100 HARV. L. REV. 1959 (1987).

damages or a derivative action are found to be favorable to the Philippine market, there should be clear and express guidelines in place so as to avoid the need to establish the same through a long line of cases, as in the US.

B. Civil Remedies Available to the SEC

As much as it is favorable for the Philippine stock market to provide for civil remedies to investors, it is undeniable that it is the SEC that has the power to investigate and gather information to prove short-swing profits and insider trading violations. It likewise has more resources to pursue insider-trading cases in court, compared to individual investors.

The SEC, pursuant to its power to impose sanctions for the violation of laws and rules and regulations,[100] issued Memorandum Circular No. 6, which provides for a scale of penalties imposable against registered persons; namely, broker-dealers, licensed salesmen, and associated persons.[101] The penalty imposed however, is administrative in nature, and has nothing to do with the profits gained from insider trading. In effect, the SEC has no right to recover the insider trading profits. The US Securities Exchange Act of 1934, on the other hand, provides that the SEC may bring an action against the insider to seek civil penalty, the amount of which shall not exceed three times the profit gained or USD 1,000,000.[102]

This remedy is not available under the SRC. If the SEC files a case against the insider, it would have to be a criminal case, wherein the imposable penalty is a fine ranging from PHP 50,000 to PHP 5,000,000 or imprisonment ranging from seven to 21 years, or both.[103] In case no contemporaneous trader files a civil case against an insider under Section 61 of the SRC, the latter's pecuniary liability would be limited to a maximum of PHP 5,000,000 even if he profited much more from the transaction.

However, the US recognized the unfairness of subjecting the insider to civil liability twice—first to the contemporaneous trader, and second to the SEC. For this reason, the US Securities Exchange Act of 1934 sets two limitations to the pecuniary liability of the insider to the contemporaneous trader; namely: (1) it shall not exceed the profit gained or loss avoided,[104] or the difference between

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[100] Rep. Act No. 8799, § 5(f) (2000).
[101] Securities and Exchange Comm'n, Memo. Circ. No. 6 (2013).
[102] 15 U.S.C. § 78u–1 (a).
[103] Rep. Act No. 8799, § 73 (2000).
[104] 15 U.S.C. § 78t–1 (b) (1).

the purchase or sale price of the security as measured by the market price within a reasonable period after the dissemination of nonpublic information,[105] and (2) it shall be reduced by any amount that the insider is ordered by the court to disgorge at the instance of the SEC.[106]

It is posited herein that providing the SEC with a civil remedy would be a more expedient way of making insiders disgorge their profits, given that a civil case only requires preponderance of evidence.

C. Computation of Penalty

In providing for a private right of action, the standard for computing the civil liability should likewise be clearly provided for to avoid excessive and arbitrary imposition against insiders.

In the case of short-swing profits, the amount of damages recoverable by the corporation is limited to the profit gained by the insider. The computation of the profit gained may become problematic if the total number of shares bought is not equal to the total number of shares sold (or vice versa) within the six-month period. The SEC may issue implementing rules to clarify the manner of computing the profit. Perhaps a "first-in, first-out" method could be used, such that a selling transaction is matched to the earliest buying transaction. The average buying price of all purchases within the six-month period may also be used in matching selling transactions. The SEC may likewise provide that the computation will be to the effect that maximum profit is used as a basis for the penalty to be imposed, i.e. buying transactions with the lowest purchase prices are to be matched to selling transactions. It is posited herein that what is important is that the insiders are fairly apprised as to the manner of computation.

In the case of insider trading, an insider's liability with respect to a contemporaneous trader is thrice the "amount of transaction" plus actual damages,[107] unlike in the US where the civil penalty is based on the "profit gained or loss avoided."[108] The term "amount of transaction" is not defined in the SRC or the implementing rules. In the absence of jurisprudence on the matter, it is not settled whether the purchase of the shares would be considered a transaction, and the sale of the same shares another transaction. In such case, if the shares were bought for PHP 1 million and then later sold for PHP 1.2

[105] 15 U.S.C. § 78u–1 (e).
[106] 15 U.S.C. § 78t–1 (b)(2).
[107] Rep. Act No. 8799, § 63 (2000).
[108] 15 U.S.C. § 78t–1 (b)(1).

million, the amount of transaction would be PHP 2.2 million. If the purchase and subsequent sale are to be considered a single transaction, then the SEC would need to clarify the basis for the amount of the transaction, whether it would be PHP 1 million or PHP 1.2 million.

It is likewise not clear how the awarded damages are supposed to be divided among contemporaneous traders. For instance, if an insider bought 1,000 shares and 10 other persons contemporaneously sold 1,000 shares, but only one contemporaneous trader files a civil suit, would he be allowed to recover thrice the "amount of transaction" from the insider even if that plaintiff-trader only sold 100 of the 1,000 shares contemporaneously sold? If a hundred traders contemporaneously sold 10,000 shares along with the 1,000 shares traded by the insider, should the total liability of the insider to all traders (who transacted a total of 10,000 shares) be limited to thrice the "amount of transaction," or would his liability be possibly extended to thrice the "amount of transaction" multiplied by a hundred?

These issues may be clarified by the judiciary when the proper cases are filed in the future. However, it would be better if the SEC, in exercising its power to implement the SRC, clarifies these issues by amending its rules.

VIII. CONCLUSION

The Philippines has yet to see an insider case completely decided on the merits. The SEC may have investigated several suspicious trading activities in the past, but we have yet to witness a conviction. Most cases of insider trading are settled with the SEC[109] and do not reach the courts. On the one hand, this might indicate that the Philippine stock market is fair and that no violations have actually been committed. But, on the other hand, this might be a strong indication that there is great difficulty in enforcing the law caused by one, several, or all of the issues herein discussed.

First, to ensure the constitutionality of Section 27 of the SRC, the presumption of possession of nonpublic information should not be conclusive. The SRC should be amended to state clearly that possession of material nonpublic information is an essential element of the offense that needs to be proved by clear and sufficient evidence showing that the insider was, in fact, aware and in possession of the information, or that by reason of his functions on the company, he could not have been unaware of the same. In such case, an

[109] Rep. Act No. 8799, § 55 (2000).

insider who was not in possession of the information would not have the impossible task of proving his state of mind of being unaware in order to prove his innocence.

In relation to this, the SEC should likewise issue implementing rules to set specific announcement platforms that make disclosure of material information sufficiently, public and a specific standard to determine the sufficient amount of time after such disclosure for the market to absorb it. This is essential in order for insiders to know when their obligation to disclose or abstain from trading arises.

Second, in spite of the presumptions created by law against the insiders, the SEC may be apprehensive to file actions in court because, in most cases, it has purely circumstantial evidence on hand. Aside from administrative issues such as the lack of funds and resources, privacy laws in the Philippines may prevent the SEC from gathering strong evidence against insiders. Any changes in the SRC to protect the constitutional rights of insiders may need to be complemented by the amendment of privacy laws to empower the SEC to enforce the SRC.

Lastly, as much as the rights of the insiders need to be protected, the State should likewise protect itself and the investing public against the damage that insider trading may cause. Congress would need to determine if the remedies of rescission and damages and derivative actions should be made available to investors prejudiced by insider trading. In any case, clear guidelines should be provided for all available remedies, so that insiders can choose which would be most expedient and favorable.

In addition, providing the SEC with a civil remedy in the case of transactions involving insider trading and short-swing profits could be more effective in preventing such illegal activities. The resources of the SEC may not be adequate to gather enough evidence to file a criminal case, but may be sufficient to successfully pursue a civil case. The disgorgement of profit is widely accepted as the best civil penalty against insiders. To provide the SEC the right to file a civil case would accomplish this end, especially when the investors are not financially capable or unwilling to pursue their right to private cause of action.

In providing for civil remedies available to the SEC and investors, however, the standard for computing the civil liability should likewise be clearly provided for to avoid excessive and arbitrary imposition against insiders.

A review of the SRC and its implementing rules may very well be the key to having more insider trading cases filed in court, such that the law can finally be a deterrent to insiders who may abuse confidential information, to the detriment of the Philippine stock market and the economy in general.

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