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**A CIVIL LIABILITY ACTION FOR INSIDER TRADING**

*FYFFES PLC v DCC PLC* [2005] IEHC 477

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## I INTRODUCTION

The main contested insider trading proceedings in Australia have been initiated by the regulator and have resulted in criminal or civil penalties.<sup>1</sup> There is no notable instance of a corporation bringing civil proceedings for insider trading against one of its former directors. To illustrate a possible alternative, this is an analysis of the detailed judgment handed down on 21 December 2005 by Ms Justice Mary Laffoy in the High Court of Ireland concerning a civil liability action for insider dealing. In *Fyffes plc v DCC plc* [2005] IEHC 477 ('*Fyffes Case*'), the company failed in its petition for €106 million compensation and, on 8 April 2006, the company announced that it would appeal the decision to the superior court, the Irish Supreme Court. It is anticipated that the appeal decision will be handed down early in 2007.

The decision in the *Fyffes Case* [2005] IEHC 477 rested on the judicial interpretation of price-sensitivity and whether the defendant had knowledge that the information was price-sensitive at the time of dealing in the shares of Fyffes plc (Fyffes). In her judgment, Laffoy J analysed the tests for insider trading in the context of the following facts: Fyffes alleged that a former non-executive director of the plaintiff company, Mr Jim Flavin, dealt in Fyffes' shares in advance of a profit correction being announced by Fyffes to the Irish Stock Exchange and the London Stock Exchange.

The decision illustrates two issues of importance to contemporary corporate regulation: a failure by the authorities to pursue enforcement of the appropriate penalties; and the failure by a company to adequately comply with its continuous disclosure obligations, thereby facilitating an environment conducive to insider trading.

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<sup>1</sup> *R v Hannes* (2002) 173 FLR 1; *R v Rivkin* (2004) 59 NSWLR 548 and *R v Doff* (2005) 23 ACLC 317 were criminal prosecutions that resulted in a conviction. *ASIC v Petsas and Miot* (2005) 23 ACLC 269 ('*Petsas*') was the first civil penalty proceeding for insider trading. It was uncontested as the defendants pleaded guilty.

***A Failure by the Regulatory Authorities***

As the regulator did not initiate proceedings against Mr Flavin, Fyffes itself took civil action against its former director. It would be encouraging to interpret this as an example of the company relieving the ‘poorly resourced’ regulators of the enforcement burden.<sup>2</sup> However, it appears possible that Fyffes felt compelled to instigate this first civil action in Ireland for alleged insider trading to pre-empt claims for compensation from a number of institutional funds, which had purchased Fyffes’ shares from the defendants at the relevant time.<sup>3</sup> To date, there has been no instance of a ‘Fyffes-style’ civil action by the issuer against a supposedly delinquent company officer in the Australian context. In the civil penalty proceedings of *Petsas* (2005) 23 ACLC 269, also the current Citigroup proceedings<sup>4</sup> and even in the ‘non-insider trading’ case against Steve Vizard,<sup>5</sup> the issuer of the securities traded by the insiders may well have suffered damage but the insiders were not officers of the ‘issuer’ companies. There is no direct parallel as Fyffes claimed that it suffered damage as the issuer of the shares underlying the claimed insider trading, while an officer of the company was the alleged insider.

The cost of uncertain criminal proceedings posed one deterrent for the regulator.<sup>6</sup> Also, in the discovery process, a separate but linked dispute arose when Fyffes demanded access to expert reports that had been prepared for DCC plc (DCC) and its

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<sup>2</sup> This has been called for in the Australian context, see Roman Tomasic ‘The Challenge of Corporate Law Enforcement - Future Directions for Corporations Law in Australia’ (Paper prepared for ALTA Conference, Victoria University, Melbourne, 4-7 July 2006).

<sup>3</sup> Fyffes commenced its proceeding within one week of the expiration of the two-year statute of limitations for civil unlawful dealing cases. The press postulated that if the Fyffes action was successful, then it was possible for the company to compensate these investors. Subsequently it was announced that there were two Irish and two American fund managers who had also commenced legal action against the defendants. Brendan McGrath, Markets Editor, ‘Fyffes will claim that Flavin took Advantage of Information’, *The Irish Times* (Dublin), 28 January 2002; ‘Fyffes claims DCC fails to answer Core Issue’, *The Irish Times* (Dublin), 29 January 2002; ‘US Investment Firms taking DCC to Court’, *The Irish Times* (Dublin), 28 February 2002.

<sup>4</sup> Australian Securities and Investment Commission, ‘ASIC Commences Proceedings against Citigroup for Conflicts and Insider Trading Breaches’ (*ASIC Media Release* 06-096, 31 March 2006).

<sup>5</sup> *ASIC v Vizard* [2005] FCA 1037 (28 July 2005).

<sup>6</sup> The case before the High Court was reported to have incurred legal costs of approximately €20 million in the 87 day hearing. Colm Keena, ‘Fyffes Appeals Insider Dealing Judgment’, *The Irish Times* (Dublin), 8 April 2006. In the ruling on costs handed down on 10 February 2006, Laffoy J determined that Fyffes would pay its own costs and 80 per cent of the defendants’ discovery costs and the costs of 25 hearing days. *Fyffes plc v DCC plc* [2006] IEHC 32 (10 February 2006) at 8.

chief executive Mr Flavin, the main defendants in the insider trading civil action.<sup>7</sup> In this separate dispute, the Irish Supreme Court upheld on appeal the decision of the High Court that expert reports were still deemed privileged when they were viewed by the Irish Stock Exchange, which acted as a conduit for the information to the Director of Public Prosecutions (DPP).<sup>8</sup> Following this decision, the DPP, presumably with the guidance of the Irish Stock Exchange,<sup>9</sup> declined to proceed with a criminal prosecution, even though the Garda Bureau of Fraud Investigation had conducted inquiries into alleged insider dealing and any resultant criminal action could have taken precedence over the civil action.<sup>10</sup> This difficult decision has similarities to that confronting the DPP in Australia when he declined to proceed with a criminal prosecution of Steve Vizard.

### ***B Failure by the Company to Disclose***

The *Fyffes Case* [2005] IEHC 477 could easily have been, and could still become, an action against the plaintiff for failure of its continuing disclosure obligations.<sup>11</sup> If Fyffes believed that the relevant inside information was material and price-sensitive then it should have disclosed it to the public. If the reason it did not disclose was because it refused to acknowledge that the inside information was price-sensitive, then it did not have a strong argument to later claim that the defendant was trading on the basis of this same undisclosed 'price-sensitive' information. One of the main policy arguments for continuous disclosure has always been that with full corporate disclosure, or alternatively total confidentiality, there could be no insider trading.

The main Australian insider trading cases, *R v Hannes* (2002) 173 FLR 1, *R v Rivkin* (2004) 59 NSWLR 548, *R v Doff* (2005) 23 ACLC 317 and *Petsas* (2005) 23 ACLC

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<sup>7</sup> Background Finance Section 'Dealing Emerged in Court Hearings', *The Irish Times* (Dublin), 11 January 2006.

<sup>8</sup> *Fyffes plc v DCC plc* [2005] IESC 3 (27 January 2005) Fennelly, McCracken JJ and Geoghegan J concurring in the Supreme Court of Ireland upheld on appeal the decision of Smyth J in the High Court of Ireland.

<sup>9</sup> *Fyffes plc v DCC plc* [2005] IESC 3 (27 January 2005) 5 (Fennelly J); Niamh Brennan, 'Court Proceedings had the Flavour of an Outlandish Work of Financial Fiction', *The Irish Times* (Dublin), 22 December 2005.

<sup>10</sup> Brendan McGrath, Markets Editor 'Fyffes claims DCC fails to answer Core Issue', *The Irish Times* (Dublin), 29 January 2002.

<sup>11</sup> Discussed in the later section D *The Law* and subsequent sections of the paper.

269 arose in the context of a breach of confidentiality prior to disclosure of negotiations for a merger or takeover. The *Fyffes Case* [2005] IEHC 477 did not occur in this takeover context but the issue of a company disclosing as soon as possible to avoid a false market, based on actual or assumed inside information, is still relevant. Takeover speculation in the Australian stock market has again focused attention on unusual share price variations for possible target companies and, while the Australian Stock Exchange aims to be vigilant in its surveillance,<sup>12</sup> there is statutory provision<sup>13</sup> for a compensation claim from a person damaged by the insider trading that can flow from non-disclosure. Although subject to appeal, the recent finding against Jubilee Mines NL<sup>14</sup> in the Supreme Court of Western Australia illustrates the possibility of private litigation against a listed company for non-disclosure and, as such, provides a companion for the *Fyffes Case* [2005] IEHC 477.

## II CASE ANALYSIS

### A *The Claims*

In the main proceedings before the High Court, the plaintiff, Fyffes, sought relief against the defendants that included: a declaration that the sale of more than 31 million Fyffes' shares in February 2000 was an unlawful insider dealing within the meaning of Part V of the *Companies Act 1990* (IE) (hereinafter referred to as the Act); a statutory and/or equitable order for an account of profits from these sales; also damages and/or compensation for breach of fiduciary duty by the former non-executive director of Fyffes, Mr Flavin.<sup>15</sup> Mr Flavin had resigned as a director of Fyffes on 9 February 2000.<sup>16</sup>

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<sup>12</sup> Fiona Buffini and Annabel Hepworth, 'ASX Gets Tough on Insider Trading', *The Australian Financial Review* (Sydney), 2 November 2006, 1, 68.

<sup>13</sup> *Corporations Act 2001* (Cth) s 1043L outlines specific situations in which a compensation order under s 1317HA may be made.

<sup>14</sup> Decision of Master Sanderson in *Kim Riley in his Capacity as Trustee of the KER Trust v Jubilee Mines NL* [2006] WASC 199; ASX, 'Supreme Court of Western Australia Proceedings – *Riley v Jubilee*' (Media Release, 6 September 2006).

<sup>15</sup> *Fyffes plc v DCC plc* IEHC 2002 No. 1183P (21 December 2005) 1, 2. Unless otherwise stated, all references are to the pages of the initial unreported judgment of Ms Justice Mary Laffoy.

<sup>16</sup> *Ibid* 330.

***B The Parties***

The plaintiff, Fyffes, is a public company listed on the Irish Stock Exchange and the London Stock Exchange and it is described as ‘the leading European fresh produce company’.<sup>17</sup> The first defendant is DCC, a public company whose shares are also listed on both the Irish Stock Exchange and the London Stock Exchange. The other main defendant was Mr Flavin, chief executive and deputy chairman of DCC and former director of Fyffes.<sup>18</sup>

***C The Facts***

Fyffes announced in its preliminary results on 14 December 1999 that, while turnover for the period decreased marginally, the board believed that 2000 would be ‘another year of further growth for Fyffes’.<sup>19</sup> Also, Fyffes launched the ‘worldoffruit.com’ in the autumn of 1999. The potential of this internet venture was the focus of recommendations by two brokers in early January 2000 that prompted price rises and active buying of Fyffes’ shares in Dublin and London. From December 1999, Fyffes’ share price rose for about two months until mid-February 2000 and then declined. ‘It closed on the London Stock Exchange at €3.16 on 17 March. The Irish Stock Exchange was closed on that day’.<sup>20</sup> At Fyffes’ Annual General Meeting the following Monday, the chairman made a statement that was, in effect, a profit warning resulting from a slower than anticipated recovery and the continuing weakness of the Euro against the US dollar.<sup>21</sup>

Following this statement, the London Stock Exchange informed Fyffes on 7 April 2000 that it was investigating dealings in the company’s securities.<sup>22</sup> A week later, the Irish Stock Exchange stated that, in particular, it was investigating the sales in early February 2000 of Fyffes’ shares by DCC and the other defendants. Information

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<sup>17</sup> Ibid 3, 14-5.

<sup>18</sup> Ibid 3.

<sup>19</sup> Ibid 6.

<sup>20</sup> Ibid 16, Friday 17 March 2000 was the St Patrick’s Day public holiday.

<sup>21</sup> Ibid 14-5.

<sup>22</sup> Ibid 16.

was also sought regarding Mr Flavin's involvement with Fyffes. That investigation continued through 2000 and into 2001.<sup>23</sup>

The hearing commenced on 2 December 2004 and continued for 87 days, concluding on 18 July 2005. 'Five years intervened between the occurrence of the events and the taking of evidence' and:

In the intervening period the facts and the surrounding circumstances had been the subject of much media comment, the two Stock Exchange investigations referred to earlier, as well as intensive pre-trial procedures. In consequence, much of what was presented as evidence of fact from each side...was overlaid with what was variously referred to by opposing counsel as *ex post facto* rationalisation and retrospective analysis. At times, the evidence of witnesses of fact verged on advocacy. At times, I believe that rationalisation veered towards revisionism.<sup>24</sup>

#### ***D The Law***

The statutory provisions that Fyffes invoked are the provisions of Part V of the Act, which implement the EU Council Directive on insider dealing.<sup>25</sup> Listed companies and their directors are also regulated by Chapter 9 (Continuing Obligations) and the Appendix to Chapter 16 (Model Code) of the Listing Rules of the London Stock Exchange and the Irish Stock Exchange. Part V of the Act creates civil liability (s 109) and criminal liability (s 111) in relation to insider trading. Section 108 was the basis of the claim and it is concerned specifically with a person connected to the

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<sup>23</sup> Ibid 17.

<sup>24</sup> Ibid 18.

<sup>25</sup> (89/592/EEC).

company.<sup>26</sup>

### ***E The Argument***

Fyffes alleged that, by being in possession of the November and December Management Reports to the board (the Reports), Mr Flavin had price-sensitive information at the time of the Share Sales and that the dealing was unlawful. The defendants denied that the information contained in those documents was price-sensitive and that Mr Flavin was dealing. Section 108(1) renders unlawful dealing by a natural person in shares of a company where, by reason of his connection with that company, the natural person has price-sensitive information. The natural person may deal as agent or principal. In either event the dealing is not lawful.<sup>27</sup>

Laffoy J decided that the evidence indicated that Mr Flavin controlled the whole process and in his personal capacity, whether as agent or as principal, he dealt in the shares that were disposed of by virtue of the Share Sales.<sup>28</sup> Mr Flavin did not have a beneficial interest in the shares, nor the capacity to dispose of them. However, Laffoy J concluded that the reality was that Mr Flavin assumed authority to act exclusively in the negotiations leading to the sales and acted with the tacit, if not express, approval of the board of DCC.

### **III THE OVERRIDING ISSUE OF PRICE SENSITIVITY**

The issue was whether, by reason of his connection as a director of Fyffes in February 2000, Mr Flavin had in his possession information of the Reports to the board, which

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<sup>26</sup> *Fyffes plc v DCC plc* IEHC 2002 No. 1183P (21 December 2005) 22-3, 30-1. Section 108 of the *Companies Act 1990* (IE) declares that: It shall not be lawful for a person who is, or at any time in the preceding 6 months has been, connected with the company to deal in any securities of that company if by reason of his so being, or having been, connected with that company he is in possession of information that is not generally available, but, if it were, would be likely materially to affect the price of those securities. Chapter 9 of the Listing Rules, January 2000 version, provides at Rule 9.1: A company must notify the Company Announcements Office without delay of any major new developments in its sphere of activity which are not public knowledge which may... lead to substantial movement in the price of its listed securities. Chapter 16 deals with the obligations of directors to comply with the Model Code when they are in possession of unpublished price-sensitive information.

<sup>27</sup> *Ibid* 58.

<sup>28</sup> *Ibid* 157.

were not generally available. The Court needed to decide if the information had been generally available, would it have been likely to materially affect the price of Fyffes' shares. The defendants stated that substantially similar information was generally available at the date of the Share Sales so it was not likely that the information contained in the Reports, if available, would have materially affected the share price.<sup>29</sup> However, the factual component of the materiality test that the specific information contained in the Reports was not generally available was not disputed by the parties, so the test of whether the information was accessible to investors was the main concern.<sup>30</sup>

As Laffoy J pointed out, there was very little guidance in the Act as to how the price-sensitivity test in s 108(1) should be applied and, as this was the first case in which any of the civil remedies provided for in Part V had been invoked, there was no authority within the jurisdiction to assist the Court.<sup>31</sup> The issue of s 108(1) goes to the materiality of the share price effect as assessed objectively. The defendants supported the 'reasonable investor' test as simply a mechanism to describe the objectivity of the price-sensitivity test and not the impact on a particular sort of investor, for instance, a market maker.<sup>32</sup>

The hypothetical test was whether in February 2000, had it been available to the reasonable investor, would the information contained in the Reports, viewed by the investor against the total mix of information about Fyffes' trading and earnings available on those dates, have impacted on the judgment of the investor to the extent that he would have concluded that the information probably would have a substantial effect on Fyffes' shares.. It was necessary to decide if an investor profile should take account of the 'dot.com mania' which was prevalent in January 2000 and at the dates of the Share Sales. Would the reasonable investor have been infected by the market's infatuation with internet stocks? The total information mix at the relevant time in

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<sup>29</sup> Ibid 205-6.

<sup>30</sup> Ibid 228-9.

<sup>31</sup> Ibid 206.

<sup>32</sup> Ibid 229.

relation to Fyffes included 'worldoffruit.com'. If the reasonable investor was one who wished to own internet stocks, then this was a relevant factor.<sup>33</sup>

The Reports were not made public, so did this mean that Fyffes' executives did not consider the information to be price-sensitive, although the Listing Rules imposed continuing disclosure obligations on companies? In applying the price-sensitivity test, Laffoy J assumed that the reasonable investor was aware in a general way that a company must make timely disclosure of non-public, price-sensitive information. This was part of the total mix of information about the company.<sup>34</sup>

Laffoy J decided that an objective analysis of the evidence concerning what took place at the time did not reveal any awareness by Fyffes' executives in early February 2000 that, if the information contained in the Reports was generally available, it would have a materially adverse impact on Fyffes' share price. Once it was available, the information did not appear to raise any concern among Fyffes' executives that they were obliged to disclose under the Listing Rules.<sup>35</sup>

Fyffes' chairman was concerned on 3 February 2000 about DCC's holdings in Fyffes being sold and the effect of the sale on the market in Fyffes' shares. Laffoy J concluded that there was no objective evidence of any concern that Mr Flavin might have been in possession of price-sensitive information and the 'evidence strongly suggests that such a possibility was not entertained at all':<sup>36</sup>

In my view, in this case there is an *inherent incongruity in reason and common sense* between the plaintiff's assertion that on receipt of the November and December Trading Reports on 25 January 2000 Mr Flavin had in his possession information which, if generally available, would be likely to materially affect Fyffes' share price, on the one hand, and the fact that at no time did Fyffes determine that, or even consider whether, if made public, the very same information would be likely to lead to a

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<sup>33</sup> Ibid 232-3.

<sup>34</sup> Ibid 237-8.

<sup>35</sup> Ibid 321.

<sup>36</sup> Ibid 322.

substantial movement in Fyffes' share price, thus triggering its duty of disclosure under the Listing Rules.<sup>37</sup>

#### **IV CONCLUSION ON STATUTORY AND EQUITABLE CLAIMS**

The statutory claim failed because Fyffes had not established the overriding price-sensitivity issue that, if the information in the Reports had been generally available at the time of the Share Sales by Mr Flavin, it would have been likely to materially adversely affect Fyffes' share price.<sup>38</sup>

The Act provides at s 109(1) that civil liability is 'without prejudice to any other cause of action which may lie' against the person charged with statutory liability for insider dealing. An insider who owes a fiduciary duty to a company and who, with the benefit of confidential information of the company, makes a profit from dealing in securities of the company may be compelled by an Irish court to give an account of profits to the company. This had been recognised in theory but the parties had failed to name a case where an Irish court had considered such a claim. Authorities in other common law jurisdictions such as the United Kingdom and Australia were also rare. Laffoy J acknowledged that Mr Flavin, as a director of Fyffes, owed fiduciary duties to the company but he was not in breach of his duties as he did not trade or use confidential inside information.<sup>39</sup>

On the evidence, Laffoy J decided that what had motivated Mr Flavin in his involvement in the Share Sales and the almost total exit of DCC from Fyffes' share register in February 2000 was the opportunity to make a substantial profit because of the increased share price on the back of 'worldoffruit.com'. Fyffes had not established any evidential nexus between the profit which the Share Sales generated

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<sup>37</sup> Ibid 323.

<sup>38</sup> Ibid 342.

<sup>39</sup> Ibid 333-4, 348.

for the DCC and the use by Mr Flavin of the confidential information. That information was considered to have had no bearing on the Share Sales.<sup>40</sup>

### **V SUMMARY OF CONCLUSIONS**

Laffoy J answered the claims as follows:

Mr Flavin dealt as agent of the DCC Group, which dealt as principal.

Mr Flavin was not in possession of price-sensitive information at the dates of the Share Sales. Therefore, the dealing was not unlawful under s 108 and no civil liability to account arises under s 109.

In relation to the non-statutory claim, Fyffes failed to establish a breach of fiduciary duty on the part of Mr Flavin. The plaintiff was neither entitled to an account in equity nor damages or compensation at common law.<sup>41</sup>

This case is significant for Irish law as it was the first time that proceedings for alleged insider trading had been launched by the issuer of the securities. In this instance the potential breach of director's fiduciary duty was also relevant. The greater significance of the case to other common law jurisdictions will depend on the outcome of the appeal before the Supreme Court of Ireland but, regardless of that decision, the case illustrates that private litigation for compensation resulting from insider trading is viable, if not always successful.

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<sup>40</sup> Ibid 363.

<sup>41</sup> Ibid 366-7.