UNIVERSITY OF ALBERTA

A COMPARATIVE APPRAISAL OF INSIDER TRADING REGULATIONS IN NIGERIA

BY

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The undersigned certify that they have read, and recommend to the Faculty of Graduate Studies and Research for acceptance, a thesis entitled "**A Comparative Appraisal of Insider Trading Regulations in Nigeria**" submitted by **Ogochukwu Victor Onwaeze** in partial fulfilment of the requirements for the degree of **Master of Laws**.

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DEDICATION

To the memory of him who gave me the inspiration to grow, but never lived to see me blossom:

Okolie Victor Onwaeze (1930 - 1987)

ABSTRACT

In a free market economy, the law ought to leave trading parties to the result of their bargains, but because it is recognised that in certain instances there is a need to protect the society or a certain class of it, the legislature sometimes lays down rules for persons engaging in certain transactions. One area in which the law has intervened is the regulation of trading by certain persons, designated insiders, in securities. This thesis examines the insider trading regulations in Nigeria from the perspective of American and Canadian insider trading legislation.

Chapter one looks at the historical development of the regulation of trading by insiders, judicial and legislative.

Chapter two lays down the theoretical basis for the thesis. It examines the arguments for and against legislative regulation of trading by insiders with the conclusion that the aim of regulations should be the prevention of fraudulent abuse of information acquired by, or from, a person in a position of trust and that the present structure of regulations does not serve this end.

Chapters 3 to 5 appraise the content of the regulations in Nigeria, testing these against the conclusion in chapter two on what the law should be directed at. The chapters also look at the interpretative problems that may confront the courts.

Chapter 6 examines the factual efficacy of the regulations noting the formidable problems of detection, investigation and enforcement. The economic cost of the regulations is particularly addressed.

Chapter 7 is a commentary on the excessive nature of the regulations in Nigeria. The chapter notes that the existing framework in the form of corporate fiduciary duties,

contractual remedies at common law and the rulemaking power of the Securities and Exchange Commission was adequate to prevent fraudulent conduct in securities transactions. There is a suggestion for expanding the scope of publicity and disclosure of corporate information and public enlightenment.

The conclusion of the study is that the insider trading regulations in Nigeria are not justified by the present social and economic level of development of the country and they should be repealed.

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Introduction.

The clamour for insider trading regulations has increased in the last three decades. This period also witnessed an increase in the debate whether insider trading regulations are justified. For most countries, however, the issue was no longer to have these or not. The question was to determine the scope of regulations. Nigeria joined the league of countries regulating insider trading in 1990. This thesis appraises the degree of prohibition of insider trading in the regulations. The thesis critiques the likely application of the provision from a comparative analysis of Canadian and American federal insider trading regulations.

Before 1960, English laws invariably applied in Nigeria and changes in English laws were generally reflected in the Nigerian legal system. In that year, Nigeria gained her independence from Britain. But as far as legal development was concerned, the midwives of that transition omitted to sever the umbilical cord. The practice, therefore, has been an unabashed plagiarism of English law by the Nigerian legislators. This uncritical acceptance of changes in English law overlooks the practical necessities of such laws in the Nigerian socio-economic setting. A recent example is the law on insider trading.

On 31st December, 1990, the *Companies and Allied Matters Decree*[1] [hereinafter *C.A.M.A.*] came into effect. The decree, a product of the efforts of the Nigerian Law Reform Commission, reflects massive codification of existing common law principles and the incorporation of new provisions from other jurisdictions. For the first time, too,

[1] Decree #1 of 1990, redesignated *The Companies and Allied Matters Act* 1990.

comprehensive legislation was made to regulate insider dealing.[2] Some attempt was made in that law to do away with the inapplicable parts of British legislation but in the end, the section on insider trading *mutatis mutandis* reflects the provisions of the English *Companies Securities (insider dealing)* Act (hereinafter *CSA*).[3]

The only pertinent observation of the Law Reform Commission explaining the purpose for the regulation of insider trading was that "insider trading has been generally condemned as evil and should be discouraged".[4] The condemnation referred to was contained in the remarks of writers and judges in other countries.[5] Unfortunately,there was no attempt to ascertain the feeling of Nigerian investors as to the need for the regulations.[6] If this had been done it might have turned out that the operators of the securities market are not so averse to insider trading as to warrant its regulation or the market may need just a little regulation. Neither was any attempt made to ascertain the frequency of insider trading in the Nigerian securities market to enable them to determine

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[2] See sections 614 to 621.

[3] (U.K.), 1985, c.8.

[4] Report of the Nigerian Law Reform Commission on Company Law (Lagos, Nigeria, 1988) at 142.

[5] There has been little discussion of insider trading problems in Nigeria except for the little exchange between M. Odedina and C. Ogunbanjo noted in G.O. Olawoye, *Status and Duties of Company Directors* (Ile-Ife, Nigeria: University of Ife Press, 1977) at 144 n1, and the articles, E.K. Aigbekaen, "Insider Trading and the Privatisation of Public Enterprises in Nigeria" unpublished seminar paper delivered at the university of Benin faculty of law seminar series, 13th February 1992 and C.O. Okonkwo, "A Critical Appraisal of Insider Trading Transaction Under the Law" (unpublished seminar paper, 1991).

[6] This ought to be a pertinent consideration for in the end it is the investors and the market operators that will be affected by the law. It will be ironic if the investors whom the law is meant to protect reject the need for such a protection. One of the matters which the Attorney General's Committee on Securities Legislation in Ontario (hereinafter the Kimber Report) took into consideration was whether "insider trading is a matter of such public concern to the investing public that rules to control it should be established". *Ibid.* para. 2.01.

the scope of the regulations.[7] This would have enabled the Commission to avoid the problem of "overkill". Indeed insider trading in its present formulation finds little place in the Nigerian securities market, so that the massive regulations in *CAMA* appear hardly necessary,[8] with the result that it will either breed contempt for the law, if it is strictly enforced, or it will become a dead letter law.[9]

Remarkably enough no case of insider trading has ever been litigated in Nigeria[10] and it might be a long time before any reaches the courts. It may thus appear idle to speculate on what the reaction of the courts will be to the formidable problems of interpretation which the regulations will undoubtedly present. But it is not too soon to anticipate the possible problems and make suggestions on how to streamline the laws to suit the Nigerian securities market, for although the courts have stated on several occasions that they are not bound by English decisions,[11] the temptation to follow the English courts' interpretation of the *CSA* might be too difficult to resist.[12] This tempta-

[7] For such a survey see E. Rosenbaum et al., "Corporate and Investment Attitudes Towards Insider Trading in Canada" (1983-84), 8 Can. B.L.J. 485, J.H. Lorie & V. Niederhoffer, "Predictive and Statistical Properties of Insider Trading" (1968) 11 J. L. & Econs. 45.

[8] See B.A.K. Rider, "Policing the City - Combating Fraud and Other Abuses in the Corporate Securities Industry" (1988) C.L.P. 47 at 48.

[9] As does the law on bigamy in Nigeria, section 37 of the *Marriage Act*, 1914.

[10] It would be affectation to argue that they do not occur, but the investors and operators of the market hardly see it as such. One of such cases which can be regarded as one of insider trading involved Francis Okotie-Eboh who as Minister for Finance bought shares in a shoe company in anticipation of his plan to grant certain tax exemptions to shoe companies. See Olawoye, *supra* note 4 at 157 n1.

[11] See for example, *Ali* v. *Okulaja* [1966] 2 W.L.R. 620, *Surakatu* v. *N.H.D.S.* [1977] N.C.A.R. 432, *Kigo* v. *Holman Brothers* [1980] 8-11 S.C. 43.

[12] For a recent example of this trend of copying english decisions see *Narumal* v. *N.B.T.C.* [1989] 2 N.W.L.R. 730. For a commentary on this case see V. Onwaeze, "The Demise of the Doctrine of Fundamental Breach in the Nigerian Law of Contract" (on file with B.C. Third World L.J.)

tion is acute because a cursory reading of the *CAMA* may lead to the conclusion that the legislation is the same. A closer reading, however, reveals important differences in phraseology. These differences and the differences in the socio-economic development and consciousness of both countries in relation to the question of insider trading should provide a basis for different interpretations. There must be a regard for the need to nurture the growing securities market in Nigeria.

CHAPTER 1

A HISTORICAL SKETCH OF INSIDER TRADING REGULATIONS.

1.1 Introduction.

History is replete with tales of abuse of confidence by people placed in positions of trust. This often occurs by the misappropriation of "public" information or opportunity for purely private gains. The problem is no less acute in the field of corporate law generally and the securities market in particular.[1] Professor Loss once remarked that,

> the very nature (of securities) makes them a ready device by which people of questionable morals prey upon the unsophisticated and gullible.[2]

The temptation to abuse confidential corporate information sometimes results in what is often referred to as insider trading. Although there is general agreement about the notion of insider trading, variations in the scope of regulations has given rise to differing definitions of the concept. The Attorney General's Committee on Securities Regulations in Ontario defines an insider as "a person whose relationship to a company is such that he is likely to have access to material information concerning the company not known to the general public".[3] Insider trading may be loosely defined as "dealing

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[1] Complaints about the practice of trading by manipulating the market have been made for over four hundred years. Sir William Holdsworth has a passage as follows: "A report of the Commissioners of Trade, published in 1696, accused the dealers in shares of rigging the market, and the promoters of companies fraudulently raising the price of shares by making false statements as to the prospect of the company, and then selling their holdings at a high price". See W. Holdsworth, *A History of English Law*, 2nd ed., vol. 8 (London: Methuen and Sweet and Maxwell, 1937) at 214.

[2] L. Loss, "The Protection of Investors" (1963) 80 S.A.L.J. 53.

[3] The Kimber Report, para. 2.01. Various statutes now have their own definitions. See section 614 *CAMA* and *Canadian Business Corporations Act*, RSC 1985, c-44, sections 126 and 131 [hereinafter *CBCA*]. The problems of definition, perhaps, accounts for the open endedness of section 10(b) of the U.S. *Securities Exchange Act* 1934.

in corporate securities where one party has, and the other party does not have, access to confidential information which has a substantial bearing on the value of those securities"[4] or which would affect the investment decision of a reasonable investor.[5]

The various definitions[6] will need some modifications if unanimity is to be achieved, but definitional inexactitudes do not raise insurmountable problems, for the lack of precise definitions has not prevented the legislators and judges from developing rules to regulate insider trading. The fact that the practice is regarded as objectionable is taken as enough justification for the regulations.[7]

1.2 Common Law Restrictions.

The common law has for long imposed a duty on fiduciaries not to use information received by virtue of that position for private gains.[8] In fact they are not expected to make secret profit from carrying out their duties as fiduciaries.

As far as corporate information is concerned, directors are no doubt fiduciaries of the company and the rule has been developed that a director of the company shall not

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[4] Justice (Society), *Insider Trading: a Report* (1980) para. 1.

[5] *SEC* v. *Texas Gulf Sulphur Company* 401 F. 2d 833 (1968).

[6] See *Insider Trading: A Canadian Legal Manual* (Montreal: Jewel Publications, 1990) para 1-3; B.A. Rider and H.L. Ffrench, *The Regulation of Insider Trading* (Dobbs Ferry, New York: Oceana Publication Inc., 1979) at XIII; R. Clark, *Corporate Law* (Toronto: Little, Brown and Co., 1986) at 264; W.H. Painter, *Federal Regulation of Insider Trading* (Charlottesville, Virginia: The Michie Company, 1968) at 2-3; *Multiple Access Limited* v. *McCutcheon* (1983), 18 B.L.R. 138 at 143 (S.C.C.).

[7] The theoretical basis of the regulations is discussed in chapter 2.

[8] *Keech* v. *Sanford* (1726), Sel. Cas. Ch. 61.

appropriate an opportunity belonging to the company for his own benefits.[9] The duty not to expropriate corporate property is sometimes imposed on majority shareholders.[10] The corporate opportunity doctrine has been so expanded as to give it an inexorable character. The fact that the company could not utilise the opportunity ceased to be a defense in 1942[11] and the Canadian decisions[12] show that the directors need not use the opportunity in the course of their office as directors. Indeed the opportunity need not be known by the director by virtue of his position as such, the American test being that the corporate opportunity is one which in the circumstances should fairly belong to the company.[13]

Admittedly the doctrine goes beyond the scope of insider trading regulation for the opportunity exploited need not be confidential to the director. But in a way it does not neatly fit the notion of insider trading. A pertinent question is whether information acquired by a director regarding the price movement of the company's shares can be

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[9] See *Cook* v. *Deeks* [1916] 1 A.C. 554, *Regal (Hastings) Ltd.* v. *Gulliver* [1942] 1 All E.R. 378, *Canada Safeway Ltd.* v. *Thompson* [1951] 3 D.L.R. 295, (B.C. S.C.) *Zwicker* v. *Stanbury* [1953] 2 S.C.R. 438, *Peso Silver Mines Ltd.* v. *Cropper* (1966), 58 D.L.R. (2d) 1, (S.C.C.) *Industrial Development Consultant Ltd.* v. *Cooley* [1972] 1 W.L.R. 443, *Canadian Aero Services* v. *O'Malley* (1974), 40 D.L.R. (3d) 371, (S.C.C.), *Guth* v. *Loft Inc.* 5 A 2d 503 (Del. 1939), *Rosenblum* v. *Judson Engineering Corporation* 77 A.L.R. 3d 961 (1977).

[10] *Menier* v. *Hooper's Telegraph Works* (1874), L.R. 9 Ch. App. 350.

[11] *Regal (Hastings) Ltd.* v. *Gulliver*, *supra*, note 9.

[12] *Canadian Aero Services* v. *O'Malley*, *supra*, note 9, *Industrial Development Consultants Ltd.* v. *Cooley*, *supra*, note 9. Cf. *Peso Silver Mines Ltd.* v. *Crooper*, *supra*, note 9.

[13] See *Guth* v. *Loft Inc.*, *supra*, note 9, *Rosenblum* v. *Judson Engineering Corporation*, *supra*, note 9.

properly regarded as a corporate opportunity.[14] A corporate opportunity is an economic opportunity which falls in the general line of business of the company and unless it is successfully shown that trading in its shares falls within the general line of business of a corporation,[15] it is hard to see how use of unpublished price-sensitive information by the director can bring the corporate opportunity doctrine into play.

Granting even that this query is overcome, the possibility of ratification[16] (bearing in mind the manipulation of the proxy machinery) and, not least of all, the rule in *Foss* v. *Harbottle*[17] greatly deplete any remedy which the other party to the transaction might have. Where a shareholder successfully brings a derivative action, the damages awarded usually go to the company and although this may go to improve the value of his shares, it provides little comfort for the aggrieved shareholder; more so

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[14] In *Phipps* v. *Boardman* [1967] 2 A.C. 46, Lords Cohen, Hudson and Guest answered the question in the affirmative at 103, 107 and 115 respectively. Contrast Lord Upjohn at 127 and see Rider and Ffrench, *supra*, note 6 at 117.

[15] A fact which is denied by the maintenance of capital doctrine and company legislations. See *Trevor* v. *Whitworth* (1887), 12 App. Cas. 409; section 160 *CAMA*.

[16] Although this has often been noted as one of the hurdles besetting enforcement of duties against directors, in the classic insider trading scenario, it is doubtful if the company can ratify the action of the director. Ratification is possible only where the act is one which is within the powers of the company but beyond the powers of the directors. It also needs to be shown that what was done was done on behalf of the company. When the director insider deals, he is not acting for the company but is purely on a personal adventure and as such his act is not ratifiable. See *Cook* v. *Deeks*, *supra*, note 9. The confusion arises from the dictum in *Regal (Hastings) Ltd.* v. *Gulliver* that the directors would have escaped liability if their action had been ratified by the general meeting. But that statement was, perhaps, an attempt to ameliorate the rigours of a bad case which *Regal (Hastings)* undoubtedly was. A pure insider deal is not within the powers of a company and can, in a sense, be regarded as "ultra vires" the company, in which case ratification is impossible. Moreover insider trading is a crime under *CAMA* and as such the company would lack the power to ratify a crime committed by its officer. If these arguments are correct, then the second hurdle, that of corporate litigation, will also disappear, as the circumstance would constitute an "exception" to the rule in *Foss* v. *Harbottle* (1843), 2 Hare 416.

[17] *Ibid.* See Rider and Ffrench, *supra*, note 6 at 117, L.C.B. Gower et al., eds, *Gower's Principles of Modern Company Law* 4th ed. with supp. (London: Stevens and Sons, 1981) at 631 n20.

where he has sold his entire share holding to the fraudulent director.[18]

Attempts have been made to get around these difficulties and provide some sort of remedy for the shareholder. *Percival* v. *Wright*[19] had decided that, generally, directors do not owe individual shareholders any fiduciary obligations when dealing in the company's securities. That case has been the subject of critical but, at times, myopic commentary. On the facts there is much to commend the decision of Swinfey Eady J., but that case only laid down a general principle for which relevant facts and circumstances could provide exceptions. The courts have not been reluctant to find such exceptions.

Five years after the English decision, the U.S. court in *Strong* v. *Repide*[20] decided that special facts could establish a fiduciary relationship between the director and a shareholder dealing in the company's securities. The same approach was taken by the Privy Council in 1914 in *Allen* v. *Hyatt*[21] and by the Manitoba court in *Gadsden* v. *Bennetto*.[22] These cases do not, however, depart from the common law position. In *Allen* v. *Hyatt*, the court found on the facts an agency relationship between the director

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[18] P. Anisman, "Insider Trading Under the *Canadian Business Corporation Act*" [1975] *Meredith Memorial Lectures*, 151 at 173. Under section 240(c) *CBCA*, the court may order that the payment be made to former and present security holders instead of to the company.

[19] [1902] 2 Ch. 421. For comparable U.S. decisions see *Carpenter* v. *Danforth* 52 Barb. 581 (N.Y. Sup. ct. 1868), cited L. Loss, *Fundamentals of Securities Regulation*, 2nd ed. (Boston: Little, Brown and Co., 1988) at 724 n.1, *Gladstone* v. *Murray Co.* 314 Mass. 584 (1943).

[20] 213 U.S. 419 (1909). This was a civil law decision.

[21] (1914), 30 T.L.R. 444.

[22] (1913), 9 D.L.R. 719 (Man. C.A.). Cf. *Dusik* v. *Newton* (1985), 62 B.C.L.R. 1 (B.C. C.A.), *Bell* v. *Source Data Control Ltd.* (1989), 66 O.R. (2d) 78 (On. C.A.) *International Corona Resources Ltd.* v. *LAC Minerals Ltd.* (1990), 101 N.R. 239 (S.C.C.)

and the shareholder and, since an agent is a fiduciary of the principal, the case was merely applying recognised common law rules.[23] Same can be said of *Strong* v. *Repide*, and although the formulation there has been widened by subsequent cases,[24] the imprecise nature of the formulation leaves the decision to the caprice of the judge. It is remarkable that *Percival* v. *Wright* has not been expressly overruled[25] and has on more than one recent occasion received veiled, if not actual legislative[26] and judicial approval.[27] It has been argued that the special facts doctrine has become the general rule and that the courts will readily find a connection between the director and shareholder as to give rise to liability, and that this has rendered *Percival* v. *Wright* redundant. This is not necessarily so. While a present day court may be less reluctant to find liability in such a situation, the facts of the case put the decision beyond criticism. Whatever departure there has been falls within the ambit of the general decision. The special facts doctrine has been applied only in cases of active solicitation or where the circumstances gave rise

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[23] "The special facts doctrine is limited to situations involving actual agency relationship", Anisman, *supra*, note 18 at 161.

[24] See *Low* v. *Wheeler* 24 Cal. Rptr 538 (Cal. App. 1962) cited in Clark, *supra*, note 6 at 487, *Hotchkiss* v. *Fisher* 136 Kan. 530 (1932), *Jacobson* v. *Yaschik* 155 S.E. 2d 601 (1967).

[25] The Jenkins Committee in England and the Kimber Committee in Ontario had called for legislative overruling of the decision, but these recommendations were not reflected in the legislations. C. Okonkwo, "A Critical Appraisal of Insider Trading Transaction Under the Law" (unpublished seminar paper) at 4 argues that *Percival* v. *Wright* has been overruled by section 279 of *CAMA*. This is a misreading of that section which only provides that the director assumes a fiduciary relationship to a shareholder dealing in the company's securities, but the obligation is owed to the company, not the shareholder.

[26] *Companies Act* (U.K.), 1985, c.8, section 309(2), Section 279(9) *CAMA*.

[27] *Pelling* v. *Pelling* [1982] 2 W.W.R. 185 (B.C. S.C.), *Green* v. *Charterhouse Group Canada Ltd.* (1976), 12 O.R. (2d) 280 (On. C.A.), *List* v. *Fashion Park Inc.* 340 F.2d 457 (2d Cir. 1965), *Esplanade Development Limited* v. *Divine Holding Property Ltd* [1980] W.A.R. 151, H.L. Ffrench, "Minority Shareholders: *Percival v. Wright* lives on" (1981) 2 Co. Law. 236.

to an equitable duty to communicate information as in a partnership or closely held corporation.[28]

The only noticeable departure is the New Zealand case of *Coleman* v. *Myers*[29] in which the Court of Appeal thought that *Percival* v. *Wright* was wrongly decided. The fact that a closed corporation was involved and possibly an agency relationship existed provide justification for the decision.[30] This is borne out by part of the headnote to the decision which reads, "The circumstances from which (the directors) duties arose (are) the family character of the company, the position of the father and son in the family and the way in which they went about the takeover and the persuasion of shareholders". The case falls within the ambit of *Allen* v. *Hyatt* and is not a departure from *Percival* v. *Wright*[31]. The dictum was not necessary for the decision and it is submitted that it is wrong.

It was perceived that judicial effort without legislative support would be inadequate to take care of the several facets of insider trading. For one, directors traded through friends and family members (now referred to as tippees) who were not within the fiduciary rules.[32] Possibly, only actions against directors could succeed.[33] As such,

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[28] H.G. Manne, *Insider Trading and the Stock Market* (New York: The Free Press, 1966) at 22-23.

[29] [1977] 2 N.Z.L.R. 225.

[30] See *supra*, note 23 and Kimber report para 2.22.

[31] See B.L. Welling, *Corporate Law in Canada: The Governing Principles*, 2nd ed.(Toronto: Butterworths, 1991) at 359 n182.

[32] Compare the chairman of the board in *Regal (Hastings) Ltd.* v. *Gulliver*, *supra*, note 9.

[33] *Ibid.* Gower, *supra*, note 17 at 574 argues that the duty is not so restricted but may apply equally to any official of the company who is authorised to act on its behalf.

the area with the greatest incidence of insider trading lacked protection. Again the protection, where it was available, could only be applied to face-to-face transactions. While this was not a major restriction then, the emergence of stock exchanges and the rise in impersonal transactions makes it one of the biggest obstacles to private civil actions.[34] Ratification and procedural difficulties do not however pose too much problems for the aggrieved shareholder. For obvious reasons, there was no protection for a non-shareholder who traded with a director who is in possession of confidential information.[35]

Judicial reluctance to extend common law principles to insider trading has meant that most of the rules regulating insider trading were developed by the legislature.

1.3 Legislative Provisions and Judicial Activism.

A study of the history of joint stock companies reveals a consistent legislative endeavour to protect the public against the fraudulent practices of corporate managers.[36] At the same time there was conscious effort to preserve the rights of persons to deal freely in stocks without limiting too much the freedom of contract. Indeed "the trading problem (was) but one aspect of a broader area, namely; the balance which should prevail between the interest of those who invest and those who manage".[37]

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[34] This accounts for the absence of a civil remedy in the *CSA*.

[35] *Goodwin* v. *Agassiz* 283 Mass. 358 (1933).

[36] See O. Akanki, "History of Company Law" (1988) 14 Nig. J. Contemp. L. 75, B.C. Hunt, *The Development of the Business Corporation in England 1800 - 1867* (Cambridge, Mass: Harvard University Press, 1936), A. Dubois, *The English Business Corporation After the Bubble Act 1720 - 1800* (New York: Commonwealth Fund, 1938).

[37] Painter, *supra*, note 6 at 4.

Perhaps, the earliest example of legislative regulation of, what can be loosely termed, insider trading is the 1734 English Act prohibiting short selling and trading in puts and calls where the seller did not have possession or legal or beneficial ownership.[38] But the first major step was taken in 1844 by the Gladstone legislation.[39] The cornerstone of that Act was the disclosure philosophy. It was felt that by subjecting the practices of corporate managers to public glare the temptation to engage in fraudulent practices would be reduced. The disclosure requirement found its way into company legislation in several jurisdictions.[40] The major provision was for disclosure of directors' interest in the company and all other pertinent facts which would guide a prospective investor in making his decision. There the law stopped. It was left to the investor to decide whether to invest or not. But because of the prolix and convoluted nature of corporate documents which are often phrased in a lawyer's gobbledegook, the disclosure requirement provided little comfort and cosmetic protection for the uninformed investor.[41] Nothing indeed prevented the managers from using confidential information to trade.

At the turn of the 20th century there was some legislation directed at securities

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[38] *An Act to prevent the infamous practice of stock jobbing, 1734 (U.K.)*, 7 Geo. 2 c.8. See L. Loss, *Securities Regulations*, 2nd ed., vol. 2 (Boston: Little, Brown and Co., 1961) at 1225.

[39] *Joint Stock Companies Act, 1844 (U.K.)*, 7 & 8 Vict., cc. 110 & 111.

[40] For example the *Dominion Companies Act* 24 - 25 Geo. V c.33 1934, The U.S. *Securities Act* 1933 adopted the disclosure philosophy apparently under the influence of the *Companies Act, 1929 (U.K.)*, 19 & 20 Geo. V, c.23.

[41] Loss, *supra*, note 2 at 59, observed, "the typical prospectus does not make light bedtime reading". Cf. *Feit* v. *Leasco Data Processing Equipment Corporation* 332 F. Supp. 554 (EDNY 1971); cited Rider and Ffrench, *supra*, note 6 at 17. W.O. Douglas and G.E. Bates, "The Federal Securities Act of 1933" (1933) 43 Yale L.J. 171.

at securities regulation, but not to the specific issue of insider trading. At this time, however, writers had begun to discuss the problems posed to society by allowing corporate insiders to trade on confidential information. The notable works[42] recommended increased reliance on the disclosure philosophy. This was in line with the improvement on the disclosure requirements in the Gladstone legislation by the 1908 and 1929 *Companies Acts*.[43] This disclosure philosophy was to form the basis of the *Securities Act* of 1933.[44] There had been prior attempts at regulating securities transactions. The initiative had been taken at the state level by Massachusetts in 1852. Several states also formulated their "blue sky" laws but, because of the differences in them, there was clamour for federal regulation. Whatever reluctance the government had was dissolved by the collapse of the American securities market in the late 1920s. The Senate Committee on Banking and Currency was set up in 1932. A consequence of their finding that corporate insiders engaged in "sure thing speculation" was the enactment of the *Securities Exchange Act 1934*[45] amongst the purposes of which were to

(a) afford a measure of disclosure to people who buy and sell securities.

(b) prevent and afford remedies for fraud in securities trading and manipulation of the market; and

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[42] L.D. Brandeis, *Other People's Money* (Washington: National Home Library Foundation, 1933) chap 5, A.A. Berle Jr., "Publicity of Accounts and Directors' Purchases of Stocks" (1927) 25 Mich. L.R. 827.

[43] 1908 (U.K.), 8 Edw. VII, c.69 and 1929 (U.K.), 19 & 20 Geo V, c.23.

[44] See generally J.M. Landis, "The Legislative History of the Securities Act 1933" (1959) 28 Geo. Wash. L.R. 29.

[45] For a historical discourse see L. Loss, *Securities Regulation*, 2nd ed., vol. 1 (Boston: Little,Brown and Co., 1961) chap. 1 and J. Seligman, *The Transformation of Wall Street* (Boston: Houghton Mifflin Company, 1982).

(c) regulate the securities market generally.

Of immediate relevance are sections 10(b) and 16. Subject to procedural restrictions section 16 provided for absolute liability for certain persons who traded in the company's securities within a specified period. It had a three-pronged formulation:

(i) providing for disclosure of insider transactions,

(ii) corporate recovery of short swing profits,

(iii) outlawing certain transaction by insiders specifically associated with abuse.

Neither the *Securities Act 1933* nor the *Securities Exchange Act 1934* was fashioned for insider trading. Section 10(b) of the latter was intended as a general prohibition of a relatively wide variety of deceitful or manipulative practices giving the Securities and Exchange Commission (hereinafter SEC) power to develop a more flexible approach through the rule making machinery.[46] The section was relied upon eight years later when there was need to deal with a problem of misuse of inside information.[47] It may, thus, be said that the first law to focus specifically on insider trading was rule 10b-5 formulated by the SEC in 1942.[48] Literally, however, rule 10b-5 did not go much further than the then existing legislation, but the complementary role played by the courts has given it very wide application. The rule was used as the springboard to create civil liability,[49] to expand the definition of insiders[50] and to give a civil remedy to the

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[46] Painter, *supra*, note 6 at 19.

[47] The use of rule 10b-5 to regulate insider trading has been criticised on the ground that it was formulated in response to the fraudulent conduct of one corporate executive in Boston.

[48] Originally known as rule X-10b-5.

[49] *Kardon* v. *National Gypsum Co.* 69 F. Supp. 512 (1948).

aggrieved 'outsider' upon a private action.[51]

Several justifications were fashioned for judicial activism in this area, from fairness to equality of access to information.[52] The implication of a civil remedy under these statutes has been criticised. The statute was directed at fraudulent and manipulative conduct and an implied remedy must come within these qualification. The wide approach adopted by the courts, in for example, rejecting a strict requirement of scienter or reliance[53] has been said to be beyond legislative intent.[54] Evidence at the Pecora hearings justifies this assertion. The inquiry was directed mainly at the regulation of the market and not the restriction of certain persons to trade. The misconception that the statutes were intended to regulate trading by certain persons might have arisen from Pecora's attack on the investment behaviour of CEOs appearing at the hearing.

Oddly enough the cases which expanded the scope of insider trading regulations never got to the Supreme Court. When they did, the expansion era ended and since then the practice of the court has been one of contracting the scope of liability for an ill defined offence. The first of these contraction cases, *Blue Chips Stamps* v. *Manor Drug stores Ltd*,[55] upheld the rule in *Birnbaum* v. *Newport Steel Corporation*,[56] that only

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[50] *Cady, Roberts and Co.* 40 SEC 907 (1961).

[51] *Superintendent of Insurance of the State of New York* v. *Bankers Life Insurance Company* 404 U.S. 6 (1971).

[52] See chapter 2 *infra* for a discussion of these concepts.

[53] *Affiliated Ute Citizens of Utah* v. *United States* 406 U.S 128 (1972).

[54] D.W. Carlton and D.R. Fischel, "The Regulation of Insider Trading" (1982 - 83) 35 Stan. L. Rev. 857 at 884 n90, M.P. Dooley, "Enforcement of Insider Trading Restrictions" (1980) 66 Va. L. Rev. 1.

[55] 421 U.S. 723 (1975).

sellers and purchasers of securities have standing to sue under the Act. A year later *Ernst and Ernst* v. *Hochfelder*[57] put the ambit of the rule in proper focus when it held that no liability could arise unless manipulation or deception was proved. *Santa Fe Industries* v. *Green*[58] followed, in holding that corporate mismanagement absent fraud was not within the ambit of rule 10b-5 regulation.

The Supreme Court considered the basis of the regulations for the first time in *U.S.* v *Chiarella*[59] and there rejected the fairness rationale in *Speed* v. *Transamerica Corporation*[60] and the equal access approach of the second circuit in *SEC* v. *Texas Gulf Sulphur*.[61] The court laid emphasis on the fiduciary concept holding that a duty to disclose cannot arise in the absence of a special relationship giving rise to such a fiduciary obligation. This reasoning was reinforced in *Dirks* v. *SEC*[62] which held that an insider cannot be liable unless the motive to gain directly or indirectly is proved. Two elements are necessary for liability: breach of a fiduciary duty and a fraudulent motive. It is perhaps, needless to reiterate that the clock has gone full circle in the U.S. and the recent cases are no more than a refined espousal of common law principles.

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[56] 193 F. 2d 461 (2d cir. 1952).

[57] 425 U.S. 185 (1976).

[58] 430 U.S. 462 (1977).

[59] 445 U.S. 222 (1980).

[60] 99 F. Supp 808 (D. Del. 1951).

[61] *Supra*, note 5. This is the decision that has had the greatest impact in expanding the scope of insider trading prohibition and its potentials are enormous. See A. Fleischer Jr. and J.H. Flom, *Texas Gulf Sulphur-Insider Disclosure Problems* (New York: Practising Law Institute, 1968).

[62] 463 U.S. 646 (1983).

This movement has not been without opposition. There have been spirited attempts by the Court of Appeal and Congress to retrieve the stranded boat of insider trading regulations. The Court of Appeal's recourse to the misappropriation theory has been generally rebuffed.[63] Congress has been able to recover some lost ground. In 1984, the *Insider Trading Sanctions Act* was enacted, its principal provision being the power of the court to order a refund of up to three times the profit made from the insider trade in an SEC proceeding. The private right of action on a disgorgement basis of liability was recognised in the *Insider Trading Securities Fraud Enforcement Act* of 1988. From the tenor of the judgements, however, there is no doubt that the contraction of liability will continue to be the rule for sometime to come, at least until societal attitudes to insider trading change.

To return to the historical discourse, the period of the depression, 1929-32 also witnessed widespread legislation in Europe, Canada and Australia. In Canada, the initiative, as in the U.S., was taken at the provincial level.[64] The 1934 *Dominion's Companies Act*[65] reflected the disclosure philosophy. Statutory regulation of securities trading started with the *Ontario Securities Act*[66] in 1945, but this again was directed at securities generally and had little bearing on the specific question of insider trading. Incidents of insider trading were dealt with by other means such as recourse to the

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[63] See 2.2.f. *infra*.

[64] See *infra*, note 72.

[65] 24 - 25 Geo. V, c.33, 1934.

[66] 9 Geo. VI, c.22, 1945.

criminal law.[67] By 1960, however, juridical opinion had begun to sway against such practices. The impetus for specific legislation was provided by the Windfall Oils and Mines Limited Case. Before this time the Royal Commission on Banking and Finance in 1964 recommended legislation along the line of section 16 of the *Securities Exchange Act* 1934. Of more importance, however, was the report of the Kimber Committee. The committee concluded that:-

it is improper for an insider to use confidential information acquired by him by virtue of his position as an insider to make profit by trading in the securities of his company. The ideal securities market should be free and open with the prices thereon based upon the fullest possible knowledge of all relevant facts among traders. Any factor which tends to destroy or put in question this concept lessens the confidence of the investing public in the market place and is therefore a matter of public concern.[68]

The Committee therefore, recommended protection against insider dealing beyond the common law position. Vis-à-vis same time narrower and wider. The definition of insiders excluded tippees, there was no double liability and liability was not absolute or automatic. On the other hand it had fewer procedural difficulties and more precise definitions. The recommendations were substantially enacted as the *Ontario Securities Act* 1966,[69] which was adopted by fouother provinces within two years of its enactment.[70] Due to constitutional problems, it was not until 1970 that federal regulation

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[67] *Cox* v. *R.* [1963] C.C.C. 148, *R.* v. *Littler* (1974), 41 D.L.R. (3d) 523 (Quebec Ct. of Session). See generally B.A. Rider, "The Crime of Insider Trading", [1978] J.B.L. 19.

[68] Kimber Report para 2.01.

[69] S.O. 1966, c. 142.

[70] *The Securities Act*, S.A. 1967, c.76, *The Securities Act*, S.B.C. 1967, c.45, *The Securities Act*, S.S. 1967, c.81, *The Securities Act*, S.M. 1968, c.57. For the history see Anisman, *supra*, note 18 at 173-181.

of insider trading was made for the first time in Canada in the *Canada Corporation Act*,[71] more or less along the line of the Ontario legislation. Worthy of note is the fact that the federal legislation did not treat insider trading as a specie of securities law but rather as part of the substantive corporation law.[72] In Canada, insider trading is regulated mainly at provincial level and there are regulations in provincial *Securities Acts* or *Business Corporations Acts*. The federal provision only applies to Federal companies and companies that do business in a province that has no insider trading regulations. For the purpose of the study, the federal provisions are used for comparative purposes for two reasons. Firstly, space will not permit an essay of the minor differences in the provincial legislation[73] and secondly the federal provisions reflect the tenor of the majority of the provincial regulations.[74]

As opposed to the U.S., the judicial attitude in Canada has always been restrictive. The regulations have been boxed into an area of minimum extent by

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[71] 1970, 18 - 19 Eliz. II, c.70, section 98(1) and 98A, D and F. Now see *Canadian Business Corporation Act* RSC 1985, c-44, section 126-131.

[72] There is a constitutional history behind this approach. Securities regulations in Canada grew out of property legislation. The right to legislate on property was within the residual powers of the province. The first attempt at a loose regulation of securities was in the Alberta *Security Fraud Prevention Act* 1930, 20 Geo. V, c.8, 1930 which was contested and upheld by the Privy Council in *Lymburn* v. *Mayland* [1932] A.C. 318. It was, therefore, thought that securities legislations being an adjunct of property legislation, should be dealt with at provincial level. Thus, there is no federal securities legislation, although proposals for one have been on for over a decade and a half. To avoid the absence of federal insider trading rules, the provisions have been smuggled into the corporation laws. But see *Multiple Access Limited* v. *McCutcheon* (1983), 18 B.L.R. 138 (S.C.C.). In most provinces, both the *Business Corporation Act* and the *Securities Act* contain insider trading regulations.

[73] For this see V. Albioni, *Securities Law and Practice*, 2nd ed., vol. 2 (Toronto: Carswell, 1984) part 18.

[74] Reference to Canadian insider trading rules, unless otherwise indicated, is a reference to the federal regulations.

parsimonious interpretation. This may be surprising in view of the fact that the securities regulations were made to ensure that the historical approach to the obligation of directors as found in *Percival* v. *Wright* was no longer the policy of the law.[75] On the other hand the judicial attitude may only be a mirror of societal indignation over regulation of a practice which is not generally considered *malum in se*. Whatever societal feelings were, the fever had caught on with legislatures across the world. In 1961, the *Australian Uniform Companies Act* had branded insider trading as improper[76] and made extensive rules for disclosure. In Europe, the reaction has been much more restrained. France had anti-insider trading laws in 1967, but this was quite imprecise both in formulation and application. Germany had a scheme of internal regulations which companies could adopt at their discretion. By the early 1980s only three European countries had insider trading regulations of any importance.[77] In Asia save for Hong Kong and Singapore and to a lesser extent Japan, insider trading regulations are virtually non-existent.[78]

Interestingly, Britain, the country whose laws acted as the precursor of insider trading regulations, held out for a long time against agitation of legal writers for

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[75] *Insider Trading: A Canadian Legal Manual*, *supra*, note 6, para. 2-17 and *Green* v. *Charterhouse Group Canada Limited* (1976), 12 O.R. (2d) 280 at 305 (On. C.A.). This is borne out by the difference in outcome when actions on the same facts are brought under the common law and under the statutes. Contrast *Geller* v. *Transamerica Corporation* 53 F. Supp. 625 (D. Del. 1943) and *Speed* v. *Transamerica Corporation* 71 F. Supp. 457 (D. Del. 1947).

[76] Section 124, but this was phrased in the form of misuse of corporate information. The regulations have been strengthened beyond disclosure requirements to pure insider trading regulations in the *Securities Industry Code*. See S. Herne, "Insider Information: Definition in Australia, Canada, the U.K. and the U.S." (1986) 8 J. Comp. Bus. & Cap. Market Law 1.

[77] This will change by June 1992, when all European Community States will have to abide by the E.C.'s directive on insider trading regulations.

[78] For a comprehensive review see Rider and Ffrench *supra*, note 6.

regulation. The Cohen Committee's recommendations were ignored and only the portion of the Jenkin Report dealing with options became law. In the absence of statutory control[79] recourse was made to self regulation. The City Panel on Takeovers and Mergers formulated a code in 1977 to regulate the practice of those professionally concerned in takeovers and mergers and to stop trading on price sensitive information in these activities.[80]

The dissolution of parliament aborted the extensive regulations that were proposed in the Companies Bill 1973. In 1980 government bowed to pressure and insider trading was made a criminal offence in part V of the *Companies Act* of that year.[81] The provisions were consolidated in the *CSA* 1985 which has been further complemented by the *Financial Services Act 1986*[82] (hereinafter FSA).

If regulation of insider trading in Europe and North America has been in response to public opinion, the same is not true of Nigeria. Whatever legislation there is, has

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[79] Rider and Ffrench argue that section 13 of the *Prevention of Frauds (investment) Act* 1958 goes some way in preventing insider dealing; *supra*, note 6 at 19. But this is a misrepresentation of that provision. Where there has been active concealment of facts, the law of contract provided appropriate remedy for misrepresentation. Before a person can be said to be dishonest in the concealment of material facts, there must have been a duty to disclose to the other party. If I am under no duty to disclose, I have the privilege to remain mute and exercising it can hardly be described as fraudulent. In cases where there is a duty to disclose, the law on fiduciaries took good care.

[80] Self regulating bodies have the power to suspend their members or mete out other punishment for breach and such extra legal sanctions may in the end prove more effective than any attempt at comprehensive legislation. But self regulation did not provide adequate safeguard. For one it has no force of law and secondly, it only regulates the activities of those who are its members. See Justice report, *supra*, note 4, para. 4.

[81] (U.K.), 1980, c.22, Sections 68-73.

[82] (U.K.), 1986, c.30.

emerged from government's initiatives.[83] Attempt at securities regulation beyond the scope of company law rules started in 1962[84] with the establishment of the Capital Issues Committee charged with the duty of seeing to the orderly development of the capital market in Nigeria.[85] The Committee was an advisory and consultative body and had no power of enforcement. This body was replaced in 1973 by the Capital Issues Commission[86] charged with the responsibility of determining the price at which company securities were to be sold to the public either through offer for sale or direct issue and the timing and amount of sale.[87] This body soon became moribund. In 1979, the Securities and Exchange Commission was set up under the *Securities and Exchange Commission Decree*[88] with a threefold purpose

(1) to protect the interest of investors and thereby enhance their confidence in the capital market,

(2) to ensure orderly, fair and equitable dealings in securities business; and

(3) to promote the growth and development of the capital market.[89]

The Commission was empowered to make rules for the protection of the integrity

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[83] See G.O. Olawoye, *Status and Duties of Company Directors* (Ile-Ife, Nigeria: University of Ife Press, 1977) chap. 5.

[84] For the history see Securities and Exchange Commission, *The Securities and Exchange Commission: What it is and What it Does*. (Lagos, Nigeria: Securities and Exchange Commission, 1989) 9-13.

[85] The Lagos Stock Exchange (now the Nigerian Stock Exchange) had been established in 1960.

[86] Vide the *Capital Issues Decree* #14 of 1973.

[87] See G. Olawoye, "Decree Gives Wide Powers to Control Alien Enterprise" (1981) 2 Co. Law. 44.

[88] Now repealed but substantially reenacted as the *Securities and Exchange Commission Act* 1988.

[89] See B. Orji, "The *Securities and Exchange Commission Decree* 1988" [1988] 1 G.R.B.P.L. 51.

of the securities market against any abuse arising from the practice of insider dealing.[90] This was supposed to be an open ended provision like section 10(b) of the *Securities Exchange Act* 1934 giving the Commission power to make rules as the circumstances required.

Considering that the Nigerian securities market is still in its infancy and that insider trading is not widely known, practised or condemned, this was an eminently sensible compromise between premature regulation and an open cheque for abuse. As the practice scarcely existed, the commission did not formulate any rules to deal with insider trading. Despite the commission's view that this was good enough protection and its objection to more regulation, the Law Reform Commission recommended extensive regulation of insider trading along the line of the *CSA* and these were enacted into *CAMA*. Thus like in Canada insider trading is treated as part of the company law but unlike the *CBCA*, the provisions dealing with insider trading are administered by the Securities and Exchange Commission.[91]

Whether for good or bad, insider trading regulation forms a part of Nigerian company law and it remains to examine the scope of the legislation. This examination is postponed to a study of the theoretical basis for the regulations, considered in the next chapter.

[90] Section 6(e).

[91] The SEC administers the whole of part XVII. The rest of the Act is administered by the Corporate Affairs Commission. It is interesting to muse upon what the attitude of the Nigerian SEC will be towards enforcement of the regulations in the light of its opposition to specific rules.

CHAPTER 2.

THEORETICAL BASES FOR INSIDER TRADING REGULATIONS.

2.1. Introduction.

Laws are made for the purpose of ordering the relationships among individuals towards the betterment of the generality of the society. As much as the law does this by establishing standards of conduct in these relationships, it is also realised that there are certain matters which are better left to the will of the individuals involved. This is because, it is only by the development of individual talents and the full realisation of the benefits therefrom, that the society can advance, since the society develops, not by itself but, through the individuals composing it. In the sphere of private transactions, the practice is abstention rather than intervention. The law intervenes in private dealings where rules are necessary to protect the public or a certain class of it. Intervention, therefore, is usually on the grounds of public policy. However, there is no general principle of public policy that exists in *vacuo* that can be used to justify intervention.[1] Public policy is confined to certain well defined categories and such laws must find justification within one or more of these heads of public policy arguments.

Securities transactions, ordinarily, are a matter of private contract between the parties. As such, intervention in these transactions must be justified by a need to protect the public or a class of it. The fact that a public policy argument exists for regulation is, however, not the end of the question. It must be weighed against other public policy arguments that oppose regulation and the regulation is justified according to how the

[1] Public policy itself is an unruly horse, which once you get astride it, you never know where it will carry you; *Richardson* v. *Mellish* (1824), 2 Bing. 229 at 252.

scales tilt.

Initially, there was an almost general condemnation of insider trading leading to calls for its regulation. A few voices of dissent existed, albeit, without clear formulation. Perhaps, the first purposeful analysis of insider trading in economic terms was Manne's seminal work, *Insider Trading and the Stock Market*.[2] At the time it was published the views expressed therein were considered as somewhat heterodoxical. Same cannot be said today. The work provided the impetus for more reasoned analysis, both for and against, the regulation of insider trading.

There are several arguments for and against the prohibition[3] of insider trading, most of them based on public policy considerations. This chapter aims to evaluate the theoretical basis for insider trading regulations.

2.2. The Justification for Regulation.

2.2.a. Fairness Principle.

The classical argument against insider trading is that it is inherently unfair for a person to use confidential information acquired by virtue of his special status to trade to the detriment of the other party, who is ignorant of the existence of the information. Allied to this is the argument that insider trading is immoral.

Although most natural law philosophers concurred in the argument that such trading is unfair and, perhaps, immoral they were far from a consensus as to whether this

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[2] (New York: The Free Press, 1966).

[3] It has been remarked that the issue is the regulation, not the prohibition of insider trading. See J.F. Weston, "Book Review: Manne, Insider Trading and the Stock Market" (1966-67) 35 Geo. Wash. L.R. 140 at 142. This argument apparently confuses the distinction between insider trading and trading by insiders. The latter is regulated; the former is prohibited.

fact alone justified prohibition. One of the earliest commentators, Cicero thought that the other party to the trade should be able to recover his losses.[4] But prominent natural law philosophers such as Thomas Aquinas expressed the view that the behaviour is not of the type that should be outlawed or for which recovery will lie.[5] The early cases also followed this approach.[6]

The fact that fairness and morality did not warrant the regulation of these practices in antiquity when collectivism and the be-your-brother's-keeper concept formed the bases of interpersonal relationships should, perhaps, have been a pointer that such arguments will not support regulations in a society where individualism and self interest are the accepted norms. Surprisingly, however, the clamour for insider trading regulations in the 1920s and 30s was hinged on fairness arguments. Some of the advocates of these arguments while realising the obvious economic benefits of allowing insider trading, contend that such benefits cannot discount the benefits to be realised from ensuring fairness in the securities market.[7]

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[4] For a discussion of the classical arguments see G. Lawson, "The Ethics of Insider Trading" (1988) 11 Harv. J. of L. & Pub. Pol. 727 at 737 - 743.

[5] Such argument from a Saint should not be surprising for even in the *Bible* a loose example of insider trading can be found. When Pharaoh ordered the storage of grains for seven years to be sold later to merchants from other lands, he was acting on confidential information from Joseph that there would be a famine that would last for seven years; a fact not known to the Rulers of the other Kingdoms.

[6] See *Laidlaw* v. *Organ* 15 U.S (2 Wheat) 178 (1817) and Lawson, *supra*, note 4.

[7] R.A. Schotland, "Book Review: Unsafe at any Price: A Reply to Manne, Insider Trading and the Stock Market" (1967) 53 Va. L. Rev. 1425 at 1438, "When we engage in economic analysis, we do not banish permanently, the legal and moral aspects of the problem analysed". Cf. L. Loss, "The Fiduciary Concept as Applied to Trading by Corporate Insiders in the United States" (1970) 33 M.L.R. 34. W.H. Painter, "Book Review: Manne, Insider Trading and the Stock Market" (1966 - 67) 35 Geo. Wash. L.R. 146 and generally *Federal Regulation of Insider Trading* (Charlottesville, Virginia: The Michie Company, 1968) chap. 1.

Although these arguments still find currency with a few writers,[8] they are so riddled with redundancies, that they can be regarded as examples of some of the ghostly contraptions that resurrect now and then from the intellectual graveyard of those who wish to find a co-existence between law and morality. Such fairness arguments are used as a specious cloak of legitimacy to mask the theoretical bankruptcy of the regulations.[9]

A pertinent question is, whose morals are the regulations supposed to protect? Notions of fairness and morality are as disparate as there are interest groups to serve. Although governments at times legislate morality, should it be the morality of the qualitative majority as appears to be the case now or that of the quantitative majority? It takes little reasoning to imagine that were a poll to be taken, not just of securities dealers, but, of the public generally as to the need for full disclosure of information before a trade can be made, the opinion will be resoundingly negative. If fairness is to ensure that no one is to be "cheated" in a transaction, then people will cease to contract. Contracts are made with the objective of making a gain.[10] Because material benefits in the society are at a constant, a gain by one party results in a corresponding, sometimes

[8] See for example A. Fliescher Jr., "Corporate Disclosure/Insider Trading" (1967) Harv. Bus. Rev. 129, D. Hegarty, "Rule 10b-5 and the Evolution of Common Law Fraud - The Need for an Effective Statutory Proscription of Insider Trading by Outsiders" (1988) 22 Suffolk U. L.R. 813, S. Levmore, "Securities and Secrets: Insider Trading and the Law of Contract" (1982) 68 Va. L. Rev. 117 [hereafter "Securities and Secrets"], S. Levmore, "In Defense of The Regulation of Insider Trading" (1988) 11 Harv. J. of L. & Pub. Pol. 101, D. Ferber, "The Case Against Insider Trading: A Response to Professor Manne" (1969 -70) 23 Vand. L.R. 621. Cf *Re Cady, Roberts* 40 SEC 907 (1961), *Speed* v. *Transamerica Inc.* 99 F. Supp. 808 (D. Del. 1951). Such fairness arguments were rejected in *U.S.* v. *Chiarella* 445 U.S. 222 (1980).

[9] See H. Manne, "Insider Trading and the Law Professors" (1970) 23 Vand. L.R. 547 and N. Wolfson, "How to Control Insider Trading: Policing From Within" (1987) 73 A.B.A. Journal 39.

[10] Gain here, is to be distinguished from profit. Both parties may make a profit in terms of getting more output from the input, but one must make a gain at the expense of the other.

imperceptible, loss to the other. If the fairness approach is to cancel out the gains and the losses, wherein then lies the incentive to trade.[11] As the fairness principle requires a party who has been diligent in reducing market information to facts to deliver these to the less diligent, it would destroy beneficial market activity.[12] If those who urge the fairness arguments wish to protect any morals, they are to be reminded that it is their own private morality and not that of the society. It is certainly open to any contractor to disclose all he knows before contracting, but if when the law was permissive, people were generally not minded to disclose, this posits that confidentiality made good business sense. That lesson is no less valid today. It is remarkable that when insiders are 'caught', in the absence of breach of fiduciary or contractual obligations, their corporations are not usually inclined to dismiss them.[13] Rather than relying on generalised notions of fairness, what is needed is a concrete analysis of the relationship among parties competing to profit from the use of valuable information.[14] It is hypocritical to wish away the profit making motive for trading as the regulations and the fairness arguments have done.

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[11] Indeed what the fairness principle does here is to reverse the losses and gains. If it cancels out the losses and gains of both parties, theoretically, they are at par, but what has happened is that the gain taken from the insider to achieve the parity becomes the gain of the other party, which gain is correspondingly balanced by a loss to the insider. By saving the outsider from making a loss, the regulations at the same time rob the insider of the opportunity to make a gain. Why must the interest of the insider be sacrificed for that of the other party? See W.K.S. Wang, "Trading on Material Nonpublic Information on Impersonal Stock: Who is Harmed and Who Can Sue Under SEC Rule 10b-5?" (1981) 54 S. Calif. L.R. 1217.

[12] M. Conant, "Duties of Disclosure of Corporate Insiders who Purchase Shares" (1960) 46 Cornell L.R. 53 at 56 - 57.

[13] J.D. Cox, "Insider Trading and Contracting: A Critical Response to the 'Chicago School'" (1986) Duke L.J. 628 n3.

[14] J.R. Macey, "From Fairness to Contract: The New Direction of Rules Against Insider Trading" (1984) 13 Hofstra L.R. 9 at 12.

Fairness is a concept that defies objective analysis. According to Scott, it is a concept that exists in the eyes of the beholder.[15] It depends on which side of the coin one is looking at it from. A stockholder who wishes to impugn a transaction today because another used information which he was not aware of, is likely to sing a different tune the next day when a similar suit is brought against him. There can be detected a veiled tinge of jealousy in the fairness arguments in that those who cry out most are those not in a position to exploit the opportunities which insiders have.

Where lies the *cui bono* factor? The tendentious and self-seeking nature of human beings teaches that persons engaging in commercial transactions seek to take the best advantage of the opportunities at their disposal. It is, therefore unjustifiable to expect that just because certain persons assume certain positions in relation to the company, they are to live in a detached world of altruism where they are to put the interest of others before theirs in securities transactions.[16]

It is further argued that the information used by insiders is not obtained because of the exercise of their skill and industry, but because of the privileged position which they occupy. This may be so in some of the cases, but this argument ignores the fact that the insider occupies the privileged position because of certain skills which he was found to possess in the first place. Even if the insider lacks basic skills, is that enough objection

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[15] L.E. Scott, "Insider Trading: Rule 10b-5 Disclosure and Corporate Privacy" (1980) 9 J. L. Studies 801 at 805.

[16] The theory of classical egoism is that the nature of man is for him to act to his best interest, i.e, to identify that human excellence which is distinctively his own and to develop it to flourish as a person. See Lawson, *supra*, note 4; contrast J.R. Macey, "Ethics, Economics and Insider Trading: Ayn Rand Meets the Theory of the Firm" (1988) 11 Harv. J. of L. & Pub. Pol. 785. Levmore, "Securities and Secret" *supra*, note 8 argues that the nature of man is for him to act with the purpose of benefitting others and society. This seems out of tune with generally known patterns of human behaviour.

to his using information which has come into his possession? The gas station owner who comes into possession of information that a soon to be constructed by-pass would divert traffic from the station, and, therefore make it unprofitable is allowed to keep any profit which he makes from selling the station on the basis of that information to a purchaser who is ignorant of the development.[17] Can it be said that the vendor got the information about the construction through the exercise of his skills? Hardly. Why then should this objection suffice for insiders' trading in securities?

Outside of securities transactions, the courts have struck down certain transactions as unconscionable or unfair, but they have not refused to enforce bargains simply because one of the parties got a bad deal. The usual reasoning is that a transaction is fair if it is consensual and a transaction is consensual if it is not activated by fraud or duress practised by one of the parties.[18] As neither fraud nor duress is present in most securities transactions by insiders, they cannot be impugned on this ground.

It has been argued too, that fairness connotes that the situation where one party would envy the other should be eliminated. The golden rule of treating others as we would like to be treated should apply.[19] Not only is this golden rule faulty, it is futile to apply it in the proposed manner. If the other party is envious of the insider's

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[17] See Lord Atkins in *Bell* v. *Lever Brothers* [1932] A.C. 161. C.C. Cox and K.S. Fogarty, "Bases of Insider Trading Law" (1988) 49 Ohio St. L.J. 353 at 358 noted that "In the ordinary commercial transactions of everyday life, probably very few people feel bound to volunteer all material information. The seller of a house may not warn of noisy neighbours, a salesman is not expected to tell his customers of what better deals his competitors have, and not many loan applicants will initiate discussions of the weak points in their backgrounds".

[18] Cox and Fogarty, *ibid.*

[19] Levmore, "Securities and Secrets" *supra*, note 8.

informational advantage, the insider, who is required to disclose all that he knows, without reciprocity from the other party, is bound to feel envious of the special protection which the other party enjoys. If insider trading is regarded as unfair and immoral, and, therefore, criminal, it needs some explanation that it took over three and a half decades of the existence of rule 10b-5 for a worthwhile criminal prosecution to be filed, which in any event was unsuccessful.[20] The fact is that most people see nothing wrong in insider trading and consider it as a legitimate business practice. It is remarkable that outside of the United States, there has been no vigorous regulation or enforcement of insider trading regulations. This is because such trading is regarded as a perquisite of the position which insiders occupy and tallies with the underlying basis of a free market economy.[21]

It can be said that the fairness argument is now irretrievably anachronistic, but more recent and articulated arguments have arisen in favour of the regulation of insider trading.

2.2.b. Equal Access to Information.

This argument preaches the concept of market egalitarianism,[22] that is, that all traders in the market should have the same opportunity to receive information that affects the operation of the market. A person who has information which is not lawfully

[20] *U.S.* v. *Chiarella supra*, note 8. There have been some convictions in the latter part of the last decade, notably those of Boesky, Levine and Winans.

[21] See B. Shaw, "Should Insider Trading be Outside the Law?" (1988) 66 Bus. & Soc. Rev. 34, H. Bloomenthal, *International Capital Market and Securities Regulations* (New York: Clark Boardman Company, 1983) para 1-89, L.A. Hedges, "Insider Trading and the E.E.C.: Harmonisation of the Insider Trading Laws of the Member States" (1985) 8 B.C. Int'l & Comp. L.R. 151 at 160.

[22] Loss, *supra*, note 7 at 35.

accessible to other traders should desist from trading.[23] The purpose of the rule is to equalise the bargaining position of the parties.[24] Perhaps, the most articulate argument on this point is advanced by Professor Brudney.[25] He argues that insider trading is not prohibited because there is a disparity of information but because one party "has a lawful monopoly on access to information involved".[26]

"The unfairness is not a function merely of possessing more information - outsiders may possess more information than other outsiders by reason of their diligence or zeal - but of the fact that it is an advantage which cannot be competed away since it depends upon a lawful privilege which an outsider cannot acquire".[27]

A relevant query to the proposition, is whether it is only through corporate disclosure that information can be acquired. There are other ways to acquire information aside from corporate disclosure. Easterbrook argues that the inequality does not lie in access to information but in the cost of acquiring the information. While the insider may get it for free because of his position, the outsider has to spend money to look for, or

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[23] *Re Cady, Roberts and Co., supra*, note 8.

[24] *Speed* v. *Transamerica, supra*, note 8.

[25] V. Brudney, "Insiders, Outsiders and Informational Advantage Under the Federal Securities Law" (1979) 93 Harv. L.R. 322. Cf R.C. White, "Towards a Policy Basis for the Regulation of Insider Dealing" (1974) 90 L.Q.R. 494 at 511.

[26] *Ibid.* at 346. The proposition appears to be wrongly framed for if the monopoly is lawful then there can be no complain of non-disclosure or objection to its use. Perhaps, it ought to be a monopoly of lawful access to information, not a lawful monopoly of access to information.

[27] *Ibid.* "The essential element which makes an informational advantage unusable by those who possess it in dealing with those who do not is the inability of the latter to overcome it lawfully, no matter how great may be their diligence or how large their resources"; *ibid.* at 354.

purchase, the information.[28] The disparity in the cost of access should not be a basis for prohibition. The outsider who spends money to acquire the information will add that to the cost of the transaction and aim to recover this on the deal. Moreover it is not right to assume that the insider gets the information for free, for he might have bought himself into the privileged position. Again, there is hardly any corporate information that may not be lawfully acquired. The only difference may be the moment of acquisition. The insider gets it earlier, but the outsider must wait until disclosure before he can acquire it. Thus, they can both lawfully acquire the information. If, however, it is argued that the purpose of the equal access argument is to ensure that traders acquire the information at the same time, then it is totally unworkable because disclosure of the information will invariably get to those closer to the market before other participants. Or should trading be suspended until all persons have received the information?

Requiring insiders to desist from trading unless disclosure is made solves nothing as insiders would rather abstain than disclose. The disclosure requirement should be framed in such a way that forces disclosure rather than focusing on over reaching by insiders.[29] Brudney acknowledges that several factors could justify non-disclosure by the corporation. In such instances, insiders must abstain from trading, even though the delay in disclosure is not caused by them. Indeed, they may be willing to disclose, but cannot do so as disclosure must be to the public at large which may be impossible for

[28] F.H. Easterbrook, "Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information" (1981) Sup. Ct. Rev. 309, 314-339 at 330. Brudney *ibid.* at 348 notes such a possibility, but contends at 355 that the prohibition should extend to persons who acquire the information from insiders in a way that cannot be utilised by the general public.

[29] Brudney *ibid.* at 337 - 338.

several reasons. Insiders may lack the resources for such public disclosure, they may not be believed,[30] disclosure may be in breach of their employment contract, even though the trade is not, and the information may be imprecise and turn out to be incorrect or exaggerated for which the insider would be liable. An insider is unlikely to disclose if he knows that disclosure would deprive him of the benefits of his market advantage and yet expose him to liability if his disclosure turns out to be false.[31]

The equal access approach will create indolence in the market. Investors can afford not to be diligent in the knowledge that whatever information is produced will get to them. This will "turn the market into a crap game in which everyone, no matter how lazy or ill-informed would have an equal break".[32] This is against the allocational efficiency of the market.

The law cannot hope to prohibit or police trading by those with greater access to information. Suppose an insider is willing to put his shares on the market for $10.00. Before he does so, he learns of unpublished good news that will enhance the value of the shares. He waits until the news is public and then sells at $20.00. Nothing appears reprehensible here, but in a sense, the trader had used his superior access to information to avoid a 'loss' he would have made if he sold earlier. Were he not apprised of the information he would not have halted his sale.

There is, therefore, little utility in the equal access argument.

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[30] Compare the attempt by Dirks to publish the fraud in Equity Funding Inc.

[31] Brudney concedes this point, *supra*, note 25 at 337-338.

[32] Wolfson, *supra*, note 9.

2.2.c. Equal Possession of Information.

This vilified argument was relied upon by the second circuit in the seminal decision in *SEC* v. *Texas Gulf Sulphur Co.*[33] The argument is that the purpose of the insider trading regulations is to ensure that everyone trading in the market has equal possession of available information, because full disclosure and possession of information will lead to an efficient market in which stock prices reflect all available information.[34] It is argued that an insider who abstains rather than disclose should still be liable as his abstention has helped to create an inefficient market where prices do not reflect all available information.[35]

Interestingly, even those who find favour with regulation of insider trading reject this justification. Brudney, for example, calls such a market an 'egalitarian utopia'.[36] It is not possible to achieve informational equality. Parties to a transaction must trade on a disparity of information, no matter how slight.[37] The purport of the regulations is the prevention of fraud and not the equalisation of the bargaining position of the parties.[38]

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[33] 401 F.2d 833 (2d Cir. 1968), contrast *U.S.* v. *Chiarella*, *supra*, note 8.

[34] H.M. Friedman, "Efficient Market Theory and Rule 10b-5 Non-disclosure Claims: A Proposal for Reconciliation" (1982) 47 Miss. L.R. 745. The writer sought to find justification for this argument in the law of contract. "Usually, the withholding of material information in negotiating a contract is not appropriate. Contract law generally assumes that buyer and seller are both fully informed. Where one party has reason to know that the other is uninformed, the uninformed party who is affected materially and adversely will often be permitted to avoid the contract"; *ibid.* at 751, footnote omitted. No authorities were cited for this proposition and it can only be wondered what rule of contract the writer was talking about.

[35] *Ibid.* at 752 and 760.

[36] *Supra*, note 25 at 339-340.

[37] Cox, *supra*, note 13 at 635 - 642.

[38] M.P. Dooley, "Enforcement of Insider Trading Restrictions" (1980) 66 *Va. L.R.* 1 at 56 n234.

The present approach is to require that the insider disclose fully. If informational equality is to be achieved, there ought to be a corresponding requirement on the outsider to disclose all that he knows too. Even if disclosure were to be fully made, there would still be informational inequality, for only those diligent enough to look for it will possess the information. The difference in investment sophistication will also ensure that there is a disparity in possession of information.[39] As an example, a change in accounting methods may alter the reported earnings of the corporation while leaving the actual profitability unaffected.[40] Some investors will not be fooled by such gimmicks but the less imaginative are bound to base their investment decision on them. Market analysts, for example, always perform better than the average investor because of their skills in analysing market information.

Securities transactions, like most contractual relationships, are not risk free. Thus, investors have no right to expect that there would be equality of information, which eliminates the risk of trading. The risk of the other party having more knowledge is an element of every securities transaction which an investor assumes. The law ought not to turn insiders into insurers against the loss which would result from this inequality of

[39] See C.P Saari, "The Efficient Capital Market Hypothesis, Economic Theory and Regulation of the Securities Market" (1976 - 77) 29 Stan. L.R. 1031 at 1064.

[40] A change in accounting method from deferral to flow-through and depreciation accounting from declining to straight line would result in higher reported earnings that are not related to any improvement in actual earnings. These changes affect the pricing of securities of the corporation. See R.S. Kaplan and R. Roll, "Investor Evaluation of Accounting information: Some Empirical Evidence" (1972) J. Bus. 225, J. Sunders, "Relationship Between Accounting Changes and Stock Prices" (1973) 11 J. Accountancy Research 138. Although these articles concluded that these changes do not affect the market generally, they do affect the decision of particular investors, but the bad deals balance out the good ones.

strength.[41] Investors have no right to expect to get corporate information. As such there is no duty on the insiders to deliver it to them.

The equality of possession argument amounts to a condemnation of all informational inequality and is inconsistent with generally accepted notions of fairness and the law of contract. The law generally permits a person who has developed information to benefit from it by withholding it when dealing with others.[42] Its more damaging aspect is that it destroys the incentive to produce information.[43]

The irony in this argument is that the investor whom the equal possession of information approach aims to protect will not wish to trade in a market where everyone is as knowledgeable about the market as he is. The purpose of trading is to make a gain or avoid a loss. If by equal possession of information the actual prices are reflected, then the incentive to trade is lost. Most investors actually trade in the belief that the price of the securities is wrong,[44] i.e., that it does not reflect all available information. The investor trades in the belief that he knows something which the other party does not know, which will tilt the scales in his favour. He may be wrong, but that is a risk he is ready to assume.

2.2.d. Investors' Confidence in The Market.

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[41] H. Ffrench and B. Rider, "Should Insider Trading be Regulated? Some Initial Considerations" (1978) 95 S.A.L.J. 79 at 83-84, J.A.C. Hetherington, "Book Review: Insider Trading and the Logic of the Law" (1967) Wisconsin L.R. 720 at 723.

[42] Dooley, *supra*, note 38 at 63 and 65 n274 discussing *Neill v. Shamburg* 158 Pa. 263 (1893), A.T. Kronman, "Mistake, Disclosure, Information and the Law of Contract" (1978) 7 J. Legal Stud. 1

[43] Lawson, *supra*, note 4 at 735 and 743-746, Easterbrook, *supra*, note 28 at 327-329.

[44] A. Alcock, "In Defence of Insider Dealing" (1990) 140 N.L.J. 1470.

A pet argument of regulators is that insider trading destroys the confidence of investors in the securities market. When trading on confidential information is outlawed, investors will trade with the confidence that stock prices reflect their actual value.[45] The proper basis for the regulation is, therefore, the need to preserve the expectation of fairness needed to maintain investors' confidence in the securities market.[46]

This argument is not supported by any empirical evidence. What little evidence there is points to the contrary. The agitation for insider trading regulation did not come from investors or the business circles but the regulations were foisted upon the investors by a government that wished to advance its political fortunes.[47] Granted the massive regulation, it is remarkable that most of the suits have been brought by the agency of the government which promulgated them. Only few investors have been minded to sue and those who have, did so because they have been given an unmerited cause of action which can be exploited to transfer wealth from one group of persons to another. When genuine investors make a bad deal, they are often consoled by the fact that that is how the game goes and hope to have their own back at a more opportune moment of [illegible] trading.

If investors are averse to insider trading and corporations expect this aversion to

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[45] W.H. Painter, "How to Control Insider Trading: Time for an Overhaul" (1987) 73 A.B.A. Journal 38.

[46] R.M. Phillips and R.J. Zutz, "The Insider Trading Doctrine: A Need for Legislative Repair" (1984-85) 13 Hofstra L.R. 65, Hedges, *supra*, note 21, Cox, *supra*, note 13.

[47] The depression of 1929 - 32 was a major issue in the presidential campaigns of 1932. Franklin Roosevelt who had promised the people a 'new deal' was obliged to turn his promise into legislation. The indignation which tales of insider trading elicited at that time was worked upon in the congressional hearings. This was aimed, perhaps at shoring up the popularity rating of the government rather than prohibition of insider trading. See generally, J. Seligman, *The Transformation of Wall Street* (Boston: Houghton Mifflin Company, 1982) chap. 1.

affect their fortunes, they would have taken steps to prevent this aversion by establishing safety measures to prevent insider trading and publishing to the world that the corporation is free of such 'fraudulent' practices. The fact that they have not done so, even after the celebrated *Texas Gulf Sulphur Case* and the conviction of Boesky and Levine shows that corporations are generally disinterested in preventing insider trading. This disinterestedness is linked to the fact that the practice does not affect their investment fortunes. This latter result is possible only because investors do not consider insider trading such a threat to the market and continue to trade even though they are aware of the occurrence of the practice.[48] Those corporations such as law firms and printers that see a danger in allowing insider trading often take steps to prevent their employees from engaging in the practice.

In other advanced securities markets such as Japan where there is little or no regulation of insider trading, investors continue to trade in full knowledge of the incidence of insider trading.[49] After the Boesky and Levine cases, the market picked up after just a week of a slight drop in trading and continued to record increase in investment.[50] Indeed a public opinion poll, showed that while most people believed that

[48] Dooley, *supra*, note 38 at 45-46.

[49] "Markets appear to function successfully in nations, where official attitudes towards insider trading traditionally have been more benign than in the U.S. Moreover the Boesky and Levine prosecution, interpreted as evidence of widespread insider trading did not result in decreased market activity. When and if investors desert the market, it will likely be for reasons having little to do with insider trading", Cox and Fogarty, *supra*, note 17 at 354 n5.

[50] F.C. DiRusso, "The Battle Against Insider Trading: Are We Paying Too High a Price for too Little Gain?" (1989-91) 14-15 Vermont L.R. 457.

insider trading should be illegal, they would do it themselves if they had the opportunity.[51] Thus, far from destroying investors' confidence, investors would like to join in insider trading if given the chance.[52]

It can be argued that it is not insider trading that destroys the confidence of investors but the noise which attempts to enforce the regulations generate. The vigorous attempt by the regulatory bodies to point out the perils of insider trading, is sure to convince less imaginative and uninformed investors of the evil in a practice, which they had considered as part of business risks. It is this that causes some investors to lose confidence in the market, not the fact that insiders were trading on confidential information, a fact of which they had been aware for a long time.

2.2.e. Delay in Release of Information.

For the efficient operation of the market, it is important that information that would affect the market is released as quickly as possible. Regulators argue that insiders who wish to engage in insider trading are bound to keep the information secret until they have fully exploited it. Insider trading, therefore, delays release of information to the market.[53]

This argument appears to be misdirected. The relevant inquiry is as to who has the burden to release information. The duty of publication is that of the corporation, not

[51] Cox and Fogarty, *supra*, note 17 at 358 n16 citing Stuart, "Business Week/Harris poll: Outsiders Aren't Upset By Insider Trading" Bus. Week December 8, 1986 at 34.

[52] See H. Stern, "The Inside Inside Story" (1984) 133 Forbes 162.

[53] H. Painter, "Book Review: Manne, Insider Trading and the Stock Market" (1966-67) 35 Geo. Wash. L.R. 146, S. Levmore, "In Defense of Insider Trading" (1988) 11 Harv. J. of L. & Pub. Pol. 101 at 103, M. Mendelson "Book Review: The Economics of Insider Trading Reconsidered" (1968-69) 117 U. Pa. L.Rev. 470, Schotland, *supra*, note 7.

the insider. Although the corporation has to act through its officers, the officer who has the mandate to disclose may not be the one who wishes to engage in insider trading. An insider not so mandated, cannot release the information else he be in breach of his contract of employment. It is generally acknowledged that a corporation might have genuine interests that would warrant non-disclosure. Once the corporation thinks the time is ripe to release the information, it will certainly do so irrespective of whether its officers have an interest in trading. The insider's trading interest is surbodinated to that of the corporation. It is, therefore, corporate interest in non-disclosure and the fiduciary duties of employees that are the primary causes for delay in release of information and not the fact that insiders are trading.

The disclose-or-abstain rule which is recommended to cure this delay in release of information is faulty. The rule is observed more by abstention than disclosure.[54] The reasons are obvious. An insider who discloses loses the opportunity to make a gain. Rather he delivers a fortune to the other party. Secondly, disclosure may be in breach of his fiduciary duties to the company, if it is against corporate interest. Thirdly, by disclosure, the insider leaves himself open to liability if the information turns out to be incorrect.[55] Lastly, insiders would lack the facility or resources to disclose to all the world. These formidable array of difficulties leads to a practical conclusion that the rule

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[54] This rule is directed at corporate insiders rather than the regulation of the market. It is to prevent insiders from making a quick profit and not to prevent loss to the other party. Where insiders abstain, the outsider still trades in ignorance and suffer the same disadvantage he would suffer if insiders were trading. See Easterbrook, *supra*, note 28 at 326-327, Scott, *supra*, note 15 at 310-811, Cox and Fogarty, *supra*, note 17 at 353.

[55] Brudney, *supra*, note 25 at 337-338.

is one of total abstention.[56]

Conversely, insider trading compromises the corporate interest in non-disclosure and the need for the market to be aware of current information. In the first place, information is such a volatile object that it is difficult to keep under lid for a long time. Insiders are, therefore, in a hurry to utilise the information, before it loses its value of confidentiality. Rather than delay, the practice is expediency in dealing and release of the information.[57]

When inside trading takes place, the increased market activity is likely to cause changes in stock prices. Sooner rather than later, wise investors would realise that something is cooking somewhere and pattern their trade accordingly.[58] Thus, the information which the company has an interest in keeping secret is somehow reflected

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[56] A.R. Bromberg and L.D. Lowenfels, *Securities Fraud and Commodities Fraud*, vol. 3 (Colorado Springs, Colorado: Shepherd/McGraw-Hill Inc., 1990) para 7.4(181), Friedman, *supra*, note 34 at 752. Levmore, "Securities and Secret" *supra*, note 8 at 126 advocates that the rule should be one of disclosure always. But the disclosure rule as advocated is unfair to insiders. Insiders are to wait until the market has absorbed the news before they can trade. Meanwhile outsiders who get the news first are allowed to have a head start over other outsiders and the insider. The writer insists that the scheme is based on an assumption that a select few will not have long access to the information before others. This is a faulty assumption. Is the solution the suspension of trading until the news is fully absorbed? This may help cure the imbalance, but the economic cost of disrupting the market at frequent intervals outweighs this proposition. The absurd extreme has been suggested that insiders should still not be allowed to trade even after disclosure. See S.S. Kunkel, "Insider Trading: A New Equal Access Approach" (1989) 15 J. Cont. L. 51 at 67. It is wondered who will be inclined to disclose in such circumstances.

[57] Manne, *supra*, note 9 at 553.

[58] Easterbrook, *supra*, note 28 at 318 wrote "A considerable distortion of language underlies any holding that trading in a market without issuing a press release is 'fraud' or 'deceit'. These words ordinarily mean the uttering of false statements, or, perhaps, of half truths. ... False statements and half truths move the price of securities away from the accurate one. Trading on confidential information moves the price in the right direction". Cf H. Wu, "An Economist Looks at Section 16 of the *Securities Exchange Act* of 1934" (1968) 68 Col. L. Rev. 260.

in the market,[59] investors take advantage of it, the corporation is not obliged to disclose prematurely and risk claims, and the insider trader is not in breach of his obligations to the corporation. Almost everyone's interest is served by insider trading.

2.2.f. Misappropriation of Confidential Information.

It is argued that insider trading prohibition can be justified by a misappropriation theory.[60] That is, a person who trades on non-public information belonging to another without his consent in breach of a duty of trust and confidence is liable to the party with whom he trades even though that is not the person to whom the trust and confidence is owed. In a loose sense, it is based on a sort of fiduciary duty owed to the public at large, such as a duty to refrain from stealing information.

There is some justification in proscribing stealing, but in business circles insider

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[59] D.W. Carlton and D.R. Fischel, "The Regulation of Insider Trading" (1983) 35 Stan. L. Rev. 857 at 868.

[60] It is doubtful if the misappropriation theory has become a distinct theory of liability. It certainly lacked legitimacy as far as private suits are concerned. It was first raised by the minority opinion in *Chiarella*. Chief Justice Burger noted that where a person obtains informational advantage not by superior experience, foresight or industry, but by some unlawful means, he must disclose or abstain from trading. This was a faulty premise upon which Chiarella's conviction could have been based. His knowledge of the tender offering was based on superior experience for not everyone in the business could decipher the codes even if they wanted to. It was also based on his foresight that something was in the offing. It is equally arguable that he utilised his sense of industry (i.e., personal survival instincts) to trade. When the Chief Justice used the word unlawful, it is unclear if he meant unlawful as in illegal or unlawful as in tortious. Admittedly, Chiarella breached the code of conduct of his office, but his act could not be said to be unlawful in the sense of being illegal. He may be liable in tort or contract to his employers for the stain on their reputation and possible loss of distrusting clients, but that does not make his action illegal to warrant the inference of a breach of a public duty. The minority opinion in *Chiarella* was refined and adopted as the basis for conviction in *U.S.* v. *Newman* 664 F. 2d 12 (2d cir. 1981) and *SEC* v. *Materia* 745 F. 2d 197 (2d cir. 1984). However, those were criminal prosecutions and the facts showed implicit acts of fraud by the accused persons. It is remarkable that the theory did not justify liability in a civil suit based on the same facts in *Moss* v. *Morgan Stanley Inc.* 719 F. 2d 5 (2d cir. 1983) The deadlock of the Supreme Court in *U.S.* v. *Carpenter* 108 S. Ct.316 (1987) on the application of the theory is taken as giving some legitimacy to it. This is not entirely correct. The Supreme Court expressed no opinion on the theory except to announce its deadlock. Thus, the only explicit Supreme Court statement on the theory is its rejection in *Chiarella*. Interestingly the SEC has expressed little optimism for the theory and calls for its codification have been received with an almost total lack of enthusiasm.

trading standards are not as deeply felt as the standards that proscribe theft or fraudulent conduct.[61] The theory is dubious, being at odds with accepted notions of the fiduciary concept at common law.[62] At common law, where a person uses information in breach of his fiduciary obligations, his liability is to the fiduciary who owns the information and not to the person with whom he trades. As the common law adequately takes care of this sort of behaviour, there is no justification for making regulations based on a strained extension of the concept. The theory in fact reverses the common law, for the owner of the information will not be able to recover.[63]

The phrasing of the theory does not serve the aim of investor protection. A rider to liability is that the information must have been used without the consent of the owner. One advocate of the theory as the basis for an outsider's insider trading liability admits that when one with non-public information trades on it with the permission of the person who entrusted it to him, the misappropriation theory is inapplicable.[64] This reasoning defeats the aim of investor protection and strengthens the view that the source of liability

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[61] R.L. Simmon, "Penal Liability for Insider Trading in Canada, *Commission Des Valeurs Mobilières du Québec v. Blaikie*" (1988) 14 C.B.L.J. 477 at 493.

[62] It is certainly inconsistent with *Santa Fe Industries* v. *Green* 430 U.S. 462 (1977) which held that there can be no breach of the antifraud provisions of the securities laws in the absence of deception. Cf. J.R. MacAyeal, "Rule 10b-5 Developments - Theories of Liability" (1982) 39 Wash. & Lee L.R. 969 at 981.

[63] This is the effect of the rules developed by the courts. The owner of the information cannot sue because in most cases he would not have bought or sold shares and would lack standing under the rule in *Blue Chips Ltd.* v. *Manor Drug Stores* 421 U.S. 723 (1975). Where he bought or sold shares he would still be unable to sue because as the owner of the information, it is assumed he was aware of it, and must also have traded on the basis of confidential information and would be foreclosed from suing under the *im pari delicto* principle.

[64] B.B. Aldave, "Misappropriation: A General Theory of Liability for Trading on Nonpublic Information" (1984 - 85) 13 Hofstra L.R. 101 at 122.

is the person who owns the information. It has the tendency to encourage persons who cannot trade to tip others to trade. If a person trades with the permission of the owner of the information, in what way does this aid the person with whom he trades and how does it alter the position if he trades without the consent? In both instances, the other party always suffers an informational disadvantage, but while one can recover, the other cannot. More damaging is the writer's proposition that "when one simply steals information from a stranger, his trading on the information does not involve deception or fraud and does not violate (the rules). When one fortuitously discovers information that is not known to the public, the theory does not prevent him from trading on it".[65]

One objection to the theory is that it is directed at employers, not investors protection[66]. Although the cases so far have involved employees using information in breach of their employment contract, the objection is not entirely accurate. A person would be liable if he used information in breach of a duty of trust and confidence. A lawyer who trades in the securities of a company on the basis of information obtained from his client would be liable under the theory even though he is not employed by the client in the sense in which that word is normally used.

A curious fact in the application of the theory is that it is not directed at the confidentiality of the information strictly. This can be seen from its application in the

[65] *Ibid.*

[66] Kunkel, *supra*, note 56 at 65.

Carpenter Case.[67] The information contained in the "Heard on the Street" column is not nonpublic. The column is only a distillation and analysis of corporate information that can be obtained by anyone who bothers to ask for it. Winan's position is analogous to that of investment and market analysts. If the regulations are meant to prevent the use of confidential information, it is difficult to see how the misappropriation theory could have been proposed for the conviction in *Carpenter.*

2.2.g. Fiduciary Obligations and Conflict of Interest.

Insider trading on the basis of information belonging to the company is a breach of the fiduciary obligations owed to the company. It is further said that allowing insider trading will lead to a conflict of interest in that insiders will be more interested in inventing and shielding information upon which they can trade instead of concentrating on the business of the company.

When an officer of the company trades on information belonging to the company, he breaches his duty not to expropriate corporate information for his own benefit.[68] That issue is now beyond argument and it is adequately covered by the common law, but a fiduciary concept does not justify most of the regulations. Sometimes the information upon which the insider trades comes to him in a capacity separate from his insider status. Indeed the information may not belong to his corporation. Again, most times insiders trade in the shares of other corporations, and because they do not owe these corporations

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[67] See D. Sims, "United States v. Carpenter: An Inadequate Solution to the Problem of Insider Trading" (1988) 34 Wayne L.R. 1461, D.J. Block, N.E. Barton & D.D. Babich, "SEC Litigation: Private Rights of Action for Illegal Insider Trading" (1987) 15 Sec. Reg. L.J. 299.

[68] *I.D.C.* v. *Cooley* [1972] 1 W.L.R. 443.

any fiduciary obligations, they are not caught under the insider trading rules. The extension of the regulations to outsiders is not justified by the fiduciary concept. Liability must be based on an abuse of confidence.[69] The common law concept of fiduciary duties is certainly ductile and malleable. Like negligence, the categories of fiduciary relationships are not closed and the courts can extend the concept in appropriate circumstances to prevent abuse of confidence and fraud.[70] There is, therefore, nc justification for regulations which at best are repetitive of the common law, and in most cases do not tally with the notions of confidentiality and fairness.[71]

It is equally incorrect to argue that insider trading would distract managers from their duty of management. There is no general prohibition of trading by insiders.[72] Insiders may trade in securities of other corporations on public information. As investors, they must necessarily spend time to search for and analyse the market information. If such trading on outside sources does not consume all their time as to leave them little

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[69] J.P. Strickler, "Inside Information and Outside Traders: Corporate Recovery of the Outsider's Unfair Gain" (1985) 73 Calif. L.R. 483 at 494 and 496 argues for an extension of the principle to hold all parties trading on inside information liable even though they owe no fiduciary duty to the party with whom they trade. This is a strange proposition and the court have not been disposed to adopt such reasoning. Despite what is called the era of expanding insider trading liability all the seminal decisions save *Re Cady, Roberts* involved affirmative misrepresentation or the existence of a fiduciary obligation and that case was an administrative ruling. Although footnote 14 in *Dirks* is assumed to extend liability to temporary insiders, such liability must be linked to fiduciary obligations which the persons assume in the special circumstances.

[70] Easterbrook, *supra*, note 28 at 318.

[71] Wang, *supra*, note 11 at 1261; "The courts' requirement of disclosure to a large number of people seems contrary to moral precepts. Imposition of moral obligation to a stranger is usually predicated in large part upon one's proximity to the stranger. Because of the total absence of contact in the stock market context, it is difficult to understand why one investor should ever have a moral obligation to other investors who are strangers. A moral obligation ought not to exist absent some special relationship between the parties".

[72] Save for short swing transactions in section 16(b) of the *Securities Exchange Act*.

time to manage the corporation, it is difficult to see how trading on insider information which can be obtained and analysed in less time will lead to this outcome. Moreover, managers are not required to devote all their time to the management of the business of the corporation.[73]

Another conflict of interest argument is that insiders would no longer act in the best interest of the company. There are two answers to this. Where an insider is found to have acted not in the best interest of the company, he is liable in damages at common law.[74] Secondly, insider trading does not unequivocally lead to this consequence. Aside from the profit to be made, insiders, who are professionals, have a stake to ensure that the company is well managed, for this will have a bearing on their professional fortunes. An insider in unlikely to jeopardise his professional calling for profit on a one time deal, unless the opportunities for profit are immense. And realising that he may be made to return the profit to the company if it is proven that he put his interest before that of the company, only the most naive of insiders would allow their insider trading interest to override the overall interest of the company.

2.3. Justification for Deregulation.

The congeries of defects in the arguments for regulation is not enough to conclude that regulations are unjustified. It must be shown that there are stronger arguments for deregulation. This section examines this proposition.

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[73] *Re City Equitable Fire Insurance Company* [1925] Ch. 407.

[74] *Re Smith and Fawcett Ltd.* [1942] Ch. 304.

2.3.a. Economic Efficiency.

Insider trading regulations are not based on notions of economic efficiency.[75] Deregulators argue that there are many economic benefits that can be made from insider trading.

Society develops because new ideas are created which advance the old ones. As society benefits from discovery of new information that affects resources allocation, it is desirable to provide incentives for people to develop such information.[76] People produce ideas when there is a possibility of making profit. Insiders, who are usually knowledgeable about the operations of the market aim to produce valuable information upon which they can trade and make profit. It is only by trading on the information when it is still confidential that this profit can be made. Insider trading, therefore, encourages innovativeness. When the motive for gain is lost, the zeal to search for or produce valuable information will disappear and society will be the ultimate loser in terms of economic development. The chemist who discovers a new drug is given a patent to protect his right of property in the invention, but the director who formulates a better takeover scheme cannot trade on the information. This failure to regard information as property right accounts for the regulations which discount the economic aspects of the issue. The promise of gain will prompt even the most indolent to become innovative.[77]

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[75] Cox and Fogarty, *supra*, note 17 at 357.

[76] Dooley, *supra*, note 38 at 63.

[77] Manne, *supra*, note 2 at 123; C.L. Beck-Dudley and A.A. Stephens, "The Efficient Market Theory and Insider Trading: Are We Headed in the Right Direction" (1989 - 90) 27 A.B.L.J. 441 at 456, wrote: "The regulation of insider trading deals with the competition for investment information. The SEC should operate so as to encourage the collection and dissemination of information, thus allowing efficient pricing and efficient allocation of resources ... allow the potential for abnormal returns over time since investors

There are economic benefits to the company from insider trading. It may lead to a more efficient running of the corporation. When insiders produce information upon which they trade, the information also increases the value of the corporation. Where the information relates to a new product, the company usually gets the patent or copyright. It is also likely to reward the insider who produced the information. In this state of affairs, there is bound to be competition among the officers for the production of valuable information, not just for trading but also for the corporate reward. If insider trading regulations remove the incentive to produce information, the company will be ineffectively managed. Aside from this, insider trading reduces the cost of running the corporation.[78] Insiders are inclined to accept less remuneration if they are assured of the possibility of augmenting their salary which they can do by trading on confidential information. Where they know that their only source of income is the remuneration, they are likely to shoot up their price. Again, the extra which can be made will depend on the innovativeness of each officer. This as pointed out will encourage competition, which in turn benefits the company. Thus the company pays less by allowing insider trading and stills stands to make additional profits.[79]

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who identify these abnormal return possibilities provide a more efficient market in the long run".

[78] Carlton and Fischel, *supra*, note 59 at 869-872. See generally D. Fischel, "Insider Trading and Investment Analysts: An Economic Analysis of Dirks v. Securities and Exchange Commission" (1984) 13 Hofstra L.R. 27.

[79] At the end of the day the company may not have to pay anything for hiring the insider. Suppose an insider were to charge $100,000.00 if insider trading is prohibited, but because he is allowed to trade, he takes $50,000.00. He produces information upon which he trades and makes $70,000.00. The information also enhances the company's earnings by $60,000.00. If he could not trade, he might not have produced the information and the company would have earned $60,000.00 less and would still have had to pay the officer $100,000.00. Now the company has to pay only $50,000.00 and this it does from the extra $60,000.00 earned from the exploitation of the information. It, therefore makes a gain of $10,000.00 aside

Insider trading helps to move prices in the right direction and in a way benefits investors. It has been argued that the volume of trading by insiders is so little that it does not lead to a significant change in price which other investors may take advantage of. Such insignificant changes do not promote an efficient market. The little gain to the other investors is not balanced by the huge gains made by insiders.[80] This is true in so far as insiders would lack the resources to fully exploit the value of the information. But the truth is that insider trading helps to reflect, if ever so slightly, that there has been a change in the value of the securities being traded. This change puts experienced investors on inquiry and they usually pattern their trade accordingly.[81]

Insider trading regulations put a strain on the little resources of the society. The practice is one that greatly defies detection. The cost of supervising the enforcement of the regulations is much more than can be recovered by the agencies both in terms of monies recovered and the intangible benefits to society. Indeed the securities market stands to suffer in the face of massive regulations. With the development of internationalised securities market, investors are bound to channel their trade to markets

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from the saving of $50,000.00 it would have taken from its other accounts to pay the officer. The insider also makes $20,000.00 more than he would have made if he were not allowed to trade. Shareholders also gain in one of two ways. They may hold their shares and have an increase in dividends from the extra profits or the higher corporate yield will increase the price of their shares which they may sell and make profit. Almost everyone stands to gain from just one insider trading. The benefits can be imagined if this scenario is multiplied in a corporation.

[80] S. Bainbridge, "The Insider Trading Prohibition: A Legal and Economic Enigma" (1986) 38 U. of Florida L.R. 35 at 44, Schotland, *supra*, note 7 at 1443.

[81] Studies have shown that investors usually react quickly when insiders buy securities. When insiders trade a small price change occurs; leaks of the information will lead to further price changes, other investors then follow the pattern of trading and the market gradually but steadily moves towards the correct price. This is called the 'derivatively informed trading mechanism'. See R.J. Gilson and R.H. Kraakman, "The Mechanisms of Market Efficiency" (1984) 70 Va. L. Rev. 549 at 629, Saari, *supra*, note 39.

that do not have such crippling restrictions. They would have to open accounts in the banks of the foreign country, employ investment analysts and brokers and generally invest in the corporations of these countries.

Schotland argues that even if insider trading brings these economic gains, they might still be foregone "in order to secure a stock market ... that satisfies such noneconomic goals as fairness, just rewards and integrity".[82] The fairness argument has been dealt with earlier. It is only to be queried what aim fairness has if its outcome is to lead to economic depression. If insider trading leads to increased market activity which buoys the economy (a primary aim of capital market economies) so much for fairness. It is not true, as has been asserted that the SEC has no regard to economic considerations in its approach to regulations.[83] Some instances exist where the SEC has allowed economic considerations to determine their decisions. In the Boesky affair, SEC allowed Ivan Boesky to sell off a billion dollars worth of securities before disclosing his settlement with the government. The basis for this was that if announcement were made before the sale, the value of the securities would drop to the detriment of the market.[84] This argument runs on the classical cost-benefit analysis, i.e, more people stood to gain

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[82] Schotland, *supra*, note 7 at 1439. Cf O.P. Colvin, "A Dynamic Definition of and Prohibition Against Insider Trading (1991) 31 Santa Clara L.R. 603.

[83] "Since ... congress was attempting to improve the morality of the market place ... the economic effect is irrelevant", Ferber, *supra*, note 8 at 622.

[84] This has been described as the ultimate case of insider trading. Because SEC is a government agency, it is an agent for the public. The information about the settlement was, therefore, public property held in trust by the SEC as their agent. It was price sensitive as it would affect the trading decision of reasonable investors. By permitting Boesky to sell, SEC misappropriated information belonging to its principal, the public and was itself guilty of insider trading under its own rules. See generally Wolfson, *supra*, note 9.

than lose by the arrangement. Yet economic arguments for deregulation based on the same cost-benefit analysis have been rejected. Again, during discussions on how to overcome the investigatory problems associated with investor's trading through foreign intermediaries, the SEC dropped the suggestion that such investors be made to sign express waiver of confidentiality before being allowed to trade on the ground that investors would move to other markets which allow them to maintain anonymity in trading, which will result in a loss to the U.S. market.[85]

Economic efficiency arguments are discounted as those of eccentric professors, but the practical gains are too obvious to be ignored and no amount of 'foot stamping'[86] can compensate for this.

2.3.b. A Victimless Act.

Regulators argue that insider trading is harmful but have been unable to show convincingly, or at all, the persons harmed by insider trading. An act cannot be harmful in *vacuo*. If it is harmful, it must be shown to be harmful to somebody[87] and that the person's interest not to be harmed warrants protection through regulations.

The argument here, is that insider trading does not harm anyone. This discussion is necessarily restricted to dealings on impersonal stock. In face-to-face transactions, the other party may be harmed by the active concealment of facts by the insider trader who

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[85] Contrast P.Q. Noack, "West German Bank Secrecy: A Barrier to SEC Insider Trading Investigations" (1986 - 87) 20 U.C. Davies L.R. 609 at 636-642.

[86] Manne, *supra*, note 2 at 15. This is another term for the it's-just-not-right argument that condemns insider trading as wrong without pointing to any particular fact that makes it so.

[87] Manne, *ibid.* at 93.

may have initiated the trade. In this circumstance, the common law has risen brilliantly to meet the devices of insider traders.

In the impersonal market, the fact that insiders trade is not the impetus for the trade of other investors. The other investors would still trade whether or not insiders do. The 'loss' which they suffer can be attributed to the fact that they chose a wrong time to trade; the fact that insiders were also trading being coincidental.[88] Investors do not hope to trade in a risk free environment. They, therefore, insure against this risk by discounting the amount paid for the shares against the fact that someone might be trading with an informational advantage. Experienced investors also spread their portfolios so that the losses made on one can be offset by profits made on the other.

Far from giving the investor a lower yield, insider trading ensures that the investor trading with the insider gets more value for the shares sold or bought. Insider traders are in a hurry to consummate the transaction before the information loses its value. To attract the other party, they are bound to offer a higher price. Thus while an investor would have sold his shares for $10.00 if the insider refrained from trading, he would sell it for may be $12.00 to the insider, who has to top the bid of the other party in order to acquire the shares. When insiders sell, they sell at a lower price than the investor would have bought from another outsider. Rather than harm investors, insider trading benefits them.[89]

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[88] Hetherington, *supra*, note 41 at 723, Dooley, *supra*, note 38 at 33.

[89] Manne, *supra*, note 9 at 553. Wang, *supra*, note 11 observes that in this circumstance there is harm to the outsider who would have sold or bought, as the case may be, but was outbidded by the insider. This he calls "the law of conservation of securities". This is not exactly correct, for there is no general requirement in law to have regard to the interest of your competitor when making a transaction.

If an investor suffers any loss, he does so because he traded. Investors who hold on to their shares, eventually enjoy the benefits of the price change when the information is released.[90] Now, securities are held more or less permanently. Trading investors usually fall into two categories. The first are those selling to meet a contingency, who would sell whether or not insider trading was taking place.[91] The second are the over-a-time traders who trade frequently based on price movements, i.e, the speculators. For this class, they could have refrained from trading, but that is not a ground to infer a loss, for risk is a major element of speculation and speculators do not expect to be insured against this risk by insider trading proscriptions. It is only when a long term investor is induced to sell by the insider's trading that anything approximating to a loss can be said to have occurred. It needs a straining of language to find this inducement or correlation between an investor's trade and that of the insider.[92]

It is counter argued that the wrong signal given by insider trading, induce investors to sell when they would have held on to their shares or to hold on to their shares when they would have sold, and they thereby suffer loss.[93] Price fluctuations occur for several reasons and investors react to these, rightly or wrongly. When they

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[90] Manne, *supra*, note 2 at 107.

[91] Painter, *supra*, note 53 at 149 argues that this argument is not in line with reality and that the long term investor would surely fell aggrieved if he learned that insiders were making a killing when he sold. It is also argued that the emergency trader might have been inclined to look to other sources of funds to meet the contingency if he knew that in a few days time he would get increased value for the shares.

[92] See W.J. Carney, "Signalling and Causation in Insider Trading" (1986 - 87) 36 Cath. U.L.R. 863 at 866-876. The courts have refused recovery in the absence of such proof; see *Fridrich v. Bradford* 542 F.2d 307 (6th Cir. 1970).

[93] Mendelson, *supra*, note 53 at 475-476. Schotland, *supra*, note 7 at 1445 - 7.

react wrongly to price fluctuation caused by other factors, there is no general ground for recovery.[94] Why then should recovery be given for wrong reaction to price fluctuation caused by insider trading, just one of the many factors responsible for this phenomenon? Is the investor's wrong reaction to other price fluctuation factors any less a loss than the reaction to price fluctuation caused by insider trading? Again, other factors may combine with the insider trading to cause the market change to which the investor reacts, but he is allowed to claim the full difference in trading price as if it were only the insider trading that caused the 'loss'.

Assuming for a moment that harm to the investor can be demonstrated, the question of causation ought to be considered. It is not the insider trading that causes the loss, it is the information. If the information is never disclosed, the securities will not rise to the level that will allow for insider trading profits, and if it were published on time, insiders would not profit from the trade. The proximate cause of the loss is, therefore, nondisclosure. The query, then, is, who is responsible for disclosure of corporate information. It has been shown earlier that this is the responsibility of the company, not the insider.[95] Where the company has good reasons not to disclose, it must be weighed whether such corporate interest prevails over that of the investor in getting the information. In most cases, this would be so. Where the company has no reason to withhold disclosure, then it should be liable for nondisclosure, which is the proximate cause of the trader's loss and the corporation ought to be the party to be sued

[94] Dooley, *supra*, note 38 at 36.

[95] Pages 41-42.

not the insider.[96]

It is also argued that insider trading harms the corporation. When insiders trade, the company suffers a loss of reputation and may lose the patronage of customers. This affects the yield of the company, which in turn is reflected in shareholders return on their investment. It may also lead to internal delays and indolence which would affect the efficiency of the company.[97] There is force in these arguments, but they hardly justify the regulations. The common law is adequate for this. Companies have been allowed to recover for these losses based on common law principles.[98] The company may sue for breach of fiduciary duties or on the conflict of interest principle. The reply that this will not extend to catch those to whom insiders tip the information ignores the well recognised concept of the constructive trustee at common law and in appropriate circumstances tippees will be liable as such.

Another reasoning here is that insider trading causes harm to the integrity of the market by impugning investors' confidence in the market. This argument has been dealt with earlier.[99] It will only be repeated that this has not been proven.

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[96] A company may be sued for insider trading on the basis of its trading or those of its tippees, but not on the basis of the analysis in this paragraph. The argument that the outsider's loss is caused by the nondisclosure rather than the trade is supported by the fact of corporate recovery of insider trading profits. The focus is on the information, not the trade. The shares which are traded, unless in the case of an issue, do not technically belong to the company and it should not be able to recover. The company only recovers because the information used is taken to belong to the company, a focus on the information, rather than the trading itself.

[97] R.J. Haft, "The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation" (1982) 80 Mich. L.R. 1051.

[98] *Brophy* v. *Cities Services ltd* 70 A.2d 5 (Del. Ch. 1949), *Diamond* v. *Oreamuno* 248 N.E.2d 910 (N.Y. 1969).

[99] See pages 39-41.

Admittedly, insider trading may cause genuine losses at times, but the occasions are so infrequent and those who suffer so few, that it does not warrant sacrificing the benefits accruing to the gross majority for the protection of a negligible minority.[100]

2.3.c. Compensation to Entrepreneurs.

This is one of the arguments advanced in detail by Professor Manne in *Insider Trading and the Stock Market*.[101] He argues that insider trading is a sort of compensation scheme for entrepreneurs who produce information. The entrepreneur is vital to the development of the corporation and must be encouraged to continue to produce information, for in the absence of such incentive, the entrepreneur will disappear from the corporate scene, thereby setting the stage for the demise of the corporation itself.[102]

Regulators have formulated the best, albeit unconvincing, reply to this argument of all of the deregulators arguments. The first objection is that remuneration of entrepreneurs is a matter of contract between them and the corporation and as such, they are not entitled to take more by way of insider trading.[103] This is a valid argument in so far as the possibility of the entrepreneur making gains on insider trading has not been discounted in the fixing of his remuneration. If this discounting has been done, resulting

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[100] Manne, *supra*, note 2 at 110, B.L. Welling, *Corporate Law in Canada: The Governing Principles*, 2nd ed. (Toronto: Butterworths, 1991) at 356.

[101] *Supra*, note 2, Chapter IX. Cf. H. Manne, "In Defense of Insider Trading" (1966) 44:6 Harv. Bus. Rev. 113.

[102] *Ibid.* at 123.

[103] Schotland, *supra*, note 7.

in reduced cost of running the company, then insider trading by the entrepreneur will be justified. Yet the use of the word 'compensation' may lead to the misleading connotation, that the entrepreneur is getting something beyond what he is normally entitled to.

Another objection is that such trading will reduce rather than improve corporate efficiency. Insiders will not be anxious to avoid bad news since in that event, they would be able to sell and make profit by avoiding a loss.[104] Indeed, insiders may be encouraged to produce bad news because of the gains to be made therefrom. This argument has some merit but does not accord with reality. Firstly managers[105] work as a board. The participation of other managers, not interested in such conduct, in corporate decision making is an insurance against the possibility of one manager inventing bad news and dealing on it. It would require the conspiracy of the board to put the corporation out of business to achieve this possibility. A stronger fact is that managers will usually aim to produce good rather than bad news. The need to achieve professional excellence and gain the respect of colleagues is a motivating factor in the production of good news. When bad news is produced, this may result in the demise of the corporation and the manager's performance during this period will surely affect his ability to get a new managerial position. Although managers may still sell and profit on bad news, this may prove less profitable in the long run. When there is bad news, managers dispossess themselves of their shares and make a one time profit. When there is good news, they buy and keep shares. The dividends earned over a period of time will

[104] *Ibid.*, Levmore, "Securities and Secrets" *supra*, note 8 at 117.

[105] This word is used interchangeably with entrepreneur by Manne and they refer to the same category of corporate employee, perhaps not in the manner in which it is employed in common parlance.

outstrip the profits made on the one time deal on bad news. It is not to be assumed that insider trading always involves shortswing transactions. If the managers are also in control as majority shareholders, bad news which forces them to sell will result in loss of control, while good news which induces them to buy will guarantee greater control. There are, therefore, more inducements to produce good news than bad news.

It has been said that allowing for this scheme of compensation does not ensure equality among the managers themselves because the extent to which a manager will be able to exploit the information depends on the resources at his disposal.[106] Although it is possible to raise a loan to finance such trading, the possibility is slim for an innovative but impecunious entrepreneur who has no security to put up for the loan. Instead of allowing this discriminatory treatment, managers should be fully remunerated for their services and refrain from insider trading. This argument is still unanswered by deregulators who raise the compensation scheme argument.

Manne's thesis in this regard, as initially formulated, does not fit neatly into a model of deregulation and is, today, of doubtful utility.

2.3.d. Lack of Corporate Prohibition.

As argued above, there is greater possibility of harm to the corporation, than to the private investor or to the market generally. Corporations have stronger reason to feel threatened by insider trading and, therefore, have greater interest in monitoring such behaviour. And because the relationship between the company and its employees is contractual, they have a singular opportunity to prohibit the practice by inserting

[106] Bainbridge, *supra*, note 80 at 47-49.

appropriate clauses in the contract of employment.

Available data show, however, that corporations do not, generally, prohibit their employees from trading on confidential information. If the company that has greater reasons to prohibit insider trading does not do so, then prohibition for the sake of others who have less reason to expect losses from insider trading must have a faulty premise. The fact that corporations do not prohibit insider trading posits that they regard the practice as innocuous or not serious enough to justify regulations or that indeed they derive certain benefits from insider trading.[107]

Corporate control and internal monitoring ought to be a panacea for insider trading. Schotland argues that the absence of corporate prohibition is due to the formidable enforcement problems that will follow. There will, undoubtedly, be some enforcement problems, but that is not the reason for absence of corporate control. Enforcement will cost money and if this cannot be offset by the gains from the regulation, then they would have little efficiency utility in corporations.[108] Despite the cost of enforcement, firms which recognise some benefits in prohibiting their employees from trading have not hesitated to do so. The law should allow corporations which see no danger in allowing insider trading to opt out of the regulations. Most corporations would readily do so.[109] Moreover it is easier for corporations to detect insider trading

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[107] See F.H. Easterbrook, "Insider Trading as an Agency Problem" in J.W. Pratt & R.J. Zeckauser, eds, *Principals and Agents* (Boston: Mass.: Harvard Business School Press, 1985) 87 at 90-91, V.L. Georgakopoulos "Classical and Cross Insider Trading: Variations on the Theme of Rule 10b-5" (1990) 28 Am. Bus. L.J. 109 at 129.

[108] See Carlton and Fischel, *supra*, note 59 at 861-866.

[109] Painter, *supra*, note 45 acknowledges that few managers will have the nerve to propose such restrictions in the corporate charter and few shareholders will vote in favour of it.

than it is for government agencies, yet the enforcement problems have not been seen as a hurdle that would justify deregulation.

Haft made a strong point when he noted that corporations do not prohibit insider trading because those who would propose such restrictions are also those to benefit from insider trading.[110] This, however, appears to ignore the paramountcy of corporate interest. The decision to prohibit insider trading is that of the entire body of shareholders, not the board. Although the board may also constitute the majority shareholding, the pertinent question always is whether the corporation stands to gain more by prohibiting insider trading. It has been shown that corporations for which insider trading portends great danger have prohibited it, on the initiative of those who stand to gain, in recognition of the fact that the losses from allowing insider trading outweigh whatever individual gains they stand to make.

2.3.e. Securities Transaction as a Form of Contract.

A securities transaction is a contract between the vendor and purchaser of securities. The law of contract is one in which the autonomy of the will of the parties usually prevails. Although the law has stepped in to regulate this relationship at times, it is usually content to leave the parties to bargain to their best advantage.

Recognising that one party usually has a bargaining advantage over the other, the law has left a party with superior knowledge to trade with it to his advantage provided there is no fraud or deceit practised by him. The onus is on the other party to find ways of offsetting this disadvantage. The relevant factor is the consensus of the parties either

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[110] Haft, *supra*, note 97 at 1058.

in fact or by legal fiction, and the law holds a party to his bargain even though he did not exercise an informed opinion on the matter, if this shortcoming is not linked to the fraud of the other party.

It is, therefore, wondered if there is anything special in securities transactions that mark them out for special treatment. Obviously, there is none, for in ordinary securities transactions the law does not impose a general duty of disclosure. It only does so when certain persons are trading. According to Lowry,

> The offence of insider trading is not characterised by the nature of the transaction. The unlawful transaction is by its very nature identical to a regular transaction. It is because the person who carries out the operation possesses, by virtue of his position or by reason of circumstances information not known or generally available to the public that the operation which he carries out or causes to be carried out becomes unlawful.[111]

But is possession of superior information a ground for impugning the contract of consenting parties? It is not. The law allows persons with information not known to the other to trade even in situations involving more turpitude than the usual insider trading scenario. A vendor may sell his house which has a concealed defect provided there is no active misrepresentation and the defect is not latent. A merchant of goods is allowed to sell his wares which are at sea even though he knows that war will break out in the region in the next week and jeopardise the safety of the goods. A purchaser of famous paintings, who buys an ingenious copy cannot rescind the contract even if the seller knew that he was making a mistake.[112] These cases are certainly more condemnable than the

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[111] J.P. Lowry, "The International Approach to Insider Trading: The Council of Europe's Convention" [1990] J.B.L. 460 at 461.

[112] *Leaf* v. *International Galleries* [1950] 2 K.B. 86 and Lord Atkins in *Bell* v. *Lever Brothers Ltd.* [1932] A.C. 161.

insider trading case where the insider does not come in contact with the other party and does not induce his trade. The law seems to have drawn an unmeritorious distinction here. Insider trading in an economic, as distinct from a legal, sense should include all trades where information is asymmetric whether or not securities are involved.[113]

In the insider trading cases, themselves, there has been a discrimination in treatment. To take a hypothetical, A an officer of a manufacturing company informs B and C, both outsiders of the company that there would be a 100% increase in the price of the goods manufactured by the company. This information would be likely to materially affect the price of the securities of the company. B quickly begins to buy up the shares of the company in the market in the hope of selling for a profit when the price increase is announced. C, on the other hand, begins to buy up the products of the company in the market at their current price in the hope of selling them at the new price for a profit when the increase is announced. By the present formulation, B would be guilty of insider trading, but C would not, yet both parties traded on exactly the same information received from the same person in the corporation. If the information were public, it would have affected the decision of those who sold the products of the company to C in the same way as it would affect the decision of those who sold the company's shares to B. The reason for the difference in treatment is not apparent. This hypothetical can find support in the *Texas Gulf Sulphur* saga. While the officers in *Texas Gulf Sulphur* were condemned, the commentators seemed to be at ease with the suggestion that the company was entitled to keep the information secret to enable it to acquire mining rights

[113] Carlton and Fischel, *supra*, note 59 at 860.

on adjoining lands. Was this because the information was regarded as corporate property? Certainly not, for if the company had attempted to buy its shares at that time, it would no doubt be condemned. The discrimination lies in the fact that the acquisition of the land is not a securities transaction and did not warrant protection. Yet, the company would be buying on the same confidential information used in the share transaction, and this information would affect the decision of the landowner to sell and at what price. Now why should the vendor of land have less protection than the vendor of securities? There is nothing in the nature of securities that marks it out for a treatment different from other commodities which are the subject of contract.[114]

Perhaps the aim of regulating trading by insiders is to eliminate the probability of only one party making a gain all the time and somewhat equalise the profit potential of both parties. This cannot be the justification in a state with government sponsored lottery[115] where the government stands to make a profit on each round while the chance of a staker to make profit is one in about a million stakes. Talk of fairness.

As the law allows the use of informational advantage in other types of contract, it should also allow it in securities transactions.[116] As parties trade with the risk of another having superior information, the law allows a party who wants to equalise the informational position to ask specific questions of the other. Where he gives a misleading answer, he is guilty of active misrepresentation for which an action will lie. The other

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[114] See Lawson, *supra*, note 4 at 732 and generally Kronman, *supra*, note 42.

[115] Welling, *supra*, note 100.

[116] See Scott, *supra*, note 15 and Alcock, *supra*, note 44.

party has a choice not to answer the question and his silence is bound to put the outsider on notice that all is not level. It may be objected that this is not possible in impersonal markets, but the trading parties can carry on the interrogation through their brokers acting as their agent. It is remarkable that one regulator argues that in the direct question situation, the law should allow a producer of information to misrepresent the true state of things, the justification being that requiring the information producer to disclose will rob him of the value of the information and enable the other party to enjoy unmerited benefits of partaking in the production of the information. This he calls the "optimal dishonesty" rule, i.e, that the net societal gain outweighs the benefit of disclosure.[117] This is exactly the argument which deregulators have been making.

Whatever danger there is in insider trading, it is not more than that posed by other trading done on superior information which is allowed. Securities transaction whether by insiders or not should be viewed as a form of contract which it is.

2.3.f. Freedom of Contract and the Limits of the Law.

Despite its attrition over the years,[118] the freedom of contract theory developed by the political economy theorists still finds relevance in today's commercial setting. Since the 18th century, the law has ceased to focus on particular types of contract, but has developed general principles of contract which are applied to all transactions irrespective of their subject matter. The will theory still finds currency as the basis for

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[117] Levmore, "Securities and Secrets" *supra*, note 8 at 139-140.

[118] See P. Atiyah, *The Rise and Fall of Freedom of Contract* (Oxford: Clarendon Press, 1979) particularly, parts II and III, G. Gilmore, *The Death of Contract* (Columbus: Ohio State University Press, 1974).

the enforcement of most contracts.[119]

Although self interest is the motivation for most contracts, free will is the basis of contracting. It is when individuals exercise their free will and bargain to the best of their ability to achieve the optimum result that the market functions best.[120] The force that brings contracting parties together is the selfishness, the gain and the private interest of each.[121]

The relevant consideration for the enforcement of obligations is the intention of the parties as expressed or inferred from their conduct. The words of Jessel M.R. spoken almost twelve decades ago still has potency today.[122] He said,

> ... if there is one thing more than another which public policy requires, it is that men of full age and competent understanding shall have the utmost liberty in contracting, and that their contract when entered into *freely and voluntarily*, shall be held sacred and shall be enforced by courts of justice.[123]

The courts frown on unfair dealing, but the relevant consideration is a free exercise of a party's will. A contract is fair if it is consensual. In other words "free dealing (is) fair dealing".[124] When the parties bargain at arms length (as is invariably

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[119] See generally, M.R. Cohen, "The Basis of Contract" (1932) 46 Harv. L.R. 553 at 558ff.

[120] This is the 'pareto-efficiency' principle of the Adam Smith school of political economy. Cf Atiyah, *supra*, note 118 chap. 12.

[121] K. Marx, *Capital*, trans. Lawrence and Wishart (New York: International Press, 1967) vol. 1 at 172, cited in J.S. Webb, "Contract, Capitalism and the Free Market: The Changing Face of Contractual Freedom" (1987) 21 Law Teacher 23 at 24.

[122] *Printing and Numerical Registering Company* v. *Sampson* (1875) L.R. 19 Eq. 462.

[123] *Ibid.* at 465, emphasis supplied. Cf. Pothier, *Treatise on the Law of Obligation*, vol. 1, trans. Evans (1806) at 152.

[124] P. Devlin, *The Enforcement of Morals* (London: Oxford University Press, 1965) at 47.

the case in impersonal stock transactions) the law expects each to rely on his own skill and judgement. No one is expected to be his brother's keeper and to formulate ideas for the opposite party. The law has been astute in recognising that the consent of a party may be vitiated by certain factors and would, therefore, not support a contract. The generally recognised factors are mistake, misrepresentation, duress and undue influence.[125] Even then, the application of these factors are confined to narrow limits, in recognition of the need to uphold the justified expectations of contracting parties. Other broader concepts of vitiation such as inequality of bargaining power[126] and unconscionability[127] are yet to receive general acceptance.[128] These vitiating factors are missing in securities transactions on the impersonal market. There is no duress in that the insider trading is not the inducement for the contract. Mistake is nonexistent as the other party gets what he set out for in the first place. There is no misrepresentation for no statements are made to the other investor. Indeed, the ground for complaint is the failure to speak rather than anything that is said, and silence has never been a ground for impugning a contract unless there is a legal duty to speak,[129] or the silence falsifies a true statement.[130]

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[125] See generally M.P. Furmston, ed., *Cheshire and Fifoot's Law of Contract*, 11th ed. (London: Butterworths, 1986) chaps. 8 and 9.

[126] See Lord Denning's formulation in *Lloyd's Bank* v. *Bundy* [1974] 3 All E.R. 757 at 765.

[127] See for example *Henningsen* v. *Bloomfield Motors Company* (1961) 75 ALR 2d 1, *Weaver* v. *American Oil Company* (1973) 49 ALR 3d 306, *Williams* v. *Walker Thomas Furniture Company* (1965) 18 ALR 3d 1297.

[128] *National Westminster Bank* v. *Morgan* [1985] All E.R. 821, Goff and Jones *Law of Restitution*, 3rd ed. (London: Sweet and Maxwell, 1986) at 259.

[129] *Dirks* v *SEC* 463 U.S. 646 (1983).

[130] *With* v. *O'Flanergan* [1936] Ch. 575.

The absence of these factors should justify the enforcement of securities transactions by insiders. The emphasis on freedom of contract is "a deliberate relinquishment of the temptation to restrict ... individual autonomy or the completely free market in the name of social policy".[131] The case for a social policy justifying a restriction on the freedom of contract in securities has hardly been made out.

When laws are made to restrict the right of individuals, they must be in accord with societal feelings. The problem with insider trading regulations in terms of enforcement is that the public has not attained the level of consciousness which the law pretends to legislate. Laws are not made for the sake of being made, but they must have a probability of effectiveness. A dead letter law could as well have not been made. It is worse in that it leads to ridicule. The better approach would be to mould the consciousness of the public as a foundation for the law. Laws do not work well if they are out of tune with their social context.[132] Despite profuse legislation and vigorous enforcement attempts, it seems to be that insider trading is on the increase in the United States. This is apparently due to the lack of social foundation of the regulations. The futility of enforcing a law is enough reason to advise its rejection.[133]

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[131] L. Friedman, *Contract Law in America: A Social and Economic Case Study* (Madison: University of Wisconsin Press, 1965) at 21, Atiyah, *supra*, note 118, chap. 14.

[132] The approach would have been on addressing these factors which make the laws incapable of application rather than agitating for more regulation. Law has its limits as it operates in a social context. "Law cannot compel action. No one can be forced to do anything merely by a law. No law can compel any particular course of action, even if accompanied by a sanction". See A. Allot, *The Limit of the Law* (London: Butterworths, 1980) 173-174. Manne, *supra*, note 2 at 46, said: "If law is to perform its function in our society, it must conform to new problems and even new attitudes. But it is crucial that (legislators) know precisely what issues are involved before they make changes with important social, political or economic consequences".

[133] This point is discussed more in chapter 6.

2.3.g. The Sufficiency of Common Law Principles.

The beauty of the common law is its ability to move *pari passu* with changes in society, to reject old concepts as they become outdated and recognise new ones as they gain societal acceptance. It is when the common law is too slow to develop that the parliament is justified in giving it a push by legislation. Has the common law been inadequate in dealing with what, in a societal (as distinct from a legislative) sense, is loosely regarded as insider trading?

With respect to classic insiders, the common law has developed company law concepts to ensure that these individuals, in a company, do not abuse their position of trust and confidence.[134] Equally, potent agency principles have been developed to regulate relationships between them and their principals. In respect of dealings with outsiders, the law has recognised fiduciary relationships in special circumstances[135] and would, no doubt, recognise new ones as the circumstances arise. Moreover other principles that allow a party to resile from his contract even without recourse to fiduciary obligations exist, where to hold him to his bargain will be against public policy.

With regard to non-classic insiders, the rules regulating constructive trustees and other common law rules of contract would adequately protect the interest of the other party.[136]

If any law is to be made, it ought to be a codification of these common law

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[134] See generally L.C.B. Gower et al., eds, *Gower's Principles of Modern Company Law*, 4th ed. with supp. (London: Stevens and Sons, 1981) chap. 24.

[135] See for example *Strong* v. *Repide* 213 U.S. 419 (1909), *Allen* v *Hyatt* (1940), 30 T.L.R. 444.

[136] The arguments in this part are fully developed in chapter 7.

principles, yet this is not advisable as it would stultify the law's ability to adapt to changes in society. Such regulations often act as murky encrustations on recognised principles.

2.4. General comments.

Who has the burden of proof?

Regulators argue that because insider trading laws are already made, the justification for them is assumed and it is on deregulators to prove a need for rejecting them. This may be true, but it is not entirely so. If a law is based on a faulty premise, its bare existence is not enough reason to retain it. Indeed, the faulty premise should be the springboard for change. The basic premise upon which the regulations were made was the need to uphold the morals of the market. This premise has been thoroughly discredited. Regulators must, then, advance other arguments to justify the retention of the laws.

A grudging concession that can be made is that regulations are necessary to prevent fraudulent conduct in the society. However, the insider trading rules as they are framed are not directed at this aim. The relevant factor is not the information, or who possesses it, but the manner in which it is used, i.e., the conduct of the party. The courts have perhaps, recognised this by their insistence on the proof of a fraudulent intent in the use of the information.[137] As Justice Powell remarked in *Chiarella* "section 10(b) is aptly described as a catchall provision, but what it catches must be fraud. Although a

[137] *Ernst and Ernst* v. *Hochfelder* 425 U.S 185 (1976). The scienter requirement is implicit in the several knowledge requirements in *CAMA*.

trade may cause harm, it does not (*ipso facto*) constitute fraud".[138]

The present insider trading rules may elicit some feeling of unfairness, but that is not enough to classify the practice as fraudulent.[139] The conduct of the person must show a general pattern of abuse to warrant regulation or liability.[140]

If prevention of fraudulent conduct is the object of regulations, then, there is a need to amend the present discriminatory rules. The approach should be to focus on the behaviour of all participants in the market and not on particular investors. The present formulation by focusing on insiders is not only a discriminatory and shotgun approach, but is a most clumsy way to go about the very difficult task of preventing fraudulent abuse of confidence. The danger is that the wrong persons are likely to be hit by the regulations. There is, therefore, need to adopt a formalistic rather than definitive approach to the problem, where liability will depend on the form of conduct rather than the definition of the person acting.

The next three chapters in appraising the content of the regulations will test them against this underlying formalistic concept for prevention of fraudulent abuse of confidence.

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[138] 445 U.S. 222 (1980) at 234.

[139] Bromberg and Lowenfels, *supra*, note 56 para. 7.4(150)

[140] D.L. Johnstone, "Comment on *Green* v. *Charterhouse Corporation*" (1973) 51 Can B. Rev. 676 at 686. The Kimber report in para 2.05 noted that trading is improper and should be declared unlawful only if the insider does in fact abuse his position.

CHAPTER 3

WHO IS AN INSIDER: HEREIN OF PROHIBITED PERSONS.

3.1 Introduction.

An insider may be loosely defined as a person who in relation to a company occupies such a position as to give him access to confidential information which is not available to the general public.[1] But because insider trading extends beyond these persons to those who do not occupy any actual position in the company, it is usual to extend the meaning of insider to such persons. The word 'position' has come to denote, not just an office in the corporation, but the relationship of a person with the company or any of its officers. In formulating an extended meaning of insiders the definitions have sometimes confused reporting requirements imposed only on officers of the company and substantial shareholders and the prohibited dealings provisions which cover all persons prohibited under the statute, whether officer or shareholder of the company or not. Some authors have sought to clarify this by classifying the latter as secondary insiders as opposed to primary insiders. These will include tippees, persons contemplating takeovers and public officers. Whatever the merits in this classification, it is thought to be a terminological inexactitude to classify tippees and all such other persons as insiders in any sense of the word.[2] They are prohibited from certain transactions, not because they

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[1] The definition of an insider for the purposes of most insider trading legislation is statutory and this is why the meaning of the term changes from one statute to the other. It is only, perhaps, for purposes of rule 10b-5 in the U.S. that there is no statutory definition of an insider, but then that is not a purely insider trading rule and the lack of a definition has been one of the most frequent criticisms of the rule.

[2] See A. Bromberg and D. Lowenfels, *Securities Fraud and Commodities Fraud*, vol. 3 (Colorado Springs, Colorado: Shepherd/McGraw-Hill Inc., 1990) para. 7.5(000).

are insiders (in whatever sense of the word) but because it is expedient to regulate their dealings in corporate securities. The *CAMA* draws this distinction in having a definition for insiders separate from that of other prohibited persons. Whether this was intentional is hard to tell, but the distinction has an important bearing on the extent of prohibition and the liability for infringement of the regulations for the different classes of regulated persons. The adopted classification, therefore, is into insiders and other regulated persons. Sometimes, however, the loose meaning of insider is used to refer to all persons regulated by the Act.

3.2 Insiders.[3]

An insider of a company is an individual who is or has at any time in the preceding six months been knowingly connected with a company; and an individual is connected with a company if,

(1) he is a director of that company or a related company,[4]

(2) he occupies a position as an officer[5] (other than a director) or employee of that company or a related company,

(3) he occupies a position involving a professional or business relationship between himself (or his employer or a company of which he is a director) and the first company or a related company.

In the last two instances, the position must be such as may reasonably be expected

[3] Section 614 *CAMA*.

[4] A related company is any body corporate which is that company's subsidiary or holding company or a subsidiary of the company's holding company.

[5] Officer includes a Director, Manager or Secretary; section 650 *CAMA*.

to give him access to information which in relation to either company is unpublished price sensitive information, and which it would be reasonable to expect a person in his position not to disclose except for the proper performance of the functions attaching to his office.

There are certain overlaps between this definition and the definition in the Canadian and U.S. legislation. In the *CBCA* two definitions of insiders are set out. The first is for reporting and prohibition purposes[6] and the second for prohibition of misuse of confidential information.[7] The latter is of direct relevance to this discussion and there insiders include,

(1) the corporation,

(2) an affiliate of the corporation,

(3) a director or officer of the corporation,

(4) a person who beneficially owns more than ten per cent of the shares of the corporation or who exercises control or direction over more than ten per cent of the votes attached to the shares of the corporation,

(5) a person employed or retained by the company,

(6) a person who receives specific confidential information from any of the aforementioned persons with knowledge that he is so prohibited or from a deemed insider under section 131(2) with knowledge that he is so described.

Section 16 of the *Securities Exchange Act* 1934 lists two categories of insiders for

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[6] Section 126.

[7] Section 131.

reporting purposes and also in relation to prohibited dealings, *viz*:

(1) every person who is directly or indirectly the beneficial owner of more than ten per cent of any class of any equity security which is registered pursuant to section 12,

(2) a director or officer of the company.

In addition, there is the 'catch a.' provisions of rule 10b-5 which has been given an indefinite application. To qualify as an insider under this rule two things must be shown:

(a) the existence of a relationship giving access directly or indirectly to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and

(b) the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing.[8]

The American and Canadian definitions are wide enough to include those who are not insiders in the classic sense.

3.2.a Directors.

This ought to be a definite class of insiders but the definition in *CAMA* is bound to involve the court in interpretational difficulties. A director is viewed from the functional rather than the formalistic angle. Any person who performs the duties of a director is regarded as one no matter by what name he is called.[9] This is to take care

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[8] *Cady, Roberts and Co.* 40 SEC 907 at 912 (1961). The first stipulation is obviously the more important of the two. The U.S courts have in recent times laid great emphasis on this requirement and seem to have totally ignored the second. The rule here is restricted to cases involving fraud.

[9] Section 650. Compare section 2 *CBCA*.

of the situation where certain persons while not being designated directors occupy prominent positions and perform important functions on behalf of the company. Such persons would be able to escape regulation if a formalistic approach were adopted. The difficulty, however, is to determine when a person is performing the duties of a director. Directors' duties vary from company to company and depend on the particular type of director. A sales director has different duties from a finance or legal director. There is no standard list of directors duties. Perhaps, the inquiry will focus on whether the person has the power of management and supervision, or whether he has the power to bind the company in a transaction, i.e., if he can be regarded as the company's alter ego.[10] This inquiry itself is not free of difficulties, for the assumption of management powers is not conclusive of a power in the person acting to bind the company.[11] Fringe cases are bound to arise and it seems that the question shall be one of fact for the judge to decide if a particular individual qualifies as a director.

The definition is also wide enough to include the so called 'shadow directors', i.e., persons in accordance with whose directions the board is accustomed to act.[12] It should be noted that when a person appoints a nominee director who votes according to his dictates, this does not make the former a shadow director. Before a person can be regarded as a shadow director, he must have control over the board, i.e. he should be able to control a majority of the directors. But the fact that a person has the ability to

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[10] *Lennards Carrying Co.* v. *Asiatic Petroleum* [1915] A.C. 705.

[11] *Tesco Supermarkets Ltd.* v. *Nattrass.* [1972] A.C. 153.

[12] Sections 245(1) and 650 *CAMA*.

appoint or remove a majority of the directors does not suffice, neither does the fact that on isolated occasions the board has acted according to his direction. The word "accustomed to act" implies a continuous interference in, and control over, the decisions of the board. Although a corporation which exercises control over the decisions of the board of another corporation is to be regarded as a director of the latter, this does not make the former an insider for the definition of insiders in *CAMA* is said to contemplate only natural persons.[13]

However, the fact that the board is accustomed to act at the direction of a person will not make him an insider if the direction is given in a purely professional capacity.[14] There must be an element of control and the word 'dictate' rather than 'direction' more accurately captures the situation. Again, it appears to be a question of fact in each case whether the board is accustomed to act at the direction of a particular person.

3.2.b. Officers and Other Employees.

The approach here is also functional rather than formalistic. Officer is defined as including directors, managers or secretary,[15] but in recognising the shortcomings of such pejorative definition, *CAMA* included other employees who occupy such positions as may reasonably be expected to give them access to unpublished price sensitive information. It may be difficult at times to determine whether a person is an employee of the company or not. An auditor who is paid a yearly retainer might, in a loose sense,

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[13] This proposition is challenged *infra* pages 87-94.

[14] Section 245(3).

[15] See note 5.

be regarded as an employee of the company, yet the fact that he provides only services indicates that a master and servant relationship is not involved. It has been suggested that the relevant inquiry is whether there is a contract of service or a contract for services between the person and the company. The former involves an employment, the latter does not. In any event, persons with a contract for services are likely to be in a professional or business relationship with the company and would be covered by the provision.

The American and Canadian provisions are different in this regard since officers there are defined by reference to form and not function. In America, officers mean a president, vice president, treasurer, secretary, comptroller or any other person who performs for the company functions corresponding to those performed by such officers. The *CBCA* has a similar definition. The latter part of the definition is sure to involve difficulties because, as noted in relation to directors in the Nigerian context, there are no standard functions for the offices stated above for all companies. In linking liability to certain offices the stipulation is narrower than the formulation in Nigeria.

Admittedly, other categories of employees falling outside the designated ones may still be caught under rule 10b-5, but it is possible for these to escape liability in Canada. The Kimber report recommended that the meaning of officer should be wide enough to include members of management who have access to price sensitive information but narrow enough to exclude junior officers whether or not they have access to the information. This only reflects an anachronistic adherence to formalism and views insider trading in its classical sense. The law ought not to be directed at particular offices but the aim should be to discourage the misuse of confidential information. The law should be astute enough to recognise that in today's corporate world certain junior employees may be placed in positions giving access to confidential information whereas certain persons traditionally designated as officers play only a figurative role with little or no access to information of an intrinsic value.[16] It would be anomalous in such a case to prohibit the latter while leaving the former to trade on the confidential information[17] merely because of the designation of their positions.[18] The Nigerian provision is preferred. This is not ignoring the rider that the position must be such as may reasonably be expected to give the person access to confidential information. It is said that the fact that an officer gains access to information is not enough for designating him as an insider if his position is not such as is reasonably expected to give him access to such information.[19] This would constitute a restriction on the Act if the intendment is to prevent fraudulent conduct. It is suggested that the courts give the provision a liberal application and not decide the matter by reference to the office occupied by a person. Thus, although

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[16] Specific instances might make the assumption that certain employees have better access to confidential information than others wholly unjustified. See J. Boyle and R.W. Sykes et al., eds, *Gore Browne on Companies*, 7th supp. to 44th ed., vol. 1 (Bristol: Jordans and Sons Ltd, 1990) para. 12.19.3.

[17] The functional approach was favoured in *Colby* v. *Klune* 178 F. 2d 872 (2d cir. 1949). See B.A. Rider and H.L. Ffrench, *The Regulation of Insider Trading* (Dobbs Ferry, New York: Oceana Publications Inc., 1979) at 20.

[18] It was perhaps in recognition of the danger in such a restricted formulation that the *CBCA* included as insiders a person employed or retained by the corporation. This would certainly take care of junior officers who nevertheless have access to confidential information. But in correcting the omission, the legislator went too far by including all employees of the company without any discrimination as to whether they have access or not to corporate information. Surely, this will save the court time in inquiring whether a particular employee was in a position giving access to confidential information, yet a general prohibition appears extreme.

[19] P.F. Wallace, "Who is Subject to the Prohibition Against Insider Trading: A Comparative Study of American, British and French Law" (1985) 15 SouthWestern U.L.R. 217 at 251.

the position of a messenger is not one that is reasonably expected to give him access to confidential information, it is not to be taken that a messenger can never fit the description of an insider. Where, therefore, a particular messenger has grown in importance so much so as to have access to confidential information, he should be covered by the provisions irrespective of the fact that such positions do not usually guarantee access to confidential information. The focus should be on the manner in which the person came into possession of, and his behaviour after he obtained, the information. An attempt to shield the information from publication may provide ground for implying bad faith and make the person liable. Since the provision uses 'may' in qualifying the rider, it is not an absolute requirement for all cases.

The fact that the person is to occupy a position that is reasonably expected to give him access to confidential information does not mean that the information for which he can be liable must come to him by virtue of that position. An auditor who occupies a position that is reasonably expected to give him access to confidential information, who learns of information not related to his duty as auditor, for example, about impending import restrictions, will be regarded as an insider if he trades on the information.

There is a further rider that the information must be one which it would not be reasonable to expect the person to disclose except for the proper performance of the duties attached to his office. This rider only reflects the fact that secrecy is the gravamen of the regulation. If the information is one which the officer can disclose to anyone, the fact that he did not disclose it will not make him an insider. From this, it may be said that the disclose-or-abstain rule has no place in Nigeria. The rule is one of abstention.

if the information is one that the officer can reasonably be expected to disclose, he can trade without disclosure; if it is one which he can disclose only in the course of the performance of his duty, he cannot trade even if he discloses, because disclosure merely for the purpose of trading cannot be said to have been done in the course of the proper performance of his duties.

3.2.c. Persons in a Professional or Business Relationship With the Company.

There are certain persons who have access to confidential information of a company but who do not fit into any of the common law or statutorily prohibited categories because they are not officers of the company, did not receive the information from anyone, and do not owe the company any fiduciary obligations. It is this class of persons that are within this prohibited category. This would, for example cover legal advisers, auditors, accountants, surveyors and indeed anyone who is in a professional or business relationship with the company.

There is a point of difference here with the Canadian and American legislation. The only similar provision in the *CBCA* is the reference to a person retained by the corporation[20]. This envisages someone working for the company but who is not a normal employee. The pertinent question is the meaning to be attached to the word 'retained'. This connotes a relationship spanning a period of time, so that a person who in relation to a single transaction with the company, obtains confidential information on which he trades will not be regarded as a retained person and, therefore, an insider. There are some other defects in that provision. Take as an example, the situation where

[20] Section 131.

the auditor of a corporation is another corporation. It is that corporation and not its employees that would qualify as a retained person. The natural persons not being retained persons can use the confidential information to trade without liability unless they are at the same time directors or officers of the retained corporation in which case they would be regarded as deemed insiders under section 131(2). The corporation itself may be liable if the persons who acted are regarded as the agents of the company. The problem, however, is that a principal is only liable for the acts of the agent performed within the scope of the agency. An employee who trades on confidential information obtained while acting for the auditing corporation, would not be acting in the course of the employment and the company cannot be liable for this, unless it is shown that the company was negligent in employing the worker. The Anisman report had sought to provide for this situation by including as insiders any person whose relationship to the issuer gives him access to a material confidential information.[21] This is undoubtedly a very wide provision. It is not tied to any contractual relationship between the person and the issuer. It would include persons connected with insiders of the issuer such as their spouse and children. The provision is devoid of the reasonableness of access requirement.[22] The pertinent question is whether the person did gain access to the information, not whether he was expected to do so. The provision would have furthered the aim of a general

[21] P. Anisman et al., *Proposal for a Securities Market Law for Canada*, vol. 1 (Ottawa: Consumer and Corporate Affairs Canada, 1979) section 12.02(i)(b)(v), [hereinafter Anisman report].

[22] The E.C. Directive on Insider Trading in Art. 2.1. went a step further by including as insiders of a company, persons who in the course of performing their duties obtain confidential information relating to the company. It is not necessary to show a professional or business relationship between with the company in whose shares he traded or indeed with any company at all.

approach to prevention of fraudulent conduct, but it never got to the statute books.

The possibility for such evasion is limited in Nigeria, for an employee of a company which has a professional or business relationship with another company is also an insider of that company.[23] It does seem that in the U.S. such a situation will be covered by rule 10b-5. The appellate decision in *Securities and Exchange Commission* v. *Texas Gulf Sulphur Co.*[24] held the company engineer, chief geologist and geologist and an attorney to be insiders. But these were officers of the company. Painter ventures the suggestion that the *Cady, Roberts & Co.* definition would also extend to non-employees,[25] but the decision in *United States* v. *Chiarella*[26] seems to show that such a duty cannot be imposed, at least, not on an employee of a company having a business relationship with the issuer in the absence of a fiduciary obligation.[27] The closest thing to this would be the 'misappropriation theory' under which a person who uses material non-public information in breach of a duty of trust and confidence is liable if he trades on that information notwithstanding that the duty of trust and confidence is not owed to

[23] Section 614.

[24] 401 F. 2d 833 (2d cir. 1968).

[25] See W.H. Painter, *Federal Regulation of Insider Trading* (Charlottesville, Virginia: The Michie Company, 1968) at 222, L. Loss, "The Fiduciary Concept as Applied to Trading by Corporate Insiders in the United States" (1970) 33 M.L.R. 34 at 45-46 comments that "even a total stranger in an arms length transaction violates the rule if he affirmatively mistakes a material fact".

[26] 445 U.S. 222 (1980). *Contra*, R. Clark, *Corporate Law* (Toronto: Little, Brown and Co., 1986) at 351-355.

[27] It is argued that Chiarella would be an insider under this provision because he is a person involved in a professional or business relationship between himself and the other company, D.M. Branson, "Insider Trading: The British Experience in the Light of American Experience" [1982] J.B.L. 342 at 348. This assertion confuses two things. Chiarella traded in the shares of the target company, but the company with which he was in a professional or business relationship vide his employers is the tender offeror company not the target company in which he traded.

the shareholder with whom he deals.[28] The theory is regarded with some dubiety and is not unanimously accepted.[29] The majority in *Chiarella* refused to endorse it and it appears that a different peg is needed upon which to hang this class of persons referred to in *CAMA*.

The problem with the Nigerian provision is one of interpretation. When can it be said that a professional relationship exists and what is the scope of a business relationship? It is suggested that a strict pigeonholing of professionals be avoided and a professional relationship should be inferred where a person has been engaged to give expert advice or perform some other jobs requiring special skills which he possesses and on which the company relies.[30] Delimiting the scope of business relationships is even more problematic. Obviously it goes beyond mere professional relationship but it is doubtful if it connotes an ordinary commercial relationship. That is, does the fact that company A supplies company B fibre for the production of carpets establish a business relationship between the two companies so as to make company A and its employees prohibited from dealing in the securities of company B and vice versa where the positions of the employees reasonably give them access to unpublished price sensitive information? The tenor of the law is to answer in the affirmative but it is opined that a restrictive interpretation be given to this otherwise wide formulation and it is hoped that the courts

[28] The dissenters' opinion in *Chiarella* v. *U.S.*, *supra*, note 26. Cf. *U.S.* v. *Carpenter* 108 S. Ct. 316 (1987), *Bateman Eichler, Hill Richard* v. *Brenner* 472 U.S. 299 (1985)

[29] See Chapter 2.2.f.

[30] "There is no need for the relationship to be contractual in the strict sense of the word, although it would seem that it must have a commercial element, albeit merely the expectation of payment and the receipt of professional fees", Boyle and Sykes, *supra*, note 16.

will use the qualification to the subsection to limit its application.

3.3 Points of Divergence.

There are two obvious points of difference in the definition of insider between the Nigerian and the American and Canadian legislation. The first omits corporations (and their affiliates) and substantial shareholders from the definition of insiders. What possible justification is there for this?

3.3.a Corporations as Insiders.

In defining insiders, *CAMA* uses the word 'individual'. This is also the word used by the *CSA*. There has been overwhelming agreement that the use of the word connotes that a company cannot be an insider under the Act.[31] There is some justification for this inference. In statutes where the word individual was used to define a right or liability this has been interpreted to refer to only natural persons.[32]

It is, however, incorrect to think that reference to individual always excludes corporations and other non-natural persons. *Black's Law Dictionary* states as follows:-

> individual as a noun denotes a person as distinguished from a group or class, and also very commonly a private or natural person as distinguished from a partnership, corporation or association; *but it is said that this restrictive signification is not necessarily inherent in the word and that it may in proper cases include artificial*

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[31] P.L.R. Mitchell, *Directors Duties and Insider Trading* (London: Butterworths, 1982) at 152, D. Sugarman, "The Companies Act 1980(5)" (1981) 2 Co. Law. 13 at 15, C.M. Schmitthoff et al., eds, *Palmer's Company Law*, 24th ed., vol. 1 (London: Stevens and sons, 1987) at 472, R.R. Pennington, *Pennington's Company Law*, 6th ed. (London: Butterworths, 1990) at 399 n8, B. Hannigan, *Insider Dealing* (London: Kluwer Law Publishers, 1988) at 57, L.C.B. Gower et al., eds, *Gower's Principles of Modern Company Law*, 4th ed. with supp. (London: Stevens and Sons, 1981) at 636-638A, Boyle and Sykes, *supra*, note 16 para. 12.19.1.

[32] See for example *R* v. *Colgate-Palmolive* (1971), 8 CCC (2d) 40 (Co. ct. Ont.), *Re Witchekan Lake Farms Ltd.* [1975] 1 W.W.R. 471 (Sask. C.A.).

persons.[33]

Indeed certain cases have held that 'individual' may also extend to artificial persons where the context so requires. In *Great Northern Rly. Co.* v. *Great Central Rly. Co.*[34] Wright J. held that individual means any legal person who is not the general public. The decision whether the word 'individual' includes a non-natural person must be based on the context in which it is used. In *Re Witchekan Lake Farms Limited*,[35] there was enough justification for this. Section 30 of the *Bankruptcy Act* in which the word 'individual' called for construction, was an amendment to a section of an earlier Act where the word 'person' was used. The replacement of the word 'person' with 'individual' clearly showed an intention by the draftsman to exclude non-natural persons. Such is not the situation in *CAMA*. Where such interpretation would lead to absurdity or encourage evasionary tactics, the word 'individual' is taken to include corporations. Otherwise a person who is affected by a legislation may then form a corporation and act through it.[36] A director who is prohibited as an insider would be able to form and make a corporation which he represents a director of the company.[37] Acting as the

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[33] *Black's Law Dictionary*, 6th ed. (St. Paul, Minn.: West Publishing Co., 1990). Emphasis supplied.

[34] (1899), 10 Ry & Can. Tr. Cas. 266 at 275. Cf *Allen* v. *Khan* [1968] 1 Q.B. 609, *Commissioner of Taxation of the Commonwealth* v. *Cappid Property Limited* (1971), 45 A.L.J.R. 329.

[35] *Supra*, note 32.

[36] These were the tactics adopted in *Commissioner of Taxation of the Commonwealth* v. *Cappid Property Ltd. supra* note 34.

[37] It is yet unclear if the *CAMA* altered the old position whereby corporations could be directors of a company. Section 257 of *CAMA* disqualifies a corporation other than its representative appointed to the board for a given term from being a director. There is a clearer provision in section 105(1) of the *CBCA* which disqualifies a person who is not an individual from being a director. See pages 92-93 *infra*.

representative of the company, he receives confidential information on which he trades, but since it is the company and not him as the natural person, that is regarded as the director, he is not technically liable under the Act. The position of the individual has not changed but he masquerades behind the corporate form to trade.[38]

The argument may be made that the reference to persons in the provisions dealing with procuring, counselling or communicating information shows that the other provisions were intended to apply to individuals, i.e. natural persons only. If this is correct then section 620 of *CAMA* needs some reasoning to understand. It stipulates that:

> "An insider who contravenes any provision of section 615 of this decree or *any person who contravenes any provision of section 616* of this decree shall be guilty of an offence".[39]

Now section 616 covers public officers. Yet the provision mentions any person who contravenes the provisions of section 616 which from the premise above would include corporations. This cannot be so since a corporation cannot be a public officer[40] and it goes to show that the use of 'person' in certain places and 'individual' in others is not conclusive of an intention to discriminate in the application of the sections. Indeed in defining insiders and the extent of their liability, the word 'person' is used in at least

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[38] The director may be made liable if the veil of corporate personality is lifted, as a person is not entitled to do as a corporation what he is not entitled to do as a natural person; see *Gilford Motors* v. *Horne* [1933] Ch. 935 and *Jones* v. *Lipman* [1962] 1 W.L.R. 832. But lifting the veil of incorporation is not something the courts do too readily, and it was even remarked in *Omisade* v. *Akande* [1978] N.C.L.R. 563 that the corporate personality principle is sacrosanct.

[39] Emphasis supplied. It is noteworthy that the equivalent in section 8 *CSA* mentions individuals.

[40] A corporation sole may be a public officer, e.g. the Public Trustee, but this could be adequately covered by the definition of individual in its strict sense.

three relevant places; sections 614(2)(b)(ii), 615(2)(b) and 615(3)(b), i.e. that the information is one which it would not be reasonable to expect *a person* so connected not to disclose except for the proper performance of the functions attached to the position. Consistency would have demanded the use of 'an individual' rather than 'a person' to achieve the same result. It is remarkable that the same qualification in relation to public officers uses the word 'individual', not 'person'.[41]

Thus there ought to be some other reasons aside from the use of the word individual for concluding that companies cannot be insiders. Perhaps because insider trading involves a state of mind which cannot be attributed to a company accounts for the exclusion.[42] But then it is recognised that even though as an artificial person a company cannot have a state of mind, that since it acts through natural persons, the state of mind of those persons is to be ascribed to the company.[43] And in the U.S. where scienter is a requirement for rule 10b-5 liability,[44] the courts have found no difficulty in holding corporations liable.

It will be shocking if companies were excluded as insiders. Companies are allowed to own shares in other companies and are, in certain circumstances, permitted

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[41] Section 616(1)(b).

[42] Boyle and Sykes, *supra*, note 16 para 12.19.1., a company cannot be an insider due to the emphasis placed on the dishonest state of mind of the trader and it would be complex and artificial to impute an individual's state of mind to a company. This cannot be the justification, for are artificiality and fiction not the hallmarks of corporate personality?

[43] *Bolton (engineering) Co. Ltd.* v. *Graham and Sons* [1957] 1 Q.B. 159.

[44] *Ernst and Ernst* v *Hochfelder* 425 U.S. 185 (1976).

to own their own shares.[45] They, therefore, stand in a position to use confidential information acquired through their officers.[46] It has been argued that this omission does not present too much danger because the director who procures the company to engage in insider dealing will be guilty of counselling or procuring the company.[47] This may be true, but the liability is that of the director or officer and not that of the company.[48] Sometimes, of course, the company may indemnify the director, but this is a rather tortuous way to get to the wrongdoer. Again it does not follow that in all cases where the director procures the company to insider deal, he is liable. A person is only liable for counselling or procuring if he is an insider. Consider this scenario. Company A is the director of company B. C is company A's nominee on the board of company B, but C is not a director or officer of A. Thus technically C is not a director of B[49] nor an insider of it since he is not a director or officer of a related company. In such a case C can counsel or procure a person including company A to deal in the securities of company B by virtue of information acquired from representing company A on the board

[45] Section 160 of *CAMA*.

[46] Sugarman, *supra*, note 31 at 15, notes that "The distinction between individuals and companies is clearly open to abuse for companies can and do participate in insider dealing. Since other countries have felt able to include companies within their definition of insider, it surely was not beyond the wit of the statutory draftsman to include companies within the definition of insider, so that the provisions ... are not evaded by resort to the corporate form".

[47] Gower, *supra*, note 31 at 636 - 638F, Hannigan, *supra*, note 31 at 57, C. Okonkwo, "A Critical Appraisal of Insider Trading Transaction Under the law" (unpublished seminar paper).

[48] For example, the E.C. directive on insider trading in Art 2.2 provides that where the insider is a company or other type of a legal person, the prohibition on insider dealing applies to the natural person who takes part in the decision to carry out the transaction for the account of the legal persons concerned.

[49] The force of the proposition is somewhat weakened by section 257 of *CAMA* which implies that it is the person who sits on the board that is regarded as a director under the Act and not the company that appointed or nominated him.

of company B. Even if C is a director of company A, he will still not be an insider of company B unless the latter is A's related company i.e. A's subsidiary company. A subsidiary company is one in which another company controls the composition of its board or holds more than half in nominal value of its equity share capital.[50] Thus, where company A owns a third of the shares of company B and has two of its five directors, its directors are not insiders of company B and can counsel or procure it to deal in the shares of company B without the company or the directors becoming liable for insider trading. It is unclear if the company can be made liable as a shadow director of another company. A shadow director is a person in accordance with whose directions the board is accustomed to act. A holding company would in all probability qualify as a shadow director of the subsidiary company even if it does not appoint a majority of the board. The reluctance to forcefully argue the point is due to the fact that section 257 of *CAMA* appears to exclude corporations from holding the position of directors and it may be said that is not permissible to make them directors through the back door. However, it is opined that the section applies only to directors so appointed and not to deemed directors which shadow directors are. When a thing is deemed something, it means that it is not that thing but for the purposes of the law, it is regarded as one.[51] The connotation is usually one of artificiality.[52] As the word 'person' clearly includes a

[50] Section 338 *CAMA*.

[51] *Savannah Bank Ltd.* v. *Ammels Ajilo* [1989] 1 N.W.L.R. 305.

[52] In *R* v. *Norfolk County Council* (1891), L.J.Q.B. 379, Cave J said "Generally speaking, when you talk of a thing being deemed to be something, you do not mean to say that it is that which it is deemed to be. It is rather an admission that it is not what it is deemed to be, and that, notwithstanding it is not that particular thing, nevertheless ... it is to be deemed to be that thing".

corporation, there is no reason why a company at whose direction, the board of another company is accustomed to act, should not be regarded as a shadow director, and, therefore, an insider of that company.

The suggested interpretation of 'individual' becomes starkly absurd when considered in relation to the provision covering person contemplating a takeovers.[53] Generally, takeover bids are made by companies and not individuals. A company will come within the provisions if it makes the bid in conjunction with an individual. It is hard to comprehend why the company will be liable if it makes the bid with an individual but not if it makes it alone or with another company. The bid will have to be made on behalf of the company by its directors and it has been suggested that the likely interpretation will be that the director is an individual contemplating making a takeover offer.[54] This suggestion cannot be correct. For one, it ignores the principle of corporate personality in confusing the director making the bid with the company which he is representing. Secondly the director making the offer is already prohibited by section 615(3) and the suggested interpretation will only make the section a surplusage. If it is accepted that individuals do not include corporations and that the above interpretation of that sub-section is incorrect, then the current commercial practice will render the sub-section on takeovers almost destitute of application. Takeover bids do not apply to private companies and it is hard to imagine an individual making a bid for a public company.

It is submitted that the context of insider dealing warrants extending the meaning

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[53] Section 615(6) *CAMA*.

[54] Hannigan, *supra*, note 31 at 68.

of 'individual' to non-natural persons and that the courts should so interpret it. To avoid the problem of leaving the matter to implication, the law should be amended to reflect corporations as insiders.

3.3.b Shareholders as Corporate Insiders.

Unlike the Canadian and American regulations which list persons who beneficially own ten per cent of the company's shares as insiders,[55] shareholders are not regarded as insiders in *CAMA*, no matter the extent of their holding. This is, perhaps, due to the fact that shareholding in public companies in Nigeria is widely distributed and rarely does one shareholder hold as much as ten per cent of the shares in a company. But this tends to ignore the tremendous privileges which substantial shareholders have. Moreover, the practice of nominee shareholding is widely used so that a person owning less than ten per cent of the shares may beneficially have a much larger interest.[56] The only restriction on substantial shareholders is to report the state of their shareholding to the company.[57] Since the report is made to the company, it may be difficult for the public to have access to it. However, a shareholder who controls the board of the company will be regarded as a shadow director and therefore an insider. The only reason why this omission is there is, perhaps, because it is also missing from the *CSA*. The exclusion of substantial shareholders as insiders does not, however, have too many negative

[55] There are certain differences in the two legislations. The Canadian legislation relates to beneficial ownership of ten per cent of the shares of the corporation whereas the U.S. legislation talks of ten per cent ownership of any class of equity securities of the corporation. Additionally, the latter covers direct and indirect beneficial ownership.

[56] This is the usual practice with shareholding in banks and foreign companies.

[57] Section 95. This refers to holders of ten per cent of the shares of the company having unrestricted voting rights at any general meeting of the company.

implications, as there is no absolute prohibition on trading in securities in the *CAMA*. Since shareholders do not usually have direct access to the company's confidential information, a shareholder who gets it must have obtained it from an insider, and, if the necessary elements are present, will be liable as a tippee.[58] A shareholder is only likely to have direct access to confidential corporate information if he controls the board, in which case he is to be treated as a shadow director and, therefore, an insider.

3.4 Other Regulated Persons.

3.4.a. Tippees.

No area of insider trading has caused more obloquy than the problem of tippees and it has been said that

> "Tipping because it involves a more widespread imbalance of information presents an even greater threat to the integrity of the marketplace than simple insider trading".[59]

Tippees are not classic insiders but are those who directly or indirectly possess price sensitive information. The problem here is one of drawing the line. In simple terms a tippee is a person who knowingly obtained, directly or indirectly confidential information from an insider.[60]

This looks simple enough, but there are interpretational problems to be tackled. Firstly, the information must be knowingly obtained. It has been held that a person is not

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[58] As will be seen in chapter 5 different liabilities attach depending on whether a person qualifies as an insider or a tippee.

[59] *Fridrich* v. *Bra[illegible]* 542 F. 2d 307 at 327 (6th cir. 1976).

[60] Section 615([illegible]

a tippee unless he knows the person from whom he obtained the information.[61] Will the office messenger who stumbles on information carelessly dumped in the trash can by one of the directors be held to have known the person from whom he obtained it? Possibly yes, but not all the cases lend themselves to such a simple solution.

The more pressing inquiry is the meaning of the word obtained. It was held in *R* v. *Fisher*[62] that obtain connotes some positive effort on the part of the tippee so that the tippee who is merely told to deal will not be prohibited. But on appeal in *Attorney Generals Reference (No. 1 of 1988)*[63] the House of Lords concluded that a person obtained confidential information about the company if he acquired or got it without any effort on his part or even if it were volunteered to him.[64] The latter decision is sure to work hardship in some cases. For example, a person who is continuously fed confidential information against his wish may be prohibited from dealing even though by an educated guess he could have come to the same conclusion and made a good deal on the securities. It does seem that it would be better to require some effort on the part of the tippee either in the form of active solicitation or passive acquiescence in receiving and using the information.[65]

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[61] *Attorney General's Reference (#1 of 1988)* [1989] A.C. 971.

[62] Unrep. but discussed by Hannigan *supra*, note 31 at 72.

[63] *Supra*, note 61.

[64] See A.D.M. Forte, "Insider Dealing - A Tip Too Far" [1989] Juridical Rev. 203 and contrast E.A. Coleman, "Securities Regulation, Involuntary Recipients of Inside Information" (1990) 11 Co. Law. 18.

[65] The facts of the Fisher case would seem to justify the conclusion of the House of Lords. When the information that the bid of a rival takeover bidder had been accepted was passed on to him, he was told that the information was still confidential and the revelation of the information to him made him an insider. His plea that he did not know that he was within the prohibition sounds less than convincing, although the

This does not solve all the difficulties that might arise. What of the secretary who reads the director's files when he is not around? Obviously he has not obtained the information from anybody, but there is enough ground to hold such a person liable as the provisions talk of receiving directly or indirectly from an insider. This would be a form of indirect receipt. There is also the problem of persons to whom the information is not directed but who nevertheless receive it such as the eavesdropper[66] or the steward in a restaurant who overhears some insider discussion. In such a case it appears that liability will depend on his knowledge of the status of the persons whom he overheard. *Cady, Roberts & Co.* regards a tippee as one who knew or at least should reasonably have inferred that he was being given an insider tip.[67] The word 'given' connotes a personal contact between the tipper and the tippee. The problem of tippees has not received much judicial exposition in Canada, but it seems the same interpretation will be adopted. The *CBCA* talks of 'receive' rather than 'obtain', but this does not have a bearing on the interpretation of the provisions as the two words connote about the same thing.

Not only should the tippee know the person from whom he obtained the information, he must also know that the information is one which it would be reasonable to expect the person not to disclose except for the proper performance of the functions

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reckless manner in which he dealt, without any attempt to conceal the deal, lends a little credence to the defence.

[66] For example *SEC* v *Switzer* 590 F. supp. 756 (W.D. Okla. 1984).

[67] This is a better formulation. It ought not to be necessary always that the person knows from whom he obtained the tip if he can infer that he was being given a tip. Suppose a person constantly receives a call from a caller who gives him tips without disclosing his identity and the tips lead to profitable trades, he ought to know after sometime that he is getting information from an insider even if he does not know the person who calls.

attaching to his position. It appears that it is the subjective knowledge of the tippee that is important. If he perceives that what he has been told is something the insider would tell anyone, it becomes irrelevant that it is unpublished price sensitive information and his trading on it is not prohibited. However, the query cannot be entirely subjective for if it were, the alleged tippee would be able to escape merely by pleading that he did not know that the insider would not be reasonably expected to disclose the information. This is an exploitable loophole for the alleged tippee, and it is suggested that the question should be resolved by reference to the conduct of the tippee after he received the information.[68] Overt attempts to hide the information from others is enough reason to hold that he knew that the information was one which ought not to have been released to him.

There is a difference in tippee definition and liability in the U.S. In Nigeria, a tippee stands or falls according to his conduct. In the U.S. a tippee stands or falls according to the conduct of the tipper. A person does not qualify as a tippee unless the tip was given in breach of a fiduciary duty and with the motive to benefit directly or indirectly from the tip. "The tippee assumes liability not because he has been given a tip, but because it has been given to him improperly".[69] A fallout of this is that a person who receives confidential information without a breach is not only free to trade on it but

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[68] See *SEC* v. *Musella* 578 F. Supp. 428 (1984), P. Anisman, *Insider Trading Regulation For Australia: An Outline of the Issues and Alternatives* (Camberra: Australian Government Publishing Service, 1986) 27-28.

[69] *Dirks* v. *SEC* 463 U.S. 646 at 662 (1983), see L. Loss, *Fundamentals of Securities Regulation*, 2nd ed. (Boston: Little, Brown and Co., 1988) at 755-766.

to receive benefit for passing it on to others.[70] The irony is that the tippee's benefits which may be substantial are disregarded for the tipper's benefits which may be insignificant, to find liability.[71]

There is a fallacy in assuming that in every tipping situation, there must be a guilty tipper to whom the tippee's liability is to be tied.[72] This linkage is wrong. The relevant factor is the *mala fides* of the defendant in trading. Did he shield the information or cash in on it knowing that the tip was a slip?[73]

Tippees present a myriad of problems that would warrant a book of its own.[74] The difficulty seems to lie in the attempt to force a functional concept into a definitive paradigm. The attention ought to be focused on how and not from whom the tippee got the information and his behaviour thereafter. To paraphrase the Justice Society, the restrictions should apply not only to persons having legitimate access to confidential information but also to persons acquiring it by dishonest or improper means, but no restriction should be placed on the use of information by people who have acquired it without impropriety and who are not themselves insiders.[75] This is a sensible

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[70] Bromberg and Lowenfels *supra*, note 2 para. 7.5(528).

[71] *Ibid.* para. 7.5(524).

[72] In *SEC* v. *Platt* 565 F. supp 1244 (W.D. Okla. 1983) the tippees who made profits of over $600,000.00 were exonerated because the tip was overheard from a conversation between the tipper and his wife in a public place.

[73] See chapter 4.3.b. below.

[74] There is, however, no book dealing solely with that problem, but see Hannigan, *supra*, note 31 at 70-74, Painter, *supra*, note 25 at 142-144, Clark, *supra*, note 26 at 320-326.

[75] Justice (Society), *Insider Trading: A Report* (1980) para. 23.

compromise and such a clarification is suggested for the *CAMA*.

The American cases and the *CBCA*[76] show that the liability of a tippee extends to a person receiving information from him with knowledge that the tippee received it from an insider, i.e. the sub tippee. There is no basis for such extension in the *CAMA*. The *CAMA* only prohibits a tippee from communicating the information to another person[77] but it is silent on whether such a person incurs any liability for using the information. It is hoped that the courts will extend the prohibition on the tippee to the sub tippees who have knowledge of how he got the information and used it with a fraudulent intent.

3.4.b Persons Contemplating Takeovers.[78]

This subsection has no equivalent in the *CBCA*.[79] Takeovers known as tender offers in the U.S. are dealt with by special rules under sections 13(d)-(e) and 14(d)-(e) of the *Securities Exchange Act* 1934 added by the *Williams Act* in 1968. Basically the reporting requirement applies to those making a tender offer and they and their tippees are also prohibited from dealing. This has been made possible by SEC's formulation of rule 14e-3.[80] Those contemplating tender offers may also be covered by rule 10b-5.[81]

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[76] Section 131(1)(f)

[77] Section 615(8).

[78] Section 615(6).

[79] Certain provinces in Canada (British Columbia, Manitoba, Saskatchewan, Alberta, Nova Scotia and Ontario) have this prohibition. The Anisman report proposed in section 12.02(3) that if a person proposes to make a takeover bid for the securities of an issuer he is to be deemed an insider of the issuer.

[80] *O'Connors and Associates* v. *Dean Witter Reynolds Inc.* 559 F. Supp. 800 (SDNY 1983).

[81] Painter, *supra*, note 25 at 330-339.

It has already been noted that the provisions in *CAMA* will be anomalous if restricted to individuals for these do not usually make takeover bids.[82] The individual making the bid is prohibited from dealing in the securities of the target company otherwise than as a takeover bidder. The possible interpretation is that the individual is prohibited from buying securities in the company unless in the manner open to takeover bidders under the Act. The *CAMA* requires a takeover bid, subject to certain exceptions, to be made to all the shareholders of the class of shares sought to be acquired.[83] The bidder cannot buy up small holdings from individual shareholders so as to execute a 'greenmail' or a 'bear raid'. It may also be directed at preventing warehousing.

The provision seems to be directed towards preventing the takeover bidder from engaging in schemes to make excessive profit after the takeover. There appears to be some hardship for the bidder here. Takeover bids are usually made with the aim of making some profit on the resulting securities and if the bidder is not allowed to deal in the securities of the target company there is no return on the time, energy and capital which go into planning and executing a takeover. The provision might have the effect of discouraging financial diligence by corporate insiders. Secondly, the information that a takeover bid is contemplated is created by the bidder so that in a way of speaking, it is his property and it is hardly just to prevent him from enjoying the fruits of his 'invention'.[84] A relevant question is the point in time at which it can be said that an

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[82] Page 93.

[83] Section 595.

[84] J.R. Macey, "From Fairness to Contract: The New Direction of the Rules Against Insider Trading" (1984) 13 Hofstra L. Rev. 9.

individual is prohibited. It is easy to comprehend when a person contemplates a takeover, but it may be difficult to ascertain the time at which a person can be said to be contemplating a takeover. Is it when the bid is made or when preliminary inquiries are begun? This is a heavily subjective inquiry which can only be answered on an objective basis.

An insight may be had by analogy from two sources. In *Basic Inc.* v. *Levinson*[85] it was held that the fact that discussions are already in progress could be material even before any agreement in principle is reached and even though the probability of reaching such an agreement is less than fifty percent. That statement was made with regard to the question of the materiality of disclosed facts in a merger negotiation, but can be used to decide when a takeover is contemplated. When facts about the takeover negotiations are deemed material it is no longer open to argument that a takeover was not contemplated. Of more relevance is an SEC release of September 1984[86] which states that the proscription in Rule 14e-3 "applies when a person takes a substantial step to commence a tender offer or commences a tender offer". A substantial step includes:

(i) voting on a resolution by the offeror's board of directors relating to the tender offer,

(ii) formulation of a plan or proposal to make a tender offer; or

(iii) activities which substantially facilitate the tender offer, (e.g., arranging financing, preparing or directing or authorising the preparation of tender offer materials,

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[85] 107 S. Ct. 1284 (1987).

[86] 45 Fed. Reg. 60413 n33 quoted in H.L. Pitt, "Insider Trading: The Lower Courts' Reaction to Dirks" in *Insider Trading: Coping With the Use and Abuse of Market Sensitive Information* (New York: Law & Business/Harcourt Brace Jovanovich, 1985) 3 at 187.

authorising negotiations, negotiating or entering into agreement with any person to act as a dealer, manager, soliciting dealer, forwarding agent or depository in connection with the tender offer).[87]

It is suggested that the initiation of preliminary inquiries should suffice as contemplation of a takeover.

3.4.c Public Officers.

This covers those who are not insiders of a company nor tippees of insiders, but who in one way or the other have access to confidential information relating to the company. There are cogent reasons for including public officers under the regulation.[88] This is to forestall the use of price sensitive information relating to companies which emanate from government sources instead of from the company itself. A top government official in the Ministry of Budget and Planning, for example, will get early access to information about imports and tariffs, trade concessions, impending increases in corporate taxation, and other fiscal recommendations that would be implemented in due course. He would be able to trade in advance of the release of the measures and make hugh profits. In the same way, public officers in other ministries or governmental agencies would have information affecting the companies that carry on business of the type regulated by the Ministry or Agency. For now, the prohibition is limited to public officers as defined in section 277 of the 1979 Constitution as amended, but the *CAMA* gives the Minister of Trade power to make an order designating certain members,

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[87] *Ibid.*

[88] See H.G. Manne, *Insider Trading and The Stock Market* (New York: The Free Press, 1966) chap. XII.

officers or employees of any body public officers for the purposes of the regulations.[89] There would be need to make such an order due to the limited class of persons covered by section 277. Only public officers holding the top most positions are covered. An order when made would include persons such as Inspectors appointed to investigate the affairs of a company under section 314 - 326 of the Act, staff of the Corporate Affairs Commission, the SEC and staff of the Ministry of Trade. In addition to these, the stock exchange forbids its members from dealing in the securities of their clients,[90] and government appointed members of the Securities and Exchange Commission are regarded as insiders for purposes of dealing on the stock exchange.[91]

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[89] Section 616(4).

[90] SEC *A Handbook on Securities and Exchange Commission Decree 1988 and SEC Regulations* (Lagos, Nigeria: Securities and Exchange Commission, 1989) at 13.

[91] Section 3(4) *Securities and Exchange Commission Decree* 1988.

CHAPTER 4

PROHIBITED TRANSACTIONS.

As there is no uniform definition for prohibited persons, in the *CAMA*, the basis and extent of prohibition from certain transactions differ for each group of prohibited persons.

4.1. Absolute Prohibition.

Unlike in the U.S. and Canada, there is no provision for absolute prohibition of certain dealings in Nigeria. Section 130 of the *CBCA* prohibits an insider, as defined in section 126, from engaging in short sale or buying or selling a call or put in respect of shares of the corporation or any of its affiliates. The prohibition here does not depend on use of confidential information or even possession of it. It has been remarked that there is no absolute liability on insiders in the *CBCA* and that there must be proof of possession and use of insider information.[1] This assertion does not reflect the tenor of section 130, and may have been made because of the recognition of the inherent unfairness of absolute prohibition to corporate insiders. There is no civil liability for breach of this section. Because the purpose of insider trading regulations ought to be the prevention of abuse of confidence, it is doubted if, in stipulating a criminal penalty, the law intended the offence to be one of strict liability not requiring proof of *mens rea*. It is to be noted that the prohibition operates not only when the person occupies the position, but also up to six months after relinquishing the position.

[1] P. Anisman, "Insider Trading Under the *Canadian Business Corporations Act*" [1975] *Meredith Memorial Lectures* 151 at 226. The Kimber Report had recommended in para. 2.24 that "liability should only arise if wrong-doing or impropriety is established and not on an automatic basis as exists under section 16(b) of the *Securities Exchange Act* of 1934", but this recommendation is not reflected in the *CBCA*.

There is a much wider prohibition in section 16 of the *Securities Exchange Act*. Section 16(b) prohibits beneficial owners, directors or officers as defined in section 16(a) from engaging in short swing transactions, i.e., a sale and a purchase or a purchase and sale of unexempt security within a period of six months. Although the subsection is "for the purpose of preventing the unfair use of information", *Smolowe* v. *Delendo*[2] decided that it must be given an objective character, i.e. the affected persons are absolutely prohibited from dealing and liability does not depend on proof of use of insider information. There is a presumption of its use. Not only is there no need to show use of the information, there is also no need to prove actual possession of confidential information.[3]

This is an odd interpretation. Section 16(b) has been given a dangerously liberal interpretation stretching it beyond what the legislature must have intended. It has been held that for the purpose of liability, the insider need not hold the position both at the time of sale and purchase or vice versa.[4] This is harsh. A person who is not a ten per cent shareholder who purchases or sells securities and later becomes a director ought not to be held accountable if he sells or purchases (as the case may be) within six months of the first transaction. It may be otherwise if the first transaction was done while he was

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[2] 138 F. 2d 231 (2d Cir. 1943).

[3] In *Gund* v. *First Florida Bank Inc.* 726 F. 2d 628 (2d cir. 1984) it was noted that Congress designed the section as an objective rule designed to have a clearly prophylactic effect. The court will not permit a defence that the officer acted in good faith or that inside information was not in fact abused. The question of whether someone is a director or officer hangs entirely on his or her title without regard to actual access to insider information.

[4] In relation to directors see *Adler* v. *Klawan* 267 F. 2d 840 (2d cir. 1959), *Blau* v. *Allen* 163 F. Supp. 702 (SDNY 1958); for shareholders, *Stella* v. *Graham Paige Motors Corporation* 232 F. 2d 299 (2d cir. 1956).

a director and the second after he quit the position. *Stella* v. *Graham-Paige Motors Corporation*[5] decided that for computing ten per cent ownership of shares, the purchase which made the person a ten per cent shareholder is to be regarded as a prohibited transaction.[6] And because purchase is defined as including any contract to buy, purchase or 'otherwise acquire', sundry transactions such as the conversion of redeemable preferred to common stock[7] have been held to amount to a purchase prohibiting a sale within six months.

Perhaps, the automatic liability rule is linked to the strict accountability duty imposed on directors and other fiduciaries dealing in the property of the beneficiary at common law.[8] It is designed to avoid the temptation to do wrong and the appearance of wrong doing as well as to prevent misconduct[9] and has been helpful in avoiding problems of proof. There is merit in this argument but it may be stretching evidential expediency too far to sacrifice the interest of corporate officers to enter into commercial transactions. There are legion reasons why a corporate insider may wish to engage in a securities transaction, apart from the need to settle a debt previously contracted, and the law ought not to unduly restrict this right. Though there is some sense in policing this class of persons more closely, "it would be unreasonable to impose on all corporate

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[5] *Ibid.*

[6] The converse and more acceptable decision was reached in *Foremost-McKesson, Inc.* v. *Provident Sec. Co.* 423 U.S. 232 (1976). Cf. *Reliance Electrical Co.* v. *Emerson Electrical Co.* 404 U.S. 418 (1972).

[7] *Park & Tilford Inc.* v. *Schulte* 160 F. 2d 984 (2d cir. 1947).

[8] *Keech* v. *Sanford* (1726) Sel. Cas. Ch. 61, *Cook* v. *Deeks* [1916] 1 A.C. 554.

[9] H.P. Crawford, "Insider Trading" (1965) 8 Can. B. J. 400 at 405.

insiders the extra burden of vague anti-insider laws".[10] A total prohibition will have the effect of discouraging competent people interested in investing in securities from assuming managerial responsibilities. This will result in companies being run by inefficient hands. Moreover it is desirable to encourage officers to have a stake in the company which will act as an incentive towards striving for managerial excellence. In recognition of this fact, the courts have tried to restrict the inexorable application of the section. In 1973, the U.S. Supreme Court sought the congressional intent in enacting the provision. It concluded that the mischief aimed at was the suppression of speculative abuse and held that because the circumstances of the case did not evince such speculative abuse, section 16(b) was inapplicable.[11] With regard to determining the status of 10% shareholders, the strict rule has been somewhat ameliorated. Liability is imposed only if both the sale and the purchase or vice versa occur while a person is a beneficial owner of 10% or more of the appropriate class of securities. Thus, the purchase as a result of which one becomes a 10% holder cannot be matched with a sale made after he became a 10% holder.[12] Also a person owning more than 10% and selling down to 10% can be liable for such sale if appropriately matched with a purchase within the last six months, but he incurs no liability with respect to sales which occur after he has reduced his holding to less than 10% even though occurring within the same six months period.[13]

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[10] B.A. Rider and H.L. Ffrench, *The Regulation of Insider Trading* (Dobbs Ferry, New York: Oceana Publications Inc., 1979) 4.

[11] *Kern County Land Co.* v. *Occidental Petroleum Corp.* 411 U.S. 582 (1973).

[12] *Foremost McKesson Inc.* v. *Provident Security Co.* 423 U.S. 96 (1976).

[13] *Reliance Electric Co.* v. *Emerson Electric Co.* 404 U.S. 418 (1972).

This latter approach is the better one. The focus of the law is to prevent fraudulent and abusive conduct and not to act as a trap for unwary investors. The law ought not to be applied in an esoteric manner, but must look at the circumstances of each case.

Unlike in Canada, there is one statutory defence to the U.S. provisions, and that is, if the security was acquired in good faith in connection with a debt previously contracted. The fear has been expressed that if this defence is given a wide interpretation, it would render the prohibition in the section useless. The argument is that any transaction not carried out with a view to making a profit may be said to be in connection with a debt previously contracted. Included here are sundry things like paying the tax assessment, medical bills, school fees, insurance premium etc. It is, however, doubtful if this could have been the purport of the proviso. It can hardly be said that the transactions cited above would involve a debt previously contracted in the strict sense of the word. Not surprisingly, in the courts' expansion of the scope of the section, the defence has been so circumscribed as to be almost obliterated. The defence itself appears to be unnecessary as it is inherent in the section. In one instance, it can be presumed, in the other, it is inapplicable. Because most securities acquisitions are more or less of a permanent nature, where a corporate insider purchases and sells within six months, the hurried sale would be, almost always, evidence that the second transaction was made for the purpose of meeting an unexpected financial contingency. The same cannot be said for a sale followed by a purchase within six months. Indeed, it is hard to imagine how the defence would apply in the case of the sale followed by a purchase.

If it is understood that the object of insider trading regulations is to prevent the abuse of confidential information, there is a way to compromise the protection of investors with the interest of insiders. Instead of making trading in the company's securities by such persons irrebuttable evidence of use of insider information, it would be preferable to make the transaction prima facie, but rebuttable, evidence of use of insider information with the onus being on the insider to rebut the presumption by credible evidence. This will allow insiders with genuine reasons to trade without too many restrictions.[14] The strict construction given to section 16(b) is, perhaps, due to the fact that it contains legion possibilities for evasionary tactics.[15] The greatest loophole is the six months limitation proviso. A director who follows a purchase with a sale six months and a day after, is free from liability, no matter the amount of evidence of fraud advanced. It is amazing how the space of twenty four hours could make the difference between a legal and an illegal act. The six months rule of thumb limitation should have no place in a fraud prevention regime. The prohibition should apply so long as the probability of abuse exists.[16] This is the approach adopted in Rule 10b-5. An insider who escapes section 16(b), if fraud is proved, is likely to be caught by Rule 10b-5. In fact the expansion of the scope of Rule 10b-5 has almost rendered section 16(b) redundant and calls for its abolition have been made on more than one occasion.[17] Rule

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[14] Rider and Ffrench, *supra*, note 10 at 46.

[15] W.H. Painter, *Federal Regulation of Insider Trading* (Charlottesville, Virginia: The Michie Company, 1968) at 25-26.

[16] P. Anisman, *Insider Trading Regulation For Australia: An Outline of the Issues and Alternatives* (Canberra: Australian Government Publishing Service, 1986) at 16.

[17] See M.A. O'Connor, "Toward a More Efficient Deterrence of Insider Trading: The Repeal of Section 16(b)" (1989) 58 Fordham L.R. 309.

10b-5 approximates to the prohibitions in *CAMA* which is examined next.

4.2. The Bases for Prohibition.

Unlike the U.S. and Canada where simple regulations have been complicated by judicial exposition, the provisions in *CAMA* are themselves complicated and may need judicial exposition to simplify them. Under the *CBCA*, all insiders are prohibited from dealing only in public companies, and in the U.S. and the provinces in Canada, insider trading prohibition covers both public and private companies. In Nigeria, insiders are prohibited from dealing only in public companies while other prohibited persons may not deal in public or private companies. It is not apparent why there is this dichotomy between the two classes. If anything, there is greater need for regulation of dealings in private companies as most people do not deal on the stock exchange and only very few companies are quoted.[18]

The clamour for insider trading regulations has, as one of its basic reference points, the decision in *Percival* v. *Wright*[19] which involved a private deal between a shareholder and a director. If the purpose of legislative intervention is to reverse the 'injustice' in that decision, then *CAMA* has obviously missed the point. This argument is countered by another; that *Percival* v. *Wright* has been overruled by section 279(2)(b)

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[18] The argument for more regulation of private deals stands to reason if it is accepted that the insider trading regulations were initiated with a view to seeing that the historical approach to the obligation of directors as expressed in *Percival* v. *Wright* [1902] 2 Ch. 421 was no longer the policy of the law. See *Insider Trading: A Canadian Legal Manual*, (Montreal: Jewel Publications, 1990) para 2-17.

[19] *Ibid.*

of *CAMA*.[20] This, it is submitted, is a misreading of that subsection. The section states,

> (2) A director shall also owe fiduciary relationship(sic) *with the company* in the following circumstances
>
> (b) where even though he is not an agent of any shareholder such a shareholder or other person is dealing with the company's securities.[21]

The subsection does not change much, as the fiduciary obligation is owed to the company and not to the shareholder which was the ground for failure in *Percival* v. *Wright*. And indeed section 279(9) states that any duty imposed on a director under the section shall be enforced against the director *by the company*.

Private deals provide the greatest examples of use of insider information with a fraudulent intent and there are stronger reasons for more regulation in these situations.[22] In the stock exchange deals, the director has no contact with the other party and is indeed not aware with whom he is dealing. Although fraudulent intent might still be present it is not of the type of active concealment present in face-to-face transactions. Restricting the law in this way will only encourage insiders with insider information to conduct their business outside the prohibited channels which reduces the effectiveness of the regula-

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[20] C. Okonkwo, "A Critical Appraisal of Insider Trading Transaction Under the law" (unpublished seminar paper).

[21] Emphasis supplied.

[22] "An insider of a (private) company who avails himself of his position for advantage at the expense of his shareholders or affected purchasers or sellers will commit no less dishonourable act than would the insider of a public company. To permit such behaviour in (private) companies is inconsistent and there are no persuasive arguments to exempt insiders of (private) companies from such standards". See M. Yontef, "Insider Trading" in P. Anisman et al., *Proposals For a Securities Market in Canada*, vol. 3 (Ottawa: Consumer and Corporate Affairs Canada, 1979).

tions.[23]

There are certain similarities in the bases for prohibition of the different categories of prohibited persons and these will be dealt with first.

4.3. General Bases For Prohibition.

4.3.a. Unpublished Price Sensitive Information.[24]

This is the equivalent of specific confidential information in the *CBCA*. Unpublished price sensitive information is information which firstly relates to specific matters relating or of concern (directly or indirectly) to the company, that is to say, is not of a general nature relating to or of concern to that company.[25] The requirement of specificity[26] connotes that the information must be a settled one. It is something more than a vague hope or unfounded rumour.[27] The discovery in the *Texas Gulf Sulphur Case*[28] would certainly qualify as one. So would information that the expected dividends

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[23] D. Sugarman, "The *Companies Act* 1980(5)" (1981) 2 *Co. Law.* 13 at 19.

[24] There is no such stipulation in respect of tippees of insiders. The only requirement here is that the information is one which it would not be reasonable to expect the insider to disclose except for the proper performance of his functions. But since information which the insider cannot disclose except for the proper performance of his functions is unpublished price sensitive information, it all comes down to the same thing. This is an additional requirement for insiders. It goes to add nothing but only accounts for situations where the insider may reveal information without incurring liability for tipping.

[25] Section 614 *CAMA*.

[26] Unpublished price sensitive information includes both corporate and market information. Specificity, does not connote that the information relate to the company alone. Information would still be specific if it relates to a certain type of companies of which the particular company belongs. Here the information is of a specific matter not relating to, but of concern to the company. An imminent increase in petroleum profit tax, though not specifically relating to any oil company is of concern to all oil companies and is, therefore, confidential information for the purposes of the regulations. The line between information that is of a specific nature and one that is of a general nature is, however, a neat one.

[27] See B. Hannigan, *Insider Dealing* (London: Kluwer Law Publishers, 1988) at 52-57.

[28] 401 F. 2d 833 (2d cir. 1968).

of the company will be reduced or that a new export prohibition of a company's product is soon to become law. But a sanguine expectation as in *List* v. *Fashion Park*[29] would clearly not suffice.

The second requirement is the more important and the first is in a way directly tied to it, and this is that the information must be one that is not generally known to those persons who are accustomed or would be likely to deal in those securities but which if it were generally known would be likely to materially affect the price of those securities. Certain of the terms here are sure to involve interpretational difficulties. For example what is meant by accustomed to deal? This seems to connote that one dealing or separate dealings spread over a period of time would not be enough to bring a person within this category. The commission may have had dealings of a continuous nature in mind. Another issue is whether accustomed to deal refers to the principal parties to the transactions or to their agents when they deal through another person. The situation in mind here is where a person undertakes a one time deal through a stockbroker. The person dealing may not be accustomed to deal in those securities but his broker would undoubtedly be. For the purpose of the definition is it the experience of the broker or his principal that is relevant? It is suggested that it is the knowledge of the person executing the trade, whether as principal or agent that is the relevant one. It is a question of fact whether a person is accustomed to deal in a particular security and whether in the circumstances knowledge of the information would be imputed to him.

Hannigan argues that this requirement is obscure for it only reflects the

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[29] 340 F. 2d 457 (2d cir. 1965).

requirement of publication.[30] This is not entirely correct. Of course published information ceases to be confidential,[31] but the purpose of the requirement is to impute constructive knowledge in certain cases so that even where the information is not published it can still be regarded as non-confidential. Indeed the *CBCA* goes further to add that the information would not be regarded as confidential if with due diligence it would have been known to the other party.[32]

A more pressing inquiry is the meaning of publication. The provision requires that the information is not *generally* known. This connotes that mere disclosure to the other party to the transaction does not suffice, for in such a case the information cannot be said to be generally known. There must be a public disclosure. The way this is to be done is unclear. It is said that disclosure in a news medium with little circulation cannot be publication. This is not entirely correct. The decision must be based on the circumstances of the case. Where the information is of concern to a small class of specialised investors, the fact that the medium used has little circulation becomes irrelevant if by that medium

[30] Hannigan, *supra*, note 27 at 56.

[31] This raises the question whether information becomes public once it is released to the press or whether there should be time for it to circulate before insiders can deal. The preponderance of opinion is in favour of the view that time ought to be given for circulation, for if it were otherwise an insider may time the conclusion of a deal to the specific time of the release of the information. The time interval would depend on the nature of the market, the nature and complexity of the information, the place of the company's business and the medium of dissemination. A rule of thumb is one full trading day. See Anisman, *supra*, note 1 at 231, Painter, *supra*, note 15 at 209, Hannigan, *supra*, note 27 at 56, Justice (society), *Insider Trading: A Report* para. 25, Anisman Report para 2.13. *SEC* v. *Texas Gulf Sulphur*, *supra*, note 28, *Green* v. *Charterhouse Group Canada Limited* (1976) 12 O.R. 2d 280 (On. C.A.)

[32] This raises the issue of the validity of the constructive notice rule that a person is deemed to know everything that has been published. Where the information is published in a medium accepted as giving rise to public notice, there is no inquiry as to due diligence and a person will still be fixed with notice even if with due diligence he would not have known the information. The position of the person dealing is somehow helped by the Canadian provision, in that if the information is one which a prudent person would have found out, he is not liable even if he did not publish it.

the information can get to all those reasonably concerned in getting it. The requirement for general disclosure is to prevent selective disclosure.[33] It is also aimed at giving everyone a chance to partake in the exploitation of the information. One vital issue in Nigeria is whether the deposition of a document at the Corporate Affairs Commission can be regarded as public disclosure. Under the former Companies Act,[34] if the document is one that requires filing, then this would amount to publication under the constructive notice rule. But the constructive notice rule, to a large extent, is no longer part of Nigerian company law,[35] so that a person is not necessarily affected with notice by such deposition. It is suggested that the courts accept deposition as notice to investors.[36] Imposing a requirement to use the print or electronic media for publicity will greatly increase the cost of running companies.

The disclose-to-all-or-none rule is also adopted in the U.S., at least as far as SEC proceedings are concerned.[37] The Anisman report listed the means of publication. A fact becomes public when it is disclosed

(a) in a filing

(b) by means of a press release

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[33] *Securities and Exchange Commission v. Salmon and Co.* (SDNY 1975), cited in A.R. Bromberg and L.D. Lowenfels *Securities Fraud and Commodities Fraud*, vol. 3 (Colorado Springs, Colorado: Shepherd/McGraw-Hill Inc., 1990) para. 7.4(1021).

[34] Decree #51 of 1968.

[35] Section 68 *CAMA*.

[36] It has been argued that the constructive notice rule remains to a certain extent part of the law, but now in the form of constructive knowledge under section 69(d). See M.T. Okorodudu-Fubara, "Protection of Creditors", (unpublished seminar paper) 8-9.

[37] *In Re Faberge Inc.* 45 SEC 249 at 256 (1973)

(c) by means of another form of publicity that is likely to bring it to the attention of a reasonable investor.[38]

The first two provisions solve nothing, but the third makes sense in tying the decision to the standard of a reasonable investor and giving the court room for decisions on the facts, yet the insider is left in an uncertain position as to whether there has been adequate disclosure and cannot be too sure of his position until the matter is litigated.

Allied to the issue of adequate disclosure is the question of the moment of disclosure. Insiders can trade if the information becomes public. When does information become public? Is it the moment it is released at a press conference, read over the radio or television or published in the newspapers? The preponderance of opinion is in the negative. The view is that there must be time for the information to circulate before it can be regarded as public for the purposes of allowing insiders to trade.[39] There is some sense in this suggestion, for if it were otherwise insiders would time their trade to coincide with the disclosure, but the manner in which the suggestion operates places insiders in an invidious position. The nature of information is such that certain persons are bound to get it before others. The reporter at the news conference gets it before the investor who relies on the electronic media, who in turn gets it ahead of another investor that relies on the print media. Yet, there is no 'hold' requirement on these people. The reporter is allowed to trade ahead of the insider and the other outsiders. By the time the insider is allowed to trade, the information would be almost fully exploited that at best

[38] Section 2.13.

[39] see note 31.

he makes only minimal gains. The stock exchange tries to balance the situation by suspending trading on the securities for sometime, but this cannot be done too often and is usually resorted to when the information is of colossal importance. The better approach would be to allow insiders to trade once the information is disclosed so far as the medium used is public enough in the sense of reaching reasonable investors timeously.

Unpublished price sensitive information must be material. What is material has not been easy to define. There is a difference here between the Nigerian and Canadian stipulation on the one hand and the U.S. on the other. Under the former a material fact is one which would materially affect the price of the securities.[40] In the U.S. a basic material fact is any fact which in reasonable and objective contemplation might affect the value of the corporation's securities.[41] The test is whether the reasonably prudent investor would be likely to rely upon such information in making an investment decision.[42] However, there is little difference in application. A fact that will affect the investment decision of an investor is one that is likely to have an impact on the price of the shares.[43]

The query is whether it is enough to show that the information would have

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[40] Section 614 *CAMA*, section 131 *CBCA*. The *CBCA* uses the word 'value' instead of price and it has been argued that a fact may affect the value of the securities without necessarily causing a change in the price. This may be so, but the distinction is at best tenuous.

[41] This is the test in *Texas Gulf Sulphur supra*, note 28. Cf. *TSC Industries* v. *Northway* 426 U.S. 438 (1976).

[42] *TSC Industries* v. *Northway* 426 U.S. 438 (1976).

[43] Anisman, *supra*, note 16 at 92. Under the *CAMA* the effect on the price must be material. Thus, information that would slightly affect the price of the securities is not price sensitive. There is no guidance as to how material the change should be for the information to be regarded as price sensitive and the decision ultimately rests with the Judge.

affected the decision of the reasonably prudent investor or that it would have affected the decision of the particular investor.[44] There is some support for the latter suggestion in *List* v. *Fashion Park* yet the first is the preferred one for giving effect to the duty to disclose as the purport of insider trading regulations is to prevent the abuse of confidence and not to punish a successful abuse. It is argued that if it were otherwise insiders would be able to evade their duty by pleading that the information would not have had any effect on the decision of the other party. This would be true for most stock exchange transactions, and it would have been better to put some burden on the plaintiff to show that he would not have traded if he knew of the confidential information. Adopting the other approach would allow the plaintiff to reap unmerited benefit and to escape the consequence of incompetent dealing. As a corollary to this it is the position of the cases that the requirement of reliance is answered on an objective inquiry. Actual reliance is

[44] The decision as to the materiality of a fact must in the end depend on the parties involved and the circumstances of the case because materiality varies according to who is involved. What an investment analyst considers as material may be discountenanced by a naive investor and vice versa. Also an expected increase in profit of $1,000,000.00 may be material for a small corporation, but not for a large multinational corporation. A more pertinent test for materiality will focus on the price advantage offered by the information. Also the use of the information by an insider in trading may be evidence of materiality. This meshes neatly with the reasonable investors' test since an insider can be presumed to be a reasonable investor. Yet this does not solve all the problems, for the insider must have enough basis to determine whether the information is material enough to warrant disclosure. Bromberg and Lowenfels aptly remarked that "in the few reported cases, materiality is determined with the benefit of hindsight. Few cases will come to trial unless the defendant made a substantial profit. This means that the information they had when they traded or tipped looks material in the aftermath. Analytically, materiality at a later time does not establish materiality at an earlier time, but psychological. it may seem to do so". See Bromberg and Lowenfels *supra*, note 33, para. 7.4(330), and generally paras. 7.4(311)-7.4(336). Materiality is determined at the time of the order, not by the time of the execution of the order. Thus, an insider who makes an order at the time the information is non-public will still be liable if before the execution of the order, the information is published and the impact of the information is reflected in the transaction. Conversely, an insider who makes an order will not be liable if before the order is executed, he learns of unpublished price sensitive information and goes on to execute the order. There is some strangeness in this rule, but it goes to ensuring the need to prevent fraudulent conduct whether or not the fraudster is prevented from succeeding by other intervening factors.

required in face-to-face transactions[45] but in impersonal deals proof of actual reliance is unnecessary. All that is to be shown is that the facts withheld be material in the sense that a reasonable investor might have considered them important in making his decision.[46] It has been persuasively argued that the relevant factor is causation rather than reliance because the insider's conduct may cause the plaintiff's loss even though the latter placed no reliance on it and conversely, he may place reliance on the plaintiff's conduct but such reliance may not be the proximate cause of the loss.[47] If causation is the relevant factor, it will be difficult to prove in stock exchange transaction for whether the defendant traded or not the plaintiff's loss will in all likelihood be the same. In such a case it is wrong to turn a damaged trader into a benefitting plaintiff merely because of the fortuity that an insider happened to be trading.

With respect to insiders (and possibly other prohibited persons) the unpublished price sensitive information must have been obtained by virtue of his connection with the company. Thus, if he gets the information in his private capacity, he may be able to trade on it without liability. It will be difficult for a director or officer to prove that he got the information otherwise than by virtue of his connection with the company. A director who proves that he got the information in a capacity other than that of a director

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[45] *List* v. *Fashion Park Inc. supra*, note 29.

[46] *Affiliated Ute Citizens of Utah* v. *U.S.* 406 U.S. 128 (1972), contrast *Fridrich* v. *Bradford* 542 F.2d 307 (6th Cir. 1970).

[47] See Note, "Civil Liability Under Section 10(b) and Rule 10b-5, a Suggestion for Replacing the Doctrine of Privity", (1965) 74 Yale L.J. 658. Cf. *Basic Inc.* v. *Levinson* 107 S. Ct. 1284 (1987) where the U.S. supreme court noted that causation is the primary element, reliance being merely a derivative from it. See R.C. Ferrera and G.S. Crespi, "Laying Out the Basics: A Close-up View of the Supreme Court Decision in *Basic* v. *Levinson*" (1990) 11 Co. Law. 48.

may still be liable under the corporate opportunity doctrine if it is shown that the information is one which in the circumstances ought fairly to belong to the company.[48] This is also the position in the U.S.[49] In Canada it appears that the medium through which the insider got the information is irrelevant[50] but *Green* v. *Charterhouse Group*[51] seems to have held the contrary.

4.3.b. Knowledge and Scienter.

Before a person is prohibited from dealing, he must know of his status as a prohibited person. This will be straightforward for those expressly appointed directors or officers of the company.[52] Problems are bound to arise with respect to persons who are not appointed directors or officers as such, but who perform the function of directors or officers, and, are therefore, so deemed by law. It is a question of fact whether in performing certain functions a person knew that he thereby assumed the status of an insider for purposes of liability. This must be answered upon a subjective and objective basis. A person who is obviously in direct access to confidential non-public information

[48] *Guth* v. *Loft Inc.* 5A 2d 503 (Del. 1939), and for Canada *I.D.C.* v. *Cooley* [1972] 1 W.L.R. 443.

[49] See cases in note 48 and contrast *Peso Silver Mines* v. *Crooper* (1966), 58 D.L.R. (2d) 1 (S.C.C.)

[50] Anisman, *supra*, note 1 at 226-227.

[51] *Supra*, note 31 at 309.

[52] Even in this case, it may not be apparent to a director that he is an insider of a company. Z who is a director of company A, is an insider of company B where the latter is a subsidiary of company A. He is also an insider of company C which is a subsidiary of company B, even though company C is a not subsidiary of company A. By this fact, he becomes an insider of company D which is a subsidiary of company C, even if company D is not a subsidiary of company A or B, *ad infinitum*. This knowledge requirement protects those who are "unwittingly connected with a company because of ... labyrinthine group holding"; D.D Prentice, *The Companies Act 1980* at 122, quoted in P.L.R. Mitchell, *Directors Duties and Insider Trading* (London: Butterworths, 1982).

ought to realise that he should not put the advantage of his position to fraudulent use. Perhaps there should have been some clarifications here in view of the fact that insider trading in Nigeria is a crime, so that a person who acted in what he considered perfectly lawful manner will not find himself as an accused in a prosecution. The issue should normally boil down to one of *mala fides*, and the onus is on the insider to show that he did not know that he was so connected. The same approach, it is suggested, should be adopted in respect of those in a professional or business relationship with the company. With regard to tippees, the tippee should not only know the person from whom he got the information but must also know that the tipper is an insider. Ostensible knowledge would suffice.

The person must also know that the information is unpublished price sensitive information. Thus, a good faith belief that the information has been published may be a defence to an action.[53] It has been suggested that the knowledge requirement would be satisfied if it is shown that the insider dealt recklessly, careless whether the information has become public or not.[54]

But is possession of the unpublished price sensitive information enough, or must there be proof of a fraudulent intent in entering into the transaction? In the U.S., scienter

[53] This was the proposal in section 12.02(4)(a) of the Anisman Report. The facts of *Re Cady, Roberts* 40 SEC 907 (1961) show that such a defence is unlikely to be successful in the U.S., but see H.S. Bloomenthal, *Securities Law Handbook*, 1989-90 ed. (New York: Clark Boardman Company Ltd, 1989) at 386.

[54] D.M. Branson, "Insider Trading: The British Experience in the Light of American Experience" [1982] J.B.L. 342 at 418-419.

is a requirement for liability under rule 10b-5.[55] It has been stated that in respect of tippees, there is no liability unless the tip was given with a fraudulent intent, i.e., to make a profit or avoid a loss.[56] And it is said that the purpose of the scienter requirement is to guard against the possibilities of abuse inherent in a liberal cause of action which rule 10b-5 provides.[57] The Canadian cases[58] also require some positive act on the part of the insider to establish liability. From the 'defences' in *CAMA*[59] it is clear that there is a requirement for proof of a fraudulent intent before any liability can arise.

Although it is argued that to impose a burden on the plaintiff to prove a fraudulent intent on the part of the insider would be to nullify the protective purposes of the regulations,[60] there is a good reason for this requirement. As argued earlier, there is little merit in giving a party to the transaction windfall benefits at the expense of the other on the basis of vague legislation. The purport of the legislation must be to punish abuse of confidence and there can hardly be such an abuse absent a fraudulent intent.[61] Moreover it should be noted that the burden on the plaintiff is a light one, i.e., that of introducing evidence to show fraudulent intent. The greater burden will then shift to the

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[55] *Ernst and Ernst* v. *Hochfelder* 425 U.S 185 (1976), *Santa Fe Industries* v. *Green* 430 U.S. 462 (1977).

[56] *Dirks* v. *SEC*. 463 U.S. 646 (1983).

[57] R. Clark, *Corporate Law* (Toronto: Little, Brown and Co., 1986) at 315.

[58] *Green* v. *Charterhouse Group Canada Limited*, *supra*, note 31.

[59] Sections 617 and 618.

[60] *SEC* v. *Capital Gains Research Bureau* 375 U.S. 180 (1963).

[61] See Kimber report paras. 2.05 and 2.24.

insider to show that the transaction was free of fraud.[62]

Some have argued, in respect of rule 10b-5 and the *CSA*, that possession of the confidential information is enough without proof of its use.[63] This is a strange proposition, for if it is required to show fraudulent intent, then use of the information must be assumed for there can be no fraudulent intent absent the use of the information.

4.3.c. Counselling or Procuring.

There is no equivalent Canadian or American federal legislative provision for section 615(8) or 616(3)(b), but it may be possible to stretch rule 10b-5 to cover such practices.[64] The provision prohibits a person who is prohibited from dealing in securities on a recognised stock exchange from counselling or procuring another person to deal in those securities knowing or having reasonable cause to believe that the person would deal in those securities. Although the prohibition relates to those who cannot deal on a recognised stock exchange it is wide enough to cover all categories of prohibited persons under the *CAMA*. However, the counsellor or procurer is only liable if the counselling or procuration is to deal in a public company. Thus, even though other prohibited persons aside from insiders may not deal in a private company, there is nothing to

[62] *Green* v. *Charterhouse Group Canada Limited*, *supra*, note 31 at 309. In a criminal trial the converse should be the case because of the rule that the burden is on the prosecution to prove its case beyond all reasonable doubt.

[63] A.D. Forte, "Insider Dealing - a Tip Too Far" [1989] Juridical Rev. 203 at 204.

[64] The provision against aiding and abetting under the *Insider Trading Fraud Enforcement Act 1988*, may conceivably cover such a practice.

prevent them from counselling or procuring others to do so.[65] There is no liability for the person who is procured or counselled to deal. But this is only on the assumption that he is told nothing more apart from being counselled to deal. If he is aware or could have reasonably inferred the nature of the information and knows the source and status of the person supplying the information, he will be liable as a tippee or sub tippee as the case may be.

The fact that the counselled or procured person does not deal in the securities does not absolve the procurer from liability provided that he had the knowledge or belief that the person would deal. On the other hand, the fact that the person deals does not always imply liability. The procurer or counsellor must have known or had reasonable cause to believe that the other person would deal in the securities. This tallies with the argument that what the law is out to prevent is abuse of confidence and not to punish successful abuses. This also goes to strengthen the argument that a fraudulent intent is a requirement for liability under the provisions. But the way in which the rider is phrased makes it a surplusage to the provision, for it is hard to imagine what other purpose a person would have in counselling or procuring another to deal other than with the intention that the other would so deal.

4.3.d. Communicating Confidential Information.

A person prohibited from dealing in securities on a recognised stock exchange is prohibited from communicating the price sensitive information to any other person if he

[65] Public officers cannot exploit this loophole. Section 615 does not apply to public officers. There is a separate provision against counselling or procuring by prohibited public officers in section 616 and there they are not allowed to counsel or procure anyone to deal in securities which they are prohibited from dealing in and this includes securities of a private company.

knows or has reasonable cause to believe that the other person would deal in, or procure or counsel other persons to deal in, those securities. Again the prohibition here does not extend to communication of information that leads to a deal in the securities of a private company. Communication of the information with the requisite belief is enough for liability even though no dealing in fact took place. The addition of the requirement for knowledge that the person to whom the information was communicated to would deal with it makes sense here. The regulation obviously had in mind a *Dirks* v *SEC*[66] situation. In that case, Dirks, an officer of a stockbroker dealer firm was informed by an officer of an insurance company of certain fraudulent practices in the company, information which if disclosed would have a substantial effect on the value of the company's stock. Dirks investigated the charge, and in the course of the investigation revealed his findings to some of his company's clients, who promptly disposed of their shares in the insurance company. When the fraud came to light, the value of the company's stock fell. SEC, after an investigation, censured Dirks for violating the insider trading regulations. This was affirmed by the Court of Appeal. The Supreme Court reversed the holding, principally on the ground that in giving the information, Dirks did not breach any fiduciary obligation to the insurance company. The decision could equally have been based on the fact that when he gave the information, Dirks did not intend that his clients would trade on it.[67]

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[66] 463 U.S. 646 (1983). This requirement was one of the proposals for the definition of a tipper's liability in the abortive U.S. *Insider Trading Proscription Act* 1987.

[67] The fact that Dirks may have expected to earn commission from the tip (as he eventually did) could justify an inference that he intended the clients to deal on the information since he could earn no commission unless there was a trade.

The prohibition on communication applies only if the communication is made with the expectation that the person would deal. If it is done in expectation that the person would refrain from dealing, there is no liability. This restricts the viability of the provision, but is the inference to be drawn from a plain reading of the section. The law is silent in the liability of the person to whom the information is communicated if he actually deals. The person would only be liable if he qualifies as a tippee or sub-tippee. The question, it is suggested, has to depend on the manner of dealing by the communicatee. If he deals with a fraudulent motive, that is good ground to hold him liable as a tippee. If he does not otherwise qualify as a tippee, there seems to be no ground for holding him liable for a breach of the regulations.

The prohibition on counselling or procuring others to deal and communicating confidential information has a lot to commend it, for it blocks a wide avenue for evasion of the insider trading regulations, but it is not clear why it is restricted to dealings on a recognised stock exchange.

4.4. Specific Prohibitions.

4.4.a. Insiders.

Insiders as defined in section 614 are only prohibited from dealing in securities which are offered to the public for sale or subscription. This is in distinction to other prohibited persons who are prohibited from dealing in all securities, whether of a public or private company. It is not clear why this distinction is made but it is thought that there is stronger reason to regulate the dealing of classic insiders in private companies or in private deals in public companies if, as has been argued, the insider trading regulations were out to correct *Percival* v. *Wright.*

The prohibition on the insider lasts for as long as he occupies the office and up to six months after relinquishing the office. A director who resigns his office can deal in the prohibited securities six months after the resignation notwithstanding that the information is still unpublished price sensitive information. The six months period is arbitrary, but is justified by the argument that six months is enough time for the information to become public or lose its ability to affect the price of the securities. This is not necessarily so. It is desirable that the law should not unduly restrict the right of persons to engage in free trade. However, imposing a rule of thumb limitation of six months for all cases does not tally with the objective of insider trading regulations. The objective is the suppression of abuse of information acquired by virtue of a position of trust. This objective would be better promoted if the prohibition were made to last for as long as the information remains non-public. It is possible for a director to know of particular material information that would affect the price of its shares but which is not known to the other directors; he quickly resigns his position and carefully conceals the information for six months and then deals in the securities on the basis of the information. This possibility for abuse becomes more tempting where he is a sole director or one of two directors, the other being a 'sleeping' director. The hypothesis is not unmindful of the fact that if the information is such that in the circumstances it ought fairly to belong to the company, the director will be liable to compensate the company on the corporate opportunity doctrine.[68] The director's example is only used to show the defect of the

[68] *Canadian Aero Services Ltd.* v. *O'Malley* (1973), 40 D.L.R. (3d) 471, *I.D.C.* v. *Cooley* [1972] 1 W.L.R. 443.

six months limitation. The person perpetrating the abuse may be one who does not owe the company any fiduciary obligation, for example persons in a professional or business relationship with the company.[69] With the other prohibited persons there is no such limitation and it is difficult to appreciate why insiders who have greater access to confidential information should be given more lenient treatment than the others.

Apart from being prohibited from dealing in securities of his company or a related company, an insider is prohibited from dealing in the securities of any other company offered to the public for sale or subscription if he has unpublished price sensitive information which he acquired by virtue of his connection with his company and the information relates to any transaction (actual or contemplated) involving both companies or involving one of them and the securities of the other, or to the fact that any such transaction is no longer contemplated.[70] This prolix provision is actually unnecessary. If there is a transaction between two companies, both of them are in a business relationship, and as such all employees of both companies who occupy a position that would reasonably be expected to give them access to unpublished price sensitive information are regarded as insiders of each other and are prohibited from dealing qua insiders.[71] This first provision is even wider than section 615(3)(d) for, not only is the insider prohibited from dealing in the securities of the company with whom he has a business relationship, he is additionally prohibited from dealing in the securities of that company's related com-

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[69] It is the six months limitation in section 16(b) that has acted as the greatest attrition on the viability of the provision.

[70] Section 615(3)(a) *CAMA*.

[71] See Section 614(2)(b)(ii).

pany. The only addition, perhaps, is that this subsection extends to contemplated transactions.

Insiders are prohibited from buying or selling or otherwise dealing in the affected securities. Other prohibited persons are merely prohibited from dealing. *CAMA* has no definition for dealing but in the *CSA* from which it is borrowed[72] a person deals if he buys or sells or agrees to buy or sell. If dealing is restricted to buying and selling, then the 'otherwise' must imply something more. What this is, exactly, is unclear.

4.4.b. Tippees.

A tippee remains prohibited so long as the confidential information remains non-public. Information becomes public either if it is published[73] or if it is generally known to those who are accustomed or would be likely to deal in the security. The prohibition is from dealing which, as suggested, means buying or selling. Since insider trading is a crime,[74] dealing should extend to agreements to buy or sell as this amounts to an attempt to commit the crime. It also tallies with the purpose of insider dealing regulations, which is the suppression of abuse and not the punishment of the completed abuse.

Like the insider, the tippee is prohibited from dealing in the securities of any other company if he knows that the unpublished price sensitive information relates to the securities of the company in relation to a transaction (actual or contemplated) between

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[72] Section 13(1).

[73] As to the moment of publication see note 31 and pages 115-117.

[74] Section 621 *CAMA*.

the company from which he got the tip and the other company, or involving one of them and the securities of the other, or to the fact that any such transaction is no longer contemplated. This extended prohibition makes sense in the case of tippees, but it applies only to tippees of insiders and not other tippees.

4.4.c. Persons Contemplating Takeovers and Public Officers.

Like tippees, these categories are prohibited from dealing so long as the information remains non-public. For some reason, there is no extension of prohibition to dealings in other companies. In the case of persons contemplating takeovers, A, who is contemplating a takeover of company B, may in the course of the negotiations learn of unpublished price sensitive information in relation to company C. Under the provisions, he would be free to deal in the securities of company C using the price sensitive information. It is anomalous that the law would prevent him from dealing in the securities of company B in which he has greater interest to deal, but allow him to deal in the securities of company C even where he might have got the unpublished price sensitive information fraudulently. Depending on the circumstances, however, he may be liable as a tippee but this may not always be so.

A pertinent question is when it can be said that a takeover is contemplated. It would be easy for the court to infer when a takeover has been contemplated by the overt act of the bidder, but it would take more to decide when a bidder is contemplating a takeover. This is due to the heavily subjective nature of the inquiry. Does the commencement of inquiries into the business of the company constitute contemplation of a takeover or something more specific is required?. It is submitted that the answer must be based on a subjective and objective inquiry, to decide when a person is contemplating a takeover.[75]

Public officers suffer the same prohibition as those contemplating takeovers except that in their case they are only prohibited from dealing in 'relevant securities'.[76] There is no definition of this term in *CAMA* or the *CSA* from which it was borrowed but it is doubtful if it is intended to discriminate between types of securities.[77] It is suggested that it only connotes securities of the particular company about which they are in possession of the price sensitive information.

4.5. Exempted Transactions.

Certain transactions are exempted from the prohibitions in sections 615 and 616 but a close reading shows that most of these are not really exemptions to the insider trading regulations. As the purpose of the regulations is to prevent the misuse of confidential information, and since the listed exemptions are ones in which there is no misuse of confidential information, they do not, strictly speaking, amount to insider trading. Most of the exempted transactions are required to have been undertaken in good faith. Good faith negates a fraudulent intent which is an ingredient of the offence of insider trading. In requiring proof of what is ordinarily an exculpating factor for insider trading, the regulations make nonsense of the exceptions. In the *CBCA* there are no

[75] See pages 101-103 above.

[76] Section 616(3) *CAMA*.

[77] Securities include shares, debentures, debenture stock, bonds, notes (other than promissory notes) and units under a unit trust scheme. See section 650 *CAMA*. This is wider than the definition in section 2 of the *CBCA* where the term is restricted to share of any class or a debt or obligation of a corporation including a certificate evidencing such a share or debt obligation.

excepted transactions, but those listed as exemptions in *CAMA* will undoubtedly not be regarded as cases of insider trading. In the U.S., section 16(d)[78] exempts market makers from the regulations in section 16 of the *Securities Exchange Act*. This is the only statutory exemption but again those listed in *CAMA* have not been regarded as cases of insider trading.

Perhaps the listed exemptions arise from the failure of the Law Reform Commission to have a philosophical basis for the regulations that may guide Judges who have a misinformed idea about the purpose of the regulations.

4.5.a. Dealing Other Than With a View to Making a Profit or Avoiding a Loss.[79]

It has been said that if interpreted broadly, this is just the thing to drive a coach and horses through the legislation.[80] Such a claim is hardly justified, because, like provisions have always been given a restricted application.[81] It is argued that where the insider trades with a view to, for example, realising money to pay for repairs on his damaged car, that would be regarded as trading other than with a view to making a profit or avoiding a loss. It is doubtful if the court will adopt such a liberal interpretation. Indeed in the instances cited above, it can hardly be said that the trading is with a view other than the making of a profit or the avoidance of a loss. If the insider fails to trade, he has to get the money to pay the bills from his other resources. By trading on the

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[78] Added in 1964.

[79] Section 617(1)(a).

[80] Sugarman, *supra*, note 23 at 17.

[81] See the defence in section 16(b) of the *Securities Exchange Act*, discussed at 130 - 131 above.

information to pay the bill, he has avoided a loss which he would have suffered on his other accounts, or put in another way, he has made a profit on a new account. Moreover, there is a presumption that the transaction was carried out with a view to making a profit or avoiding a loss.[82] The presumption is rebuttable but the burden on the defendant is not a light one.[83] The approach may be analogous to the interpretation of the defence in section 16(b) of the *Securities Exchange Act* that the short swing transaction was in connection with a debt previously contracted.

Another restriction is that the profit to be made or the loss to be avoided need not be monetary. As such where the prohibited individual does not deal, but 'makes a gift' of the confidential information to a trading relative or friend he would not be heard to say that he did not make a profit or avoid a loss. "The tip and the trade resemble trading by the insider followed by a gift of the profit to the recipient".[84] Moreover, not only must the defendant prove that he was not out to make a profit or avoid a loss, he must also show that he had no wish to make a profit or avoid a loss for another person. The motive to make a profit or avoid a loss will always be present to a certain extent in all transactions. The issue is whether the mere presence of that motive is enough ground to infer prohibition, or whether the motive should be a predominant or commanding one for

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[82] *Green* v. *Charterhouse Group Canada Limited*, *supra*, note 31.

[83] The burden of proof inheres in the insider only in a civil suit. In a criminal prosecution, it is the duty of the state to prove a dominant motive to make a profit or avoid a loss in so far as the common law rule that the burden of proving all the elements of an offence is on the prosecution applies.

[84] *Smolowe* v. *Delendo* 138 F. 2d 231 (2d Cir. 1943), L. Loss *Fundamentals of Securities Regulation* 2nd ed. (Boston: Little, Brown and Co., 1988) at 76.

entering into the transaction.[85] Several motives might prompt a transaction, the one to make a profit being merely one of them. It is suggested that the courts should adopt a predominant purpose test and where there is a stronger motive for the transaction, the fact that the motive to make a profit or avoid a loss is incidentally present should not deny a person reliance on the exemption.[86] All that the insider has to show is that the circumstances compelled him to realise his holdings and that he would still have traded at that time whether or not he had the price sensitive information.[87] The fact that he traded when he had the information is merely coincidental with the occurrence of a pressing need. The question is one of fact as to the actual motive of the person trading. Because of the formidable burden on the defendant, and the pejorative interpretation of cognate provisions, the exemption that the trade was with a view other than the making of a profit or the avoidance of a loss is, in the end, unlikely to be of much practical relevance.

It should be noted that what is relevant is the motive for the transaction and not its outcome. Thus the fact that the insider eventually made a profit or avoided a loss is not enough to establish liability if he did not undertake the transaction with that purpose in mind.

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[85] J. Boyle and R.W. Sykes et al., eds, *Gore Browne on Companies* 7th supp. to 44th ed., vol. 1 (Bristol: Jordans and Sons Ltd, 1990) para. 12.24.

[86] Contrast Branson, *supra*, note 54 at 419.

[87] L.C.B. Gower et al., eds, *Gower's Principles of Modern Company Law* 4th ed. with supp. (London: Stevens and Sons, 1981) 638 n91.

4.5.b. Transactions by Certain designated Offices.[88]

This exemption covers persons who the insider trading regulations will bring in conflict with their duty to clients or beneficiaries. They are permitted to deal on behalf of the client or beneficiary provided they deal in good faith. They are not thereby permitted to deal in their personal capacity. Such personal dealing would in any event negate good faith and make them liable.

4.5.b.i. Liquidators, Receivers and Trustees in Bankruptcy.[89]

How these persons obtain the information is irrelevant. A liquidator who in another capacity obtains unpublished price sensitive information about another company is permitted to deal in the securities of the other company on behalf of the company being liquidated if he does so in good faith. The same applies to receivers and trustees in bankruptcy.

4.5.b.ii. Stockbrokers.[90]

Apart from acting in good faith, two further requirements are made of stockbrokers. They are only entitled to the exemption if the information was obtained in the course of their business as stockbrokers. Thus, a stockbroker who learns of unpublished

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[88] The reason for having express exemption for these offices if yet unclear, because they are not expressly classified as insiders under the regulations. They are likely to qualify as insiders only if they are in a professional or business relationship with the company. Undoubtedly, persons in such a position are not exempted if they undertake the transactions in the manner set under the section. It may be surmised that this is meant to be a further protection for this class of officers, so that even where they are in a professional or business relationship with the company and are in possession of price sensitive information, they would still be able to deal even if the transaction does not fall under the general exemption in the section.

[89] Section 617(1)(b).

[90] Section 617(1)(c).

price sensitive information in a different capacity may not trade on it in favour of his clients. Secondly, the information must be one which it would be reasonable to expect him to obtain in the course of his business as a stockbroker. A stockbroker who gets information of an imminent drop in the amount of dividend to be paid by a company may not trade on it on behalf of his client, as it is information which he is not reasonably expected to obtain in the course of his business.[91] Moreover, the transaction must be done in good faith. It is unclear if a trade with the hope of receiving an increased commission will negate good faith.

Lastly, as the provision talks of those engaged or employed in the business of a stockbroker it may be assumed that it extends to employees of stockbrokers who are not themselves stockbrokers as defined by law. As argued above,[92] it is suggested that in referring to individuals, section 617 extends to companies as there are many stockbrokerage firms and companies.

4.5.b.iii. Other Dealers in Securities.[93]

This provision is obscure and at first glance appears to be a part of that dealing with stockbrokers. Its equivalent in the *CSA* covers those doing business as market makers.[94] As there are no market makers in Nigeria, it is suggested that it relates to persons who deal in securities as a business but not as stockbrokers.[95] The exemption

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[91] Compare Mr. Gintel in *Cady, Roberts & Co.* 40 SEC 907 [1961].

[92] See pages 87-94.

[93] Section 617(1)(d).

[94] Section 3(1)(d).

[95] This will include managers of mutual funds and unit trusts.

requirements are essentially the same as those for stockbrokers.

4.5.b.iv. Trustees and Personal Representatives.[96]

This is one of the most confusing provisions on insider trading in *CAMA*. It only covers individuals acting on behalf of corporate trustees or personal representatives. It does not apply where an individual acts as a trustee or personal representative. Why this should be so is unclear, but it appears to be an omission especially as section 7 of the *CSA*, from which it originates, expressly covers individuals acting as trustees or personal representatives.

The individual acting on behalf of the corporate trustee or personal representative, if he is otherwise prohibited from dealing, will be able to deal if he acts on the advice of a person who appears to him to be an appropriate person from whom to seek such service and who does not appear to him to be prohibited from dealing in the securities. The advisor need not be competent, nor need he not be prohibited. What is relevant is the subjective knowledge of the trustee or personal representative as to the status of the adviser. It may be difficult to disprove that what the trustee or personal representative thought of the advisor was untrue. Perhaps, there should be a requirement that his belief be reasonable.

Where he seeks and acts on such advice, the individual is presumed to have acted with propriety, i.e., otherwise than with a view to the making of a profit or the avoidance of a loss whether for himself or another person. The meaning of propriety here is almost laughable for, as Professor Gower points out, a trustee or personal

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[96] Section 618.

representative almost always acts with a view to making a profit or avoiding a loss for the beneficiary.[97] As such the presumption is almost wishy-washy. The onus is on the plaintiff to rebut the presumption but that is a burden that can be easily discharged. The provision will have utility if the presumption is made irrebuttable once the advice was sought and acted upon.

4.5.c. Facilitating the Completion or Carrying out of a Transaction.[98]

Section 617(2) of *CAMA* is the most incomprehensible of all the insider trading provisions. The reason for this is, however, not far fetched. It reflects, most vividly, the problems inherent in an uncritical acceptance of foreign legislation. In following too closely the *CSA* model, the Law Reform Commission legislated against what the *CSA* omitted and omitted to provide for what the *CSA* covered due to a failure of the draftsman to align properly the comparable subsections.

To appreciate the problems of the provision it must be fully set out.

(2) An individual shall not, by reason only of his having information relating to any particular transaction, prohibited by

(a) section 615(2),(4)(b),(5) or (6) of this decree from dealing on a recognised stock exchange; or

(b) section 615(7) or (8) of this decree from doing any other thing in relation to provisions mentioned in paragraph (a) of this subsection; or

(c) section 616 of this decree from doing anything, if he does that thing in order

[97] Gower, *supra*, note 87 at 636 - 638(f).

[98] Section 617(2).

to facilitate the completion or carrying out of the transaction.

Now the purpose of the provision is to permit prohibited persons to complete or carry out transactions between themselves or their company and other persons. In the *CSA*, while this is not allowed where the insider is dealing in the securities of his own company, the regulations provide an exemption where the dealing is in the securities of another company from which he is prohibited from dealing by extension. The provision in *CAMA* is almost the converse. Section 615(2), (4)(b) and (5)(a) of *CAMA* do not at all concern transactions of the type envisaged, but section 1(2), (4)(b), (5) and (6) of the *CSA* do and these were unwittingly copied into the *CAMA*. The relevant sections ought to be section 615(3), (5)(b), (6) or (7) of *CAMA* which are the equivalent of the English provisions. And the exemption in section 617(2)(b) ought to relate to section 615(8) or (9) and not 615(7) or (8) as it does presently.

The purport of the provisions is commendable but there must be an amendment to that subsection to reflect properly what it aims to achieve. It needs only to be pointed out that the provision covers transactions on a recognised stock exchange. As such tippees are not permitted to deal in the securities of a private company nor is any prohibited person allowed to deal in the securities of a public company which are not traded on the stock exchange even if this is done to facilitate the completion or carrying out of a transaction. It is doubtful if such a restrictive interpretation was intended as few companies trade on the one stock exchange in Nigeria. This restrictive proviso arises, perhaps again, because that is how section 3(2) of the *CSA* is phrased; without recognising that while the *CSA* uniformly covers deals on a recognised stock exchange, the same is not true of *CAMA*.

CHAPTER 5

CONSEQUENCES OF AN INSIDER DEAL.

As the regulations are meant to prevent misuse of confidential information, certain consequences have to follow such a misuse. Before discussing these, it must be pointed out that the aim of liability is to deter (and sometimes punish) the insider and not to give the other party a windfall.[1] It appears that the *CAMA* has overlooked this purpose. Although the liability provisions as they are framed may have the effect of deterring the insider, this arises only as an incidental matter. The overall purport of the civil liability provisions is in the nature of a windfall to the other trading party.

5.1 The Transaction is not Void or Voidable.

This provision is missing from the Canadian and American legislation. It is necessary to consider the implications of this novel provision and test its consistency with existing principles.

Section 619 provides,

> "No transaction shall be void or voidable by reason only that it was entered into in contravention of section 615 or 616 of this Decree".

A pertinent question is the extent to which this provision alters the common law. Under the *CAMA*, the prohibited person commits a crime if he insider deals. In a sense, therefore, his action being illegal, it can be argued that the resulting transaction is also illegal. Under the general law of contract, an illegal transaction is void or at least

[1] *List* v. *Fashion Park Inc.* 340 F. 2d 457 at 463 (2d cir. 1965).

voidable at the instance of the innocent party.[2] Where a statutory provision conflicts with a common law right, it is not to be too readily inferred that the latter has been extinguished,[3] unless the statutory provision cannot conveniently coexist with the common law right.[4] Is it possible to reconcile the common law position with the provisions of the statute? It is impossible to assume that the transaction is valid for all purposes. If this assumption is made, the issue arises whether the court can grant a decree of specific performance in favour of the insider where the other party refuses to hand over the securities. Usually as securities are tangible, damages would be the appropriate remedy, but the calculation of damages would take into account the profit that would have been made if specific performance were ordered. Thus, the insider to whom the other party refuses to hand over the securities after he discovers the confidential information upon which the insider traded, would be able to sue for damages for breach of contract and include in his damages calculation, the dividend and other benefits he would have earned if the securities were transferred to him. As the law is to prevent the abuse of confidential information, such a calculation, though permissible on a plain reading of the statute, does conflict with the intendment of the law. This would be a circumstance that would justify a departure from the literal meaning of the statute, to find the mischief which the law aimed to cure. It may be necessary to hold

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[2] See M.P. Furmston ed., *Cheshire and Fifoot's Law of Contract* 10th ed. (London: Butterworths, 1981) at 329 - 335.

[3] *R.* v. *Scott* (1856) 25 L.J.M.C. 128 at 133.

[4] *O'Flaherty* v. *McDowell* (1857) 6 H.L.C. 142 at 158. Cf. S. Edgar ed., *Craies on Statute Law*, 7th ed. (London: Sweet and Maxwell, 1971) at 344.

that the transaction is not void or voidable only in so far as it is executed.

The proper remedy for a breach of contract is a claim for damages which is provided for in the statute.[5] However, an insider deal in not impugned on the ground of a breach of contract for indeed there is none. The terms are as agreed by the parties. The transaction may be attacked on one of two contractual grounds. The first is that one of the parties was bargaining upon a mistaken assumption as to the value of the securities. If this assumption is known to the other party, as it inevitably will be in face-to-face transactions, then a case of unilateral mistake would have been made out. On this basis, it could be argued that the parties are not *ad idem* as to the terms of the contract. The second would be an extended application of the principle of inequality of bargaining power, i.e., that one party to the transaction has, and utilises to bad use, greater access to corporate information. In either case, the proper remedy at common law is avoidance of the contract by the innocent party.[6] It is, thus, difficult to find a contractual justification for section 619 and it can only be concluded that it was meant to alter the common law as it stood.

It is not to be assumed that the transaction is never void or voidable. The transaction is not void or voidable if the only ground for complaint is the use of insider information. As such the other party will still have an action for rescission if he can

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[5] Section 620 *CAMA*.

[6] This would be almost impossible if the securities are those of an actively trading company, because the remedy of rescission is subject to third party rights acquired in good faith for value and without notice of the rights of the plaintiff. Moreover, before rescission can be ordered it is necessary to specifically identify the securities, the subject of the transaction that is sought to be avoided.

prove misrepresentation as it exists in the common law of contract.[7] This would, however, be an onerous task especially in impersonal transactions. There is no duty to disclose unless there is a fiduciary relationship. The Justice Society had recommended that where the parties are in direct contact, the insider should be deemed guilty of deliberate misrepresentation.[8] Another way is to make a securities transaction one of utmost good faith requiring full disclosure.

The problem with these suggestions is that they overlook the purpose of the legislation. Insider trading regulations are meant to prevent the fraudulent abuse of confidence, and not to establish safeguards in favour of one party to the transaction. If the purpose as claimed by some writers is to maintain fairness on both sides of the bargain, it is unfair to impose too much of a disclosure requirement on one party in favour of the other. Indeed the other party might have reasons for selling the shares which will affect the value, but which are unknown to the insider, for example, the fact that he is hard pressed for cash. There is obviously no peg on which to hang these extensions of the common law. The other party has the opportunity to avoid the contract if he proves a unilateral mistake. The mistake here must be conscious rather than unconscious. But in most insider deals, especially the impersonal ones such a claim can hardly be sustained. A sells his shares to B who is an insider, in ignorance of unpublished price sensitive information known to B. This is hardly a ground for pleading mistake as the fact that B bought the shares is merely fortuitous. If B had not bought

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[7] Furmston, *supra*, note 2 at 235-265.

[8] Justice (Society), *Insider Trading: A Report* (1980) Para. 33.

them, A would have sold to C at the same price and would be precluded from pleading mistake or even in attempting to set aside the contract. Why the result would be different is difficult to appreciate. A's ignorance is not due to B's fault as it is the duty of the company, not B, to disclose corporate information.[9] It is suggested that mistake, and probably misrepresentation, will only lie if the other party entered into the transaction on the basis of the active solicitation of the insider.

It is doubtful if aside from the common law claims, a party in Canada or the U.S. can claim rescission based on the use of insider information alone.[10] There has been no judicial consideration of this in Canada. Professor Loss is of the opinion that in the U.S., a seller who proves a violation of rule 10b-5 has the choice to elect rescission or a claim for damages. If he elects the former, he gets the shares plus any dividends or interests thereon by returning the purchase price.[11] There is some judicial support for this assumption[12] and indeed it was one of the claims made by the SEC in the *Texas Gulf Sulphur Case*.[13] The basis upon which such a claim can be allowed is unclear, but as Painter comments,

unless (rescission) can be considered some form of windfall justified only by its deterrent effect on future insider trading, it can be supported only by assuming that if the inside

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[9] See pages 41-42 and 57 above.

[10] In the U.S. there is a statutory remedy for contractual rescission under section 29 of the *Securities Exchange Act* 1934.

[11] L. Loss, *Fundamentals of Securities Regulation*, 2nd ed. (Boston: Little, Brown and Co., 1988) at 966.

[12] Loc. cit., *Estate Counselling Service* v. *Merrill, Lynch, Pierce, Fenner and Smith* 303 F.2d 527 (10th cir. 1962).

[13] 401 F.2d 833 (2d Cir. 1968).

information had been disclosed, those who sold their shares would have retained them to the date the suit was brought, an assumption as unrealistic as it is difficult to prove.[14]

Where the company is a party to the transaction with its insider, there are ample grounds to avoid the contract, one of which is the conflict of interest doctrine. For shareholders or private parties it may be possible to avoid the contract under certain circumstances. It has been shown that scienter is a requirement for liability. If this can be equated with fraud, then it may be possible to bring a common law action for deceit. However, common law deceit clearly goes beyond manipulative and fraudulent conduct. There must be a representation which the representor wishes the representee to rely upon and the latter does so to his detriment. These elements would be impossible to prove in impersonal transactions. There are instances, however, where avoidance of the contract would be more appropriate than a claim for damages. The measure of damages is the difference between the price for which the shares were sold and the price for which they would have been sold if the information were disclosed. There may be post disclosure increases and then increased dividends from year to year which outstrip the amount the other party could ever recover as damages. Thus, in a case of flagrant abuse and active solicitation by the insider, it is not enough to leave the other party to a claim for damages.

[14] W.H. Painter, *Federal Regulation of Insider Trading* (Charlottesville, Virginia: The Michie Company, 1968) at 102.

5.2 Civil Liability.

5.2.a Introduction.

This is the major difference between the insider trading regulations in *CAMA* and those in the *CSA*. The civil liability provisions seem to have been borrowed from the *CBCA*. Before discussing the extent of civil liability, certain points need to be clarified. For a clearer understanding of these, it is necessary to set out section 620 of the *CAMA*.

> An insider who contravenes any of the provisions of section 615 or 616 of this Decree or any person who contravenes any provision of section 616 ... shall be guilty of an offence and-
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> (a) liable to compensate any person for any direct loss suffered by that person as a result of the transaction unless the information was known or with the exercise of reasonable diligence could have been known to that person at the time of the transaction; and
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> (b) accountable to the company for the direct benefit or advantage received or receivable by the insider as a result of the transaction.

Firstly, the use of the word "offence" to describe civil liability is anomalous. The word offence properly belongs to the domain of criminal law. Its use seems to reinforce the point that the claim for civil recovery is not based on breach of any contract, but on a breach of a public duty. This might, however, be an oversight on the part of the draftsman. In the comparable section 131 of the *CBCA* the word offence is not used.

Secondly, takeover bidders and their tippees and tippees of insiders who trade on confidential information do not incur any civil liability.[15] Section 620 talks of any insider who contravenes any of the provisions of section 615. Different categories of persons can contravene those provisions and in mentioning insiders specifically, the implication is that the other categories are excluded. The relevant maxim is *expressio unuis exclusio alterius*. Insider in this regard is as defined in section 614. Whereas the tippee is not liable, as will be shown below, the tipper remains liable to the other party. It may be argued that this is an oversight on the part of the draftsman in not recognising that, unlike in most other insider trading statutes, there is no uniform definition of insiders in *CAMA*; but a close reading of the provision does not justify such an argument. In addition to insiders, public officers who are prohibited attract civil liability if they deal in the relevant securities. It is noteworthy that the Act talks of "any person who contravenes section 616" which means that tippees of public officers are included. Moreover, the section on criminal liability[16] refers to "an individual" and is all embracing of prohibited persons. The reason for excluding tippees and takeover bidders may be the fact that civil liability is not based on any contractual obligations, but upon a breach of fiduciary duties which directors, officers and other insiders, and public officers may be said to owe to the company and the investing public at large. Perhaps the draftsman thought that in imposing liability on those who have direct access to confidential information for the trading of their tippees, the temptation to tip would be reduced. If this is the purpose of the distinction, it is unclear why tippees of public

[15] There is no such distinction in the U.S. or Canada.

[16] Section 621 *CAMA*.

officers are made to incur civil liability.

Thirdly, unlike in the *CBCA*, there is no need to establish privity of contract between the plaintiff and the defendant. This is because the basis for liability is the contravention of the provisions, not the conclusion of a contract. This is the accepted position as far as section 16(b) of the *Securities Exchange Act* is concerned.[17] In *Texas Gulf Sulphur*, SEC successfully recovered from the insiders, the gains of their tippees, even though there was no privity of contract between the insiders and the persons on whose behalf the monies were recovered. This is a wide approach that has the possibility of creating a limitless class of plaintiffs, and the defendant may be made to pay damages grossly out of proportion to any gains which he might have made from trading on the information. No wonder attempts have been made to whittle down its ambit. Even in stock exchange transactions a sort of privity between the parties is now required. The formulated rule is that the plaintiff has to establish some contemporaneity between his sale and the defendant's purchase, i.e, that the defendant was purchasing at the same time as he sold.[18] Whether the deals are contemporaneous is a question of fact in each case.[19] This approach is fraught with inconsistencies and uncertainty and does not resolve the arbitrariness of recovery. It attempts to cloak an unjustifiable provision with

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[17] Loss, *supra*, note 11 at 736.

[18] Painter, *supra*, note 14 at 113.

[19] *Shapiro* v. *Merrill Lynch, Pierce, Fenner & Smith* 495 F. 2d 228 (2d Cir 1974), *Wilson* v. *Comtech Telecommunications Corp.* 648 F. 2d 88 (1981). In *Fridrich* v. *Bradford* 542 F.2d 307 (6th Cir. 1970) it was suggested at 326 - 7 that the right of recovery be limited to those who traded on the same day as the defendant. This formulation will require a straining of language to acquire legitimacy under the provisions in Nigeria. The contemporaneity trading basis of liability has been enacted as section 20A of the *Securities Exchange Act* vide section 5 of the *Insider Trading Securities Fraud Enforcement Act* 1988.

some sort of legitimacy. It is almost impossible to match sales and purchases on a stock exchange. The choice of those to be compensated is arbitrary. As the Justice Society pointed out,

> The matching of vendor and purchaser is entirely at random and there is no obvious justification for giving a vendor who happens to have sold shares to an insider a remedy which is not available to the vendors who sold similar shares at the same time and at the same price to outsiders.[20]

The injustice in the no privity rule becomes more glaring when it is sought to make the insider liable for the gains of the tippee. Unlike the cases of procuring or counselling another to trade or communicating information to another person, where it is required to show that the insider did so with knowledge that the other party would trade on the information, there is no such requirement in relation to tipping. The rider in the U.S. that the tipping must have been done in breach of a fiduciary obligation cannot be readily read into the *CAMA*. And since the tippee bears no liability, the temptation will be to turn to the tipper who may have given the tip unknowingly. In the U.S. a tipper is not liable unless there is actually a trade by the tippee, no matter the fraudulent intent with which the tip is given. This does not tally with the purpose of preventing abuse of confidence. It is the tip itself that creates the danger which the law aims to prevent and not the fact of trading. When *Dirks* ruled that a tippee is not liable unless the tip was given with the aim of getting a benefit it is unclear whether it refers to actually getting a benefit in which case there must be trading or whether it refers to the expectation of benefits, in which case a trade is not necessary. The latter

[20] *Supra*, note 8, para 34. Cf. P. Anisman, "Insider Trading Under the *Canadian Business Corporations Act*" [1975] *Meredith Memorial Lectures* 151 at 236, D. Karjala "Statutory Regulation of Insider Trading in Impersonal Markets" (1982) Duke L.J. 627 at 632.

interpretation is preferable. A tipper is liable for the trade of his tippee and sub tippee, even though he never traded, and this has been justified on the ground that he is to take responsibility for all losses caused by his breach of duty. Extending the liability in this way is unjust for the tipper might not have intended or foreseen that his tippee will tip other persons. The Anisman report sought to provide some relief by stipulating that the insider who is sued may claim a contribution from all those whose acts gave rise to the cause of action.[21]

Fourthly, despite the no privity rule, it is necessary that the plaintiff must have concluded a transaction of sale or purchase as the statute stipulates that the loss must arise as a result of a transaction. It is, however, doubtful if this requirement can be forcefully insisted upon in Nigeria. The stipulation is that the loss must arise from a transaction. Thus there must be a contract, but it is unclear if the plaintiff, or even the defendant, needs to be a party to the contract. A person may suffer "loss" from an insider deal without being privy to it. Can a shareholder who loses control as a result of the insider deal sue for this or may the investor whose deal is preempted by that of the insider sue for the profits he stood to gain had he traded? Wang, in his "Law of Conservation of Securities" argues for recovery in this circumstance.[22] It is doubtful if the courts will adopt such an interpretation, yet if what is punished is the behaviour leading to the trade and not the trade itself, the law may be justified in making the

[21] See section 13.18(2) of the Anisman Report.

[22] W.K.S. Wang, "Trading on Material Nonpublic Information on Impersonal Stock: Who is Harmed and Who Can Sue Under SEC Rule 10b-5" (1981) 54 Southern Calif. L.R. 1217 at 1234, M. Yontef, "Insider Trading" in P. Anisman et al., *Proposals For a Securities Market in Canada*, vol. 3 (Ottawa: Consumer and Corporate Affairs Canada, 1979) at 678-679.

insider liable for the genuine losses of those he could have foreseen will be injured by his fraudulent conduct. Under the *CAMA* it appears that the relevant consideration as far as liability to the other party is concerned is whether the plaintiff suffered a loss and not whether the defendant made a profit. An insider who suffers a loss may still be liable to a plaintiff if he can also prove a loss. Such instances of double losses will be rare, but this interpretation tallies with the motive of focusing on the conduct and not its outcome.

No liability would arise even if it is shown that revelation of the confidential information would have induced a reluctant outsider to conclude the transaction. This requirement ought to be self evident if the market is to be saved from fraudulent and frivolous claims. As Justice Rehnquist remarked in *Blue Chip Stamps* v. *Manor Drugs Stores*,[23]

> a putative plaintiff, who neither purchases nor sells securities but sued instead for intangible economic injury such as loss of a non-contractual opportunity to buy or sell is more likely to be seeking a largely conjectural and speculative recovery in which the number of shares involved will depend on the plaintiff's hypothesis.[24]

Fifthly, civil liability only subsists for two years from the date of the completion of the transaction that gave rise to the cause of action.[25] This was the position of the law in Canada before 1975 and it was argued that a shrewd insider may be able to evade liability by shielding the transaction for that length of time.[26] The position in America

[23] 421 U.S. 723 (1975).

[24] See Loss, *supra*, note 11 at 792-796.

[25] Section 620(2) *CAMA*.

[26] D.L. Johnstone, "Insider Trading Liability: A Comparison of U.S. and Ontario Legislation" OSC Bulletin, September 1968, 199; quoted in Johnstone, "Coursebook on Securities Regulations" (unpublished, 1970) chap. IX at 39-40.

and Canada now is that the limitation period begins to run from the date of the discovery of the facts that gave rise to the cause of action or the date on which the facts would have been discovered with due diligence. To protect the insider from an ever present threat of liability, the Anisman report in section 13.19(3) proposed a limitation of two years from the date of discovery of the facts or six years from the date of the transaction whichever is earlier. This is a sensible compromise and is recommended for adoption in Nigeria. This is the better approach if the check on misuse of confidential information is to be worthwhile. It should be noted that where the plaintiff bases his claim on other grounds additional to misuse of confidential information, for example, misrepresentation, and that other ground is the dominant one for the action, then the two years limitation ought not to apply.

5.2.b Extent of Civil Liability.

5.2.b.i To The Other Party.

In the U.S. there are two grounds for civil liability to the other party; under section 16(b) and rule 10b-5. Under section 16(b) the basis for calculating damages is the much criticised lowest-in-highest-out formula.[27] To avoid a repetition of the well formulated criticisms,[28] no more will be said of this formula. The suggestion has been made that an insider who is liable under section 16(b) may, in appropriate circumstances, also be liable under rule 10b-5.[29] It is doubtful if this is a correct suggestion and it has

[27] *Smolowe* v. *Delendo Corporation* 136 F. 2d 231 (2d cir. 1963).

[28] See Painter, *supra*, note 14 at 31-39.

[29] L. Loss, *Securities Regulation*, 2nd ed., vol. 3 (Boston: Little, Brown and Co., 1961) at 1473-1474.

received scant judicial consideration.[30]

Of more relevance here is the basis of calculating damages to the other party under *CAMA*. The insider is liable to compensate any person for any direct loss suffered as a result of the transaction.[31] Only losses quantifiable in monetary terms can be recovered. Direct loss has been interpreted to mean the difference between the actual purchase price and the price which the shares would have attracted at the time of the transaction.[32] This is sometimes called the out-of-pocket measure of damages. It was

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[30] There has been some support for this proposition in recent writing. Indeed it has been argued that with the passage of the *Insider Trading Sanctions Act* in 1984, the insider would be liable to pay up to three times the profit realised in an SEC action, pay a disgorgement to the other party and still be liable under section 16(b). See S. Bainbridge, "The Insider Trading Prohibition: A Legal and Economic Enigma" (1986) 38 U. of florida L.R. 35 at 41. This is not a correct interpretation and, as will be shown below, the rule is not one of double liability.

[31] The fact that the direct loss must be suffered as a result of the transaction raises the issue whether there is a requirement of causation in fact or if causation in law is enough. R.N. Rapp, "Rule 10b-5 and 'Fraud-on-the-Market' - Heavy Seas Meet Tranquil Shores" (1982) 39 Wash & Lee L.R. 845 at 897 argues that there must be established, a causal link between the trade and the loss. The Anisman report rejected such a proposal noting that "the defence that the loss was not caused by the insider's violation may not be used to show that a violation could not have caused any damage at all because the trading occurred in an organised market or that the damages was caused by a trading tippee, for such an interpretation would in effect negate the provision of a remedy in the Act. It can only be used to avoid the part of the losses caused by extraneous factors". See P. Anisman et al., *Proposals for a Securities market Law for Canada*, vol. 2 (Ottawa: Consumer and Corporate Affairs Canada, 1979). The problem is how to make the severance between the losses caused by the trade and those caused by extraneous factors. To avoid this arbitrariness, it better to do away with civil recovery totally.

[32] *SEC* v. *Texas Gulf Sulphur Company supra*, note 13, *Burke* v. *Cory* (1959), 19 D.L.R. 2d 252 (On. C.A.), C. Okonkwo, "A Critical Appraisal of Insider Trading Transactions Under the Law" (unpublished seminar paper). This test is faultily applied in practice. What is actually calculated is the difference between the price paid for the shares and the price at which the shares sold shortly after disclosure. There is no guarantee that the price at which the shares sold at the time of disclosure would be the same as the price at which they would have sold if the information were disclosed at the time of the sale. The time lapse between the sale and the disclosure might be up to two weeks and, within this time, several other small factors may have combined to alter, significantly, the price of the shares. Yet the insider is made to bear the burden of the full price difference when nondisclosure is but one of several factors that altered the price of the shares. Again if the courts were to calculate the damages on the basis of what the shares would have attracted at the time of the sale if the information had been disclosed, the price put on the shares would be purely speculative and conjectural. Moreover the test is based on a false assumption that the other party would always be able to sell the shares. The rise in the price of the share which the disclosure of the information may cause might deter potential buyers, so that the trader is saddled with the shares. In this

criticised on the ground that it would make the defendant liable beyond the amount of profit made. The current measure of damages is that of the disgorgement of profits.[33] Under this calculation, the defendant is liable for the difference between the purchase price and the price which the shares would have attracted at the time of the transaction, but only to the extent that the total damages to all the plaintiffs shall not exceed the profit made by the defendant on the insider deal. Where the total claim exceeds the profit made by the defendant, the plaintiffs share the amount awarded on a pro rata basis of the loss suffered by each.[34]

If civil liability is to be allowed at all, this seems a fair configuration, but authors have condemned it as being too lax to act as a deterrent to insiders. Anisman argues for payment of something more where the seller had incurred incidental expenses.[35] In the U.S. these calls have been, unfortunately, heeded and the law there is that the insider

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regard, what the insider recovers is expectation profits which is castigated in *Blue Chips Stamps* v. *Manor Drug Stores*, *supra*, note 13.

[33] *Eklind* v. *Liggett & Myers* 635 F. 2d 156 (2d cir. 1980). See D.P. Carey, "Rule 10b-5 Developments, Damages and Contribution" (1982) 39 Wash. & Lee L.R. 997, M.C. Dickinson, "Damages for Insider Trading Violations in an Impersonal Market Context" (1981-82) 7 J. Corp. L. 97; contrast H.M. Friedman, "Efficient Market Theory and Rule 10b-5 Non-disclosure Claims: A Proposal for Reconciliation" (1982) 47 Miss L.R. 745 at 760 and W.K. Sanders, "Measure of Damages for Insider Trading: Eklind v. liggett & Myers Inc." (1981) 56 St. John's L.R. 142.

[34] This is one of the many vagaries of allowing private civil claims. If the purpose of these suits is to enable the plaintiffs recover their loss, then the pro rata share cannot be justified. The disgorgement measure only shows that the purpose of liability is to recover the ill gotten gains of the insider not to compensate the other party to the transaction. If there is no compensatory aim, then there is no basis for private civil liability for deals on impersonal market and the money should go to the public via the government.

[35] Anisman, *supra*, note 20 at 249, R. Clark, *Corporate Law* (Toronto: Little, Brown and Co., 1986) at 291.

may be made to disgorge up to three times the amount of profit made.[36] Indeed Professor Loss contends that in addition to actual damages, consequential damages are also recoverable and that rescission does not preclude recovery of consequential damages for pre-rescission losses.[37] The answer to all these is that they ignore the fact that the purport of the regulations is to deter the insider, not to benefit the other party. It is not aimed at fulfilling expectation interests.[38] There are several other provisions imposing liability which would act as a deterrent. Even if deterrence is to be achieved by multiplying the profit of the insider for liability purposes, the other party to the transaction who, factually, has suffered no loss is hardly the proper person to recover the amount.[39] A problem that arises in non-stock exchange transactions is that there is no ready market from which to ascertain the actual price which the shares would have commanded.

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[36] Section 21(d)(2) *Securities Exchange Act* added by the *Insider Trading Sanctions Act 1984*. This relates to proceedings by SEC and the money is paid to the U.S. treasury.

[37] Loss, *supra*, note 11 at 968-969.

[38] *Burke* v. *Cory*, *supra*, note 32 at 261.

[39] The provision for civil suits at the instance of the other trading party was a cause of major disagreement in the Anisman report. W.H.M. Grover argued that "the whole concept of a market remedy is wrong in theory and dangerous in practice. Nobody questions the proposition that a wrongdoer should not be left with the fruit of his wrongdoing, but it is a large jump from there to allow investors to form a lynch mob through some form of class action. In many cases, the rewards to the individual investor will be windfalls, insubstantial to most, but substantial in the aggregate. The investors do not have to prove causation, it is presumed. The defences are illusory in most situations because of the impossibility of knowing why the stock market moved the way that it did with respect to a particular stock. The temptation to unscrupulous plaintiffs and unscrupulous lawyers is only too real. The defendant is usually forced to settle. Even to permit the commission to launch such an action is fraught with danger, both because the commission is likely to prosecute only a few selected cases, which may be chosen for the wrong reasons, and because the commission bears a substantial extra administrative burden at a time when less rather than more regulatory intervention in the marketplace is desirable". *Supra*, note 31 at 237 n*. The argument could not have been more neatly put.

The statute provides one defence in favour of the insider, i.e, that the information was known or with the exercise of reasonable diligence would have been known to the other person at the time of the transaction. The purpose of the provision is to effect the other party with constructive notice of the information in appropriate circumstances, but it is uncertain how far a court would be willing to stretch this. If, for example, the information has been placed in the company's file which can be read on request by financial analysts and brokers but which is not generally open to public inspection, will the omission of the other party to consult one of these be evidence of lack of reasonable diligence? The answer would depend on the type of transaction, the level of the parties' knowledge of securities transactions and other circumstances of the case. The test should be that of the reasonably prudent investor.

5.2.b.ii To The Company.

The insider is accountable to the company for any direct benefit or advantages received or receivable by him as a result of the transaction.[40] The extent of liability here is certainly wider than that owed to the other party but the exact ambit of this bland provision is unknown. Benefits and advantages will in all likelihood be restricted to those which can be quantified in monetary terms. Does direct benefit extend to dividends which are earned on the shares? Does it include remuneration from a directorship which is incidental to the insider deal? Does it cover accounts for control acquired by virtue of the votes gained from the purchase of the shares? All these are benefits or advantages which can be received as a result of an insider deal and there are many more. Perhaps

[40] Section 620(b) *CAMA*, section 131(4)(b) *CBCA*.

the rider that only direct benefits or advantages are recoverable will be used to restrict the extent of liability, but the provision as phrased has the uncomfortable possibility of limitless application. Another disturbing issue is whether the use of the word 'receivable' connotes that benefits and advantages to be received in future can be recovered? If yes, is this an indefinite liability imposed on the insider and will liability be calculated on the basis of a clairvoyant prediction that the benefits or advantages will accrue or will liability arise from time to time as the benefits are made? It is unlikely that the section will be given this wide application, yet a literal reading readily leads to that conclusion. There is a slight difference in phrasing between the Nigerian and Canadian legislation that would warrant a parsimonious interpretation in Nigeria. Both regimes use benefit or advantage in the singular but because singular also includes plural, this does not avoid a wide interpretation. However, while the *CBCA* talks of "*any* direct benefit or advantage" the *CAMA* refers to "*the* direct benefit or advantage". The definite article "the" rather than the indefinite "any" may connote that only a once and for all benefit or advantage can be recovered by the company against the insider.

A pertinent question is whether there is any justification for corporate recovery. There has been almost unanimous condemnation of the right of a company to recover profits from the insider.[41] The ground for condemnation is that the company suffers no loss from the transaction except for an intangible loss of reputation,[42] and that corporate recovery appears as something in the nature of a windfall. It is surprising that these argu-

[41] See Clark, *supra*, note 35 at 288, J.H. Farrar, *Company Law* 2nd ed. (London: Butterworths, 1988).

[42] *Diamond* v. *Oreamuno* 24 NY 2d 494 (1969). See R.J. Haft, "The Effect of Insider Trading Rules on the Internal Efficiency of the Large Corporation" (1982) 80 Mich. L. Rev. 1051.

ments are made only in relation to corporate recovery for as has been shown, they are equally true for personal recovery, a remedy which has been generally applauded. Indeed there is greater justification for corporate than personal recovery.[43] Except as relates to corporate suits against tippees of public officers, corporate recovery is based on the breach of a fiduciary duty owed by the insider to the company. It is remarkable that the word used here is "accountable" as opposed to "compensate" used in relation to personal suits. This is reminiscent of the strict accountability rule of fiduciaries at common law and is, perhaps, why recovery goes beyond ordinary profits to other benefits. Because of this the windfall argument breaks down. A suit to enforce a fiduciary duty is not based on allegation of loss suffered by the beneficiary, but upon the breach of the fiduciary's duty.[44] The company need not show the conclusion of a contract or that it suffered loss as a result of the transaction.[45] If the property right basis of action is also adopted corporate recovery is justified. The information used belongs to the company and its property rights demand that it can prevent any person from using it to profit without its consent.[46] The rule is that it is irrelevant that the company could not have exploited the

[43] This is because as a matter of traditional fiduciary concepts the information belongs to the company. If the information belongs to the company, then it has a right to insist that it should not be used in an objectionable manner. The shareholder who has no property in the information can hardly make such a claim. See generally, M. Conant, "Duties of Disclosure of Corporate Insiders Who Purchase Shares" (1960) 66 Cornell L.Q. 53.

[44] *Brophy* v. *Cities Services ltd* 70 A.2d 5 (Del. Ch. 1949).

[45] *Aberdeen Rly.* v. *Blaikie Brothers* (1854) 2 Eq. Rep. 128. Cf G.E. Wimberly Jr., "Corporate Recovery of Insider Trading Profits at Common Law" (1985) 8 Corp. L.R. 197, T.E. Hazen, "Corporate Insider Trading: Reawakening the Common Law" (1982) 39 Wash. & Lee L.R. 845, S.M. Beck, "The Quickening of Fiduciary Obligations: Canadian Aero Services v. O'Malley" (1975) 53 Can B. Rev. 771.

[46] *Snepp* v. *U.S.* 444 U.S. 507 (1980). J. Boyle and R.W. Sykes eds, *Gore Browne on Companies* 7th supp. to 44th ed., vol. 1 (Bristol: Jordans and Sons Ltd, 1990) comment at para. 12.17.1 that it is doubtful if the director will be liable under the accounting principles if he trades to avoid a loss. The answer is that

information.[47] This rule applies with greater force here, because in insider trading cases the value of the information lies in the fact that it cannot be used, i.e., its confidentiality. The further argument that the right of action should inhere only in companies whose shares have been traded[48] is faulty especially in the area of tender offers. The share traded is usually that of the company to be acquired, but the information belongs to the tender offeror and the injury caused by the rise in the share price is to the tender offeror, not the offeree, who under this formulation is the party to recover.

In a way, corporate recovery goes to balance the interest of the trading insider and the other party where he is a shareholder who has not disposed of his entire holdings. The profit recovered from the insider goes to improve the value of their shares. Because corporate recovery should be based on breach of fiduciary duties, there is no justification for corporate recovery against tippees of public officers who do not owe the company any fiduciary obligations, except on the basis of a constructive trust.

The problem which may arise if recovery is left to the company alone is that of corporate litigation.[49] The company may be minded to acquiesce in the misdeed of its

he will. Avoiding a loss is but a negative way of making a profit. What is important is that monies which he would not otherwise have but for the trade have accrued to the director.

[47] *Regal (Hastings) Ltd* v. *Gulliver* [1942] 1 All E.R. 378.

[48] J.P Strickler, "Inside Information and Outside Traders: Corporate Recovery of the Outsider's Unfair Gain" (1985) 73 Calif. L.R. 483 at 509.

[49] It has been argued that a corporate suit is not feasible under the present rules, at least in the U.S., because of the rule in *Blue Chip Stamps* that the plaintiff must have sold or bought shares. In most cases the company would not have traded and would lack the standing to sue. See Karjala, *supra*, note 20 at 628 n4 and 641 - 44 and J.R. Macey, "From Fairness to Contract: The New Direction of the Rules Against Insider Trading" (1984) 13 Hofstra L. Rev. 9 at 47. The irony is that even where the company has traded it still cannot sue. This is because it will be imputed with knowledge of the information. The knowledge of its officers is that of the company and since the officers would invariably know of the information, the company is deemed to know too and, therefore, would have traded in breach of the rules and would be

officers, especially where they are in control of the board or are majority shareholders.[50] This is hardly a formidable problem today. The scope of the shareholders' right to bring a derivative action on behalf of the company has been greatly expanded.[51] Moreover, it is possible for the shareholder to bring an action on the ground of unfairly prejudicial or oppressive conduct.[52]

A counter argument is raised about the efficacy of derivative suits, i.e., that the benefit to the shareholder in terms of the increase in the value of his shares might be too little an incentive for him to embark on costly litigation. There are at least three replies to this. Firstly, as pointed out, the purpose of the action is not to benefit the individual shareholder but to deter the insider from fraudulent acts by enforcing the fiduciary duties. Secondly, the practice in the U.S. of providing for contingency fees is now recognised by statute. The court is empowered to make an order requiring the company to pay reasonable legal fees incurred by the applicant in connection with the proceedings.[53] Lastly, section 304(c) of *CAMA*,[54] at the same time, takes care of the windfall-in-

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precluded from suing. The maxim is *in pari delicto non oritur actio*. The argument in the text that the corporation should be able to sue is not a justification of civil liability in impersonal markets insider trading. Civil liability under the rule both to the company and to the other party is not justified. The corporate suit is based on breach of recognised common law fiduciary duties, company law concepts and the express or implied terms of the insider's contract of employment.

[50] L.C.B. Gower et al., eds, *Gower's Principles of Modern Company Law* 4th ed. with supp. (London: Stevens and Sons, 1981) 631 n20.

[51] Section 303 *CAMA*.

[52] Sections 310 and 311(2)(a) *CAMA*.

[53] Section 304(d) *CAMA*, section 240(d) *CBCA*.

[54] See also section 240(c) *CBCA*.

corporate-recovery and the absence-of-incentive-to-shareholder arguments in providing that the court may direct that any amount adjudged payable by a defendant in an action shall be paid in whole or in part, directly to former and present security holders of the company instead of to the company. If these judicial discretion are wisely exercised, they would act as a sensible means of preventing windfall recovery by the company or shareholder and at the same time ensuring appropriate recovery by the shareholder where a clear case of fraud is made out.

5.2.b.iii Double Civil Liability?

In the U.S. it is possible for a person to be liable under section 16(b) and rule 10b-5.[55] This possibility has little support and although criticised as imposing too much of a liability on the insider, it may be explained on the basis of the fact that two prohibitory provisions are in question and both must have been breached. This is different from the query here, which is, whether a single breach of the insider dealing regulations can lead to liability both to the other party and to the company.

Certain authors have assumed that this is the correct position from a literal reading of the *CBCA*,[56] but there is no judicial support for such an interpretation. The Kimber committee in its initial report had recommended an appropriate provision to avoid double liability.[57] There is an inherent unfairness in double liability that raises

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[55] Clark, *supra*, note 35 at 288, *Pappas* v. *Moss* 257 F. supp. 345 (D.N.Y. 1966).

[56] Anisman, *supra*, note 20 at 255, P. Anisman, *Insider Trading Regulation For Australia: An Outline of the Issues and Alternatives* (Camberra: Australian Government Publishing Service, 1986) 107, T. Hadden, R. Forbes & R. Simmonds, *Canadian Business Organisation Law* (Toronto: Butterworths, 1984) at 468.

[57] Para. 2.30.

serious questions of social policy.[58] The purpose of the legislation is to deter the insider from misuse of confidential information, but this does not justify crippling liability. The possibility of a suit by the company followed by one from a shareholder was rejected in *Texas Gulf Sulphur*. The ruling was that the company should hold the money in an escrow account to enable individual shareholders to make a claim against it.

Although a literal reading of *CAMA* may lead to a conclusion that double liability is the rule, this is not necessarily so. The Kimber Committee's proposal was not included in the statute, but it can be achieved by robust judicial interpretation. Where the insider has already compensated the other party for the direct loss suffered, the company can no longer sue him for the profit realised on the transaction for at that time it would no longer be part of the direct benefits or advantages realised from the transaction. What the company can then recover is the other benefits or advantages less the amount recovered by the other party. Thus, although suits by the company and individuals may be allowed, the amount to be recovered in both suits cannot exceed the amount recoverable by the company.[59] If recovery by one party is to preclude recovery by the other, the question is, who should have priority to sue for the money. As there is stronger reason for corporate recovery, the company should have the first right of action.[60] Also because the overall damages to be recovered are those recoverable by the

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[58] Painter, *supra*, note 14 at 370-371.

[59] The fact that there is no double liability can be justified by the fact that although several persons may be in breach of the insider trading rules to a single investor, he cannot recover in excess of his loss. Thus, a person who sues the tipper to recover the profit of the tippee cannot again sue the tippee even if both the tipper and tippee breached the legislation. The rule is always one of single recovery.

[60] Clark, *supra*, note 35 at 291 has the opposite suggestion.

company, a first suit by the company saves the insider and the court from a second suit by shareholders. Shareholders who have suffered genuine losses but who have no claim at common law should be able to enter a third party claim against the company to recoup their losses or sue the company for a share in the corporate recovery.

5.2.c Appraisal of Civil liability.

It has been lamented that the greatest omission in the *CSA* is the absence of civil liability.[61] This lamentation arises from a misunderstanding of the basis of insider trading regulations. Those who argue for private civil recovery confuse two things. Whether insider trading should be prohibited is one thing, those entitled to claim compensation for the breach is an entirely different question. Even if insider trading were to be outlawed because it has undesirable consequences, it is anomalous to permit private recovery by someone who suffers no separate loss from the action. Moreover, it is wrong to assume that in the absence of such civil liability, the insider is free from accounting for his misdeeds. Where there is breach of a contractual duty appropriate remedies exist at common law. Again, if he acted in breach of his fiduciary obligations, the common law is well suited to deal with the situation. Where there is no breach of a contractual or fiduciary obligation, what justification can there be for liability? Insider trading regulations are a device of public policy, i.e., the need to prevent the fraudulent abuse of confidence. Where there is a contravention, it is a contravention of a duty owed to the public and the person to whom account is owed is the public. There is no justification for certain individuals to claim the benefit arising from a breach of a public duty.

[61] B. Hannigan, *Insider Dealing* (London: Kluwer Law Publishers, 1988) at 93. For a spirited attempt to imply civil liability see 96ff.

The breach of duty by the insider should not be the inheritance of the individual shareholder. Civil liability for insider trading is misguided. Corporate recovery must be justified by a breach of a fiduciary duty, and individual recovery must be based on the breach of a fiduciary or contractual obligation. Both cases are amply covered by the common law. There are better ways to deter insider trading than giving a windfall to persons who on closer scrutiny are not altogether free from devious machinations.[62] Of greater concern is the fortuitous nature of civil recovery. It is riddled with vagaries. As Painter comments,

> ... it is doubtful (if) civil liability is appropriate where confidential information has been used ... to the detriment of an indefinite number of purchasers ... of securities. ...there seems to be no rationale basis for delimiting the class of persons who should recover. If it is concluded that everyone should recover, ... similar difficulties arise with regard to delimiting the class of defendants who should pay. Even if these obstacles are successfully overcome equally difficult problems are likely to arise with regard to the measure of damages. All of these questions raise serious doubts as to the efficacy of civil liability for controlling this type of trading abuse.[63]

If insider trading is to be regulated at all, there are at least four better ways of dealing with the phenomenon other than reliance on civil liability. The first would be to arm self-regulating bodies with more powers to deal with members who run foul of the

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[62] The present regulations give the outsider the best of two worlds. If the insider makes no gain or makes a loss, the outsider brings no action and the insider is equally destitute of a remedy. If the shares rise in price upon release of the information, but suffer a decline almost immediately after, due to other events, the outsider can still recover and leave the insider with the now worthless securities. As an alternative to allowing damages suits, the Anisman report has an excellent proposal whereby the insider can avoid a damages suit by offering to sell back to or repurchase from the outsider the securities that were previously traded. An outsider who rejects this offer has no ground to claim damages for if the securities were so valuable as the complaint seems to infer, he would consent to take them back. See section 13.20 of the Anisman Proposals. The utility of this brilliant provision is restricted as the option is made available only for direct dealings.

[63] Painter, *supra*, note 14 at 149-50, footnotes omitted.

in-house insider trading rules of the organisation.[64] The threat of loss of a professional office is often greater than any amount which the insider may be asked to pay. If he pays the money and keeps the office, he has the chance to recoup his "loss" and given the porous nature of policing machinery he is likely to do so successfully. But if he loses the office, the avenue for insider dealing would have been closed in addition to losing a professional calling and suffering disgrace before his peers. The sanction of disapproval and damaged reputation which lie in the field of self regulation are far greater than most legal sanctions.

Secondly, the company is best placed to detect trading by insiders and is better suited to apply pressure on the insider to surrender his profits. It is, therefore, a problem that would be better dealt with at management level. And because insider trading damages the image of the company it has the greatest interest in policing these breaches of duty. Where the company is lax in doing so it should incur liability.[65]

The third method is to increase the disclosure requirement imposed on companies. "Any company by making prompt and accurate disclosure of any facts likely materially to affect the value of its securities takes away from an insider the opportunity to make a profit by the use of confidential information which he has, but which is not available to those with whom he is dealing".[66] The disclosure philosophy retains much practical

[64] For the merits and demerits of regulation through self regulatory bodies see B.A.K. Rider, "Self Regulation: The British Approach to Policing Conduct in the Securities Business With Special Reference to the Role of the City Panel on Take-overs and Mergers in the Regulation of Insider Trading" (1978) 1 J. Comp. Corp. L. & Sec. Reg. 319.

[65] Compare the liability of controlling persons under section 21A of the *Securities Exchange Act* 1934.

[66] M.A. Weimberg et al., eds, *Weimberg and Blank on Takeovers and Mergers* 4th ed. (London: Sweet and Maxwell, 1979) at 563.

significance in today's corporate world.

Admittedly, the above suggestions will work well only in public companies and may still be evaded especially by tippees. The fourth suggestion would help to plug such manoeuvres. This is accountability to the public which would be realisable by expanding the scope of criminal liability. This in discussed as the next sub-heading.

5.3 Criminal Liability.

Except where short sales, calls and puts are concerned, there is no criminal liability for insider trading in the *CBCA*.[67] Section 621 of *CAMA* provides that an individual who contravenes the insider trading provisions is liable on conviction to two years imprisonment or #5,000.00 fine or both. Apparently, the insider who has compensated the other party will still be amenable to criminal prosecution.

As argued above, the appropriate deterrence for insider trading is criminal penalty. Where the person trading has no fiduciary relationship with individual traders, his breach of duty, if any, is a breach of a duty owed to the public. As such a criminal action ought to succeed where a private one would fail.[68] The question is whether insider trading is so inherently criminal as to justify imprisonment. There is nothing particularly criminal about insider trading. There are legion examples of use of confidential information in several other transactions. Securities trading is just a special type of transaction that has been singled out for regulation because the prevention of fraudulent abuse of confidence is regarded as a matter of public concern. It is submitted

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[67] Section 130(4).

[68] Contrast *U.S.* v. *Newman* 664 F. 2d 12 (2d cir. 1981) and *Moss* v. *Morgan Stanley* 719 F. 2d 5 (2d cir. 1983)

that the appropriate penalty should be a fine.[69] The court would be given a discretion, within limits, to impose appropriate fines. The maximum of 5,000.00 naira in *CAMA* is inappropriate for this purpose. The fine to be imposed should be somehow related to the profit illegally made on the insider deal. Something like a multiple of three has been recommended.[70] The fine which is recovered is to be paid into the consolidated revenue fund.[71] The person may also be restrained from holding executive office in a public company for a length of time stipulated by the court.

It may be objected that the other party who suffers a genuine loss from the insider deal is left without a remedy. This possibility can be taken care of, for the courts have the power to direct that the fine should be paid in full or in part to the complainant. A further objection is that the state may fail to prosecute, especially where the insider wields considerable influence in the society. This is not a serious objection in Nigeria. Unlike in the *CSA* where proceedings can only be instituted by the Secretary of state or by, or with the consent, of the Director of Public Prosecution,[72] there is no such limita-

[69] Certain disabilities which are consequent on conviction will act as a better deterrent than any amount paid out in a civil suit. For example an ex-convict cannot run for public office in Nigeria. See Sections 62(d), 101(d), 128(1)(a), 143(1)(a), 166(1)(a) and 181(1)(a) of the *Constitution of the Federal Republic of Nigeria 1979* as amended. Contrast F.H. Easterbrook, "Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information" [1981] Sup. Ct. Rev. 309, at 334, and "Insider Trading as an Agency Problem" in Pratt & Zeckauser eds. *Principals and Agents* (Boston, Mass.: Harvard Business School Press, 1985) 87 at 94.

[70] J. Fatinikun, "The Law on Insider Trading in Nigeria" (1990) *Guardian Finance Weekly*, Sept. 17, 9.

[71] Section 645 *CAMA*.

[72] Section 8(2) *CSA*.

tion in the *CAMA*. The right of private prosecution is recognised in Nigeria.[73] This could be expanded in respect of insider trading transactions. The further objection that lack of any personal benefit and the cost of litigation will deter private prosecution can be answered by recourse to section 645 of the *CAMA*, where it is provided that in imposing a fine, the court may direct that the whole or any part thereof be applied in or towards payment of the cost of the proceedings, or in or towards rewarding[74] the person on whose complaint or at whose suit the fine is recovered. It is not to be assumed, however, that the insider should be open to frivolous suits at the hands of shareholders. The prosecuting party must make out a *prima facie* case on the information.

[73] *Fawehimni v. Akilu and Togun* [1987] 4 N.W.L.R. 797.

[74] This should read compensate. Reward has a connotation of a windfall. Compare section 21A(e) of the *Securities Exchange Act* introduced in 1988 providing for payment of 10% of recovered profits to informants on insider trading, discussed in chapter 6.

CHAPTER 6

THE EFFICACY OF INSIDER TRADING REGULATIONS.

The utility of a law lies in its effectiveness. A law may be effective in one of two ways. It may attract compliance by its mere existence. Secondly, it may be effective by coercing compliance through its enforcement. Although a law need not be enforced to be effective as in the first instance, there must be a probability of its being enforced to coerce compliance if need be. A law that lacks a probability of enforcement is an ineffective law. There is no point in making investor protection regulations that cannot be enforced.[1]

While the mere existence of the law may deter persons who would otherwise be minded to embark on the act from engaging in the illegal activity, it is equally true that the enactment of the law would not deter those who are bent on engaging in the activity. For anything, it would make them more careful in planning and more sophisticated in execution. The cost of the added care in planning and execution will invariably be reflected in the returns which are expected from the illegal activity. They would also wish to insure against the probability of their being caught. Where the law is an ineffective one, society is the worse for its enactment, for the fact of ineffectiveness will not stop the fraudsters from increasing the value of their target. Such a situation would justify the non-regulation of what may be considered evil, because regulation would be futile, and yet increase the magnitude of operations. This scenario is true of insider trading regulations. There are several factors which inhibit the effectiveness of insider

[1] L.C.B. Gower, *Review of Investor Protection: A Discussion Document* (London: H.S.M.O., 1982) para. 3.41.

trading regulations. With the increase in the regulation of insider trading, those engaging in insider dealing have devised very sophisticated means of trading and the sums being made from such activities have multiplied many times over. This is to discount the increased cost of engaging in the activity. While the regulations may succeed in reducing the number of insider traders and trades, the overall effect might be to increase the amount lost to insider traders. What has happened is that the regulations have succeeded in eliminating the small time insider traders, but has created a power ring of insider traders, who operate in the form of a mob.

What are these factors that make insider trading regulations ineffective?

6.1. Detection and Investigation of Insider Trading Activities.

Even in 1967 when it was made, Schotland's assertion that in the enforcement of insider trading regulations, a breach is as easy to detect as it is for a young family to figure out who ate the cookies,[2] did not reflect an objective truth. Today it would be a gross overstatement. A basic requirement of insider trading regulations is the confidentiality of the information on which the trade is made. Insider trading is, thus, an activity that is shrouded in secrecy, and like all such activities, it is very difficult for the supervisory authorities to detect, unless adequate human and material resources exist to crack open the shell of secrecy.

The most advanced of the regulatory bodies in the world is the U.S. Securities and Exchange Commission. The body has been given wide powers of regulation, investigation and, at times, adjudication. Despite this, it has not been able to overcome

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[2] R.A. Schotland, "Book Review: Unsafe at any Price: A Reply to Manne, Insider Trading and the Stock Market" (1967) 53 Va. L. Rev. 1425 at 1457.

the problem of detecting insider trades. As the rules become more elaborate so do insiders create better evasionary tactics.

The internationalisation[3] of the securities market has helped to compound the problem of detection. It is possible for an investor to execute a trade in a country using insider information without stepping foot in the country.[4] The use of computers to trade makes it increasingly difficult to detect who is executing a particular trade. The stock

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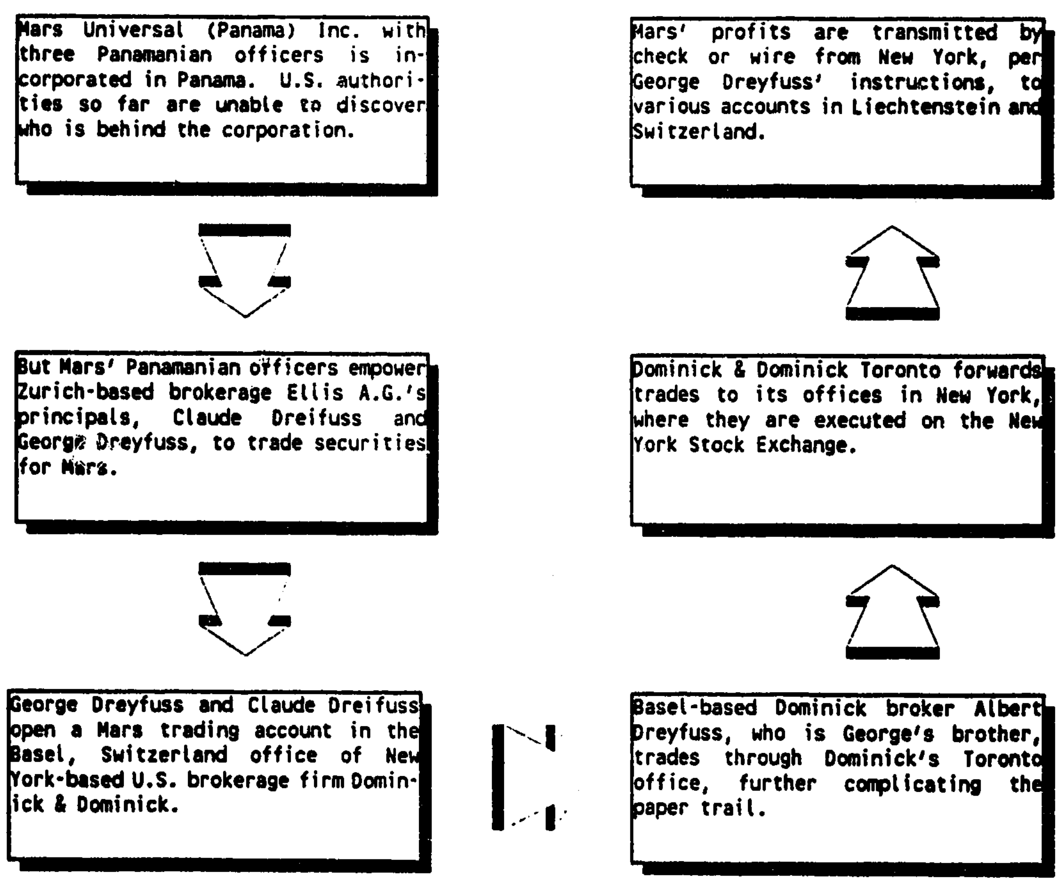
[3] Several factors have combined to blur the territorial limits of securities trading in Europe, North America and parts of Asia. For a discussion of these factors see C.V. Baltic III, "The Next Step in Insider Trading Regulation: International Cooperative Efforts in the Global Securities Market" (1992) 23 Law & Pol. in Internat'l Bus. 167 at 171 - 175.

[4] A chart of the pattern of such trading is produced in Forbes of September 18, 1989.

How to set up a secret international Stock trading network.



exchange used to be, and still is, a forum for monitoring trades to detect insider trading. This is done by the use of trade indices. Where trading in a particular stock exceeds the average trading volume, the computer marks the trade.[5] This puts the exchange on the alert that something unusual might be happening at the corporation. The broker who executed the trade is contacted and the name of the person who ordered the trade is obtained from him.[6] If the person is in one way or the other connected to the company, the matter is forwarded to the SEC, who would decide whether to investigate or not.[7] However, with the development of computerised trading, the stock exchanges are almost now redundant. It is possible for traders to bypass the floor of the exchange in executing their trade. The old method of tracing trades through the exchange is likely to become unhelpful in the near future in the advanced markets. Such computerised trading does not exist in Nigeria, so that it is still possible for market surveillance to be carried on through the exchange. The use of the trade index has been adopted in Nigeria, and where an aberrant trade is executed, the stock exchange suspends trading in the stock until the cause of the variation is known. The disruptive effect of this procedure on the market has

[5] The New York Stock Exchange, for example, relies on the Intermarket Surveillance Information Systems that carries data on all trades in all stocks or options traded on every exchange in the U.S.

[6] See R.S. Janvey, "SEC Investigation of Insider Trading" (1985 - 86) 13 Sec. Reg. L.J. 299 at 299 n1.

[7] To overcome the problem posed by an investor evading detection by trading through a foreign exchange, some stock exchanges and other regulatory bodies have reached agreements for the exchange of information. An example is the agreement between the National Association of Securities Dealers in the U.S. and the Securities Association of London. See J.T. Thomas, "Icarus and His Waxen Wings: Congress Attempts to Address the Challenges of Insider Trading in a Globalised Securities Market" (1990) 23 Vand. J. Transnat'l L. 99 at 103.

been noted earlier.[8] While computerised trading has not eroded the utility of stock market surveillance in Nigeria, the manner of keeping records, does not give room for effective use of this mechanism. Most records are still kept manually and in regrettably dismal and abysmal fashion. Computerised tracing of trades is still in a very rudimentary stage, so that the linking of trades to brokers and then to traders will be an arduous, time consuming and, in most cases, fruitless task.[9] Moreover, such tracing is efficacious only in so far as the trade is done on the stock exchange. Public companies are very few in Nigeria and quoted companies even fewer. Most public companies' shares are traded over-the-counter by broker dealers. There is no central regulatory or monitoring mechanism for over the counter trades such as the NASDAQS[10] in the U.S. or the COATS[11] in Canada. Thus, there is really no mechanism for monitoring trades in the stock of such public companies. For private companies there is no monitoring device.

A control mechanism in the U.S. and Canada is the requirement for the filing of insider reports.[12] This shows the holdings of insiders in the securities of their corporation, and increased trading by insiders may give ground for suspicion that insider information is being used. In Nigeria, public companies must keep a register of

[8] Page 118.

[9] As there is no computerised monitoring system, the Nigerian SEC sends its staff to physically observe daily trading on the exchange and investigate any anomalous trades. The staff file a daily report to the Commission which is studied to see if any unusual trades had taken place. See Securities and Exchange Commission, *The Securities and Exchange Commission: What it is and What it Does* (Lagos, Nigeria: Securities and Exchange Commission, 1989) at 21.

[10] National Association of Securities Dealers Automated Quotations Systems.

[11] Canadian Over the Counter Automated Trading Systems.

[12] Section 127 *CBCA* and section 16(a) of the *Securities Exchange Act* 1934.

Directors' holdings in the company[13] and substantial shareholders[14] are required to report changes in their holdings,[15] but the report is to be made to the company and not the regulatory bodies. Even if the report is required to be made to the SEC, such a report only shows the insider's trade in his company, not his trade in other companies of which he is not an insider. Insiders often use confidential information obtained from their cronies in other companies to trade in corporations other than theirs. Where they have to execute trades in their own corporations, this is usually done through nominees.[16] Such nominees need not file any report of the trade and the fact that the insider has been indirectly trading in the securities of his company would not be revealed in the insider report.

There are several evasive tactics which are adopted to trade on inside information. Traders minded to engage in insider trades have developed methods of covering their trail. Some institutional investment houses are but a branch of a larger corporation that engages in other financial services. A branch of the firm may receive information which would affect the fortune of the investment of another branch of the firm. The information is passed on to the investment branch which trades on it and avoids a loss or makes a

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[13] Section 275 *CAMA*.

[14] A persons who holds by himself or through his nominees, shares in the company which entitle him to exercise at least 10% of the unrestricted voting rights at any general meeting of the company.

[15] Section 95 *CAMA*.

[16] These nominees would qualify as tippees if they are informed of the confidential information before the trade is executed. Where the insider merely asks the nominee to trade on his behalf without revealing the information to him, he cannot be held liable as the knowledge requirements would not be satisfied unless the knowledge of the principal (i.e. the insider) is imputed to the nominee. The fact is that it would be difficult to use the present scheme of "insider" reports to detect a trade by the insider executed through a nominee.

profit for the clients and, of course, a general profit for the group. Since the subsidiaries are managed by an overall board which has an interest in seeing to the prosperity of the entire group, it is expected that such price sensitive information be exchanged as a matter of course. The reaction to this practice of swapping information within the group is the requirement of the setting up of what is now known as "the chinese wall". This requires the management to establish an imaginary wall between the different branches of the corporation to ensure that information does not filter from one side to the other. Information is a volatile object and given the various ways in which it gets around, ranging from the morning office gossips, discussions at coffee and lunch breaks to executive dinners, it is doubtful if these fictitious legal barriers would in any way prevent the exchange of information.

The exchange of information is an obvious abuse of the regulations and may be easily detected. Other less obvious tactics include scalping,[17] front running[18] and executive backscratching.[19] In the advanced markets of North America and Europe,

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[17] Scalping is the situation where an investment advisor buys shares in a corporation which he is about to recommend to his clients. When the client places the order to buy, the investors sells the securities into the market for the increased price which is caused by the increase in volume of trade in the securities. This practice qualifies better as a manipulative device but also involves the use of "insider information" as the person who sold to the investment analyst is unaware of the confidential information that the securities would be in greater demand in a short while.

[18] Front running involves the investment advisor buying, by himself or through nominees, securities up front with knowledge that a client is going to place an order for the purchase of the securities in the corporation. This is also more of a manipulative device which involves the use of insider information in a loose sense.

[19] This is the swapping of valuable information by corporate executives. The officer of a corporation who is prohibited from trading on confidential information relating to the securities of the company, communicates the information to an executive in another company, who trades and makes profit, in the hope that when a similar situation arises in the other company, the executive there would reciprocate the gesture.

devices such as trading through nominees, foreign intermediaries and multi-layered transactions are common. Some investors with insider information place their orders through brokers in other countries, who then execute the trade through a nominee who owns a numbered account in a bank in a country with bank secrecy laws. The proceeds are laundered into secret accounts by various means. Such foreign and multi-layered trades often succeed as a red herring in the trail of investigation by the SEC. The sophisticated SEC investigating machinery is usually not capable of unscrambling these trades, and it only on an off chance that some of the few trades which have been detected where known.[20] A grave impediment is the fact that securities regulations have no extra-territorial application and once the trade is executed and the culprits are beyond the borders of the regulatory body's jurisdiction, there is no way to continue the investigation.

The SEC in the U.S. has tried to avoid this handicap by entering into memoranda of understanding with a number of countries for the exchange of information and the investigation of insider trades.[21] These M.O.U.s have helped in the investigation and

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[20] In the Collier case in Britain for example, Collier in an effort to take advantage of a takeover bid to be made by one of the clients of the bank at which he was head of securities placed an order to purchase shares in the target company from Los Angeles through a friend in the name of a Cayman Island registered company. Some complaints arose from the transaction and the identity of the company was traced. This revealed the name of the company without showing who was actually behind the trade. Collier was identified as the trader on the off chance that one of the staff at the brokerage firm which executed the order had previously worked with Collier and knew that Collier owned the Cayman Island company.

[21] See for example, *Switzerland - United States: Memorandum of Understanding to Establish Mutually Acceptable Means for Improving International Enforcement Cooperation in the Field of Insider Trading* of 31st August, 1982, printed in (1983) 22 I.L.M. 1; *Memorandum of Understanding on the Exchange of Information Between the SEC, Commodities Futures Trading Commission and the United Kingdom Department of Trade and Industries in Matters Relating to Securities and Futures* of 23rd September 1986; *Memorandum of Understanding: Securities and Exchange Commission and Ontario Securities Commission, Commission des Valuers Mobilieres du Quebec, British Columbia Securities Commission* of 7th January, 1988.

settlement of some insider trading cases,[22] but overall, they have not proved to be the solution to the problem. A basic obstacle to international efforts to curb insider trading is the fact that insider trading notions vary from one country to another and for there to be an effective international regime of insider trading investigation, there ought to be a fairly general notion of what the conduct connotes.[23] The various international conventions that have discussed this have failed to achieve a workable compromise.[24] It is feared that the U.S. would attempt to foist its advanced and crippling regulations on countries whose markets are not advanced enough and, therefore, not ready for such massive regulations.[25] Again, the economic interest of most countries in attracting foreign investors has handicapped attempts to secure cooperation from these countries. Investors usually drift to countries with the least rigorous laws and those countries interested in attracting foreign investors, of necessity, fashion their laws in such a way

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[22] *SEC* v. *Certain Unknown Purchasers of the Common Stock, and Call Options for the Common Stock of Santa Fe International Corporation* 35 SEC Docket (1986), *SEC* v. *Kurz* [1986 - 1987 Transfer Binder] Fed. Sec. L. Rep. (CCH) 92, 867.

[23] L.A. Hedges, "Insider Trading and the EEC: Harmonisation of the Insider Trading Laws of the Member States" (1985) B.C. Int'l & Comp. L. Rev. 151; A.E. Stutz, "A New Look at the EEC Directive on Insider Trading" (1990) 23 Vand. J. Transnat'l L. 135 at 146. The European Community in its directive established a minimum standard notion of what the conduct requires leaving it to member states to make more elaborate rules if they so wished. For a discussion of the directive see M. Ashe, "The Directive on Insider Trading" (1992) 13 Co. Law. 15.

[24] The European convention succeeded in some way in establishing acceptable guidelines for assistance in the investigation of violations of securities regulations. Art 10(1) of the E.C. directive authorises regulatory authorities in member states to cooperate *whenever necessary* in the discharge of their duties. Assistance may be refused if, *inter alia*, it would harm the security or public policy interests of the requested state. And because what constitutes security and public interest of a state is determined by the requested state it is unlikely that the convention would succeed more than the memoranda of agreement. See generally J.P. Lowry, "The International Approach to Insider Trading: The Council of Europe's Convention" [1990] J.B.L. 460

[25] Stutz, *supra*, note 23.

that assure foreign investors of increased profits while at the same time promoting the development of local industries. The banking laws of such countries assure the investors of the secrecy of their transactions. In addition to the bank secrecy laws, some of the countries have what is called blocking legislation.[26] Regulators in the U.S. have recognised the futility of insisting on express waiver of confidentiality by foreign institutional investors who wish to trade in the U.S. market. While there has been some progress in forcing such concessions from Switzerland,[27] it is generally acknowledged that new secret banking havens spring up as the old ones are penetrated.[28] Countries which hitherto cooperated have started to backtrack for fear of losing their markets to competitors. Moreover, these M.O.U.s are in the nature of "gentlemen's agreements" and can be flouted at will by the signatories. Comity might reduce the risk of non-

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[26] Blocking legislation is different from a secrecy law. The secrecy law relates to the banks and other financial institutions and individual banks, in conjunction with the customer involved, may waive the confidentiality clause. Blocking laws 'block' investigatory access to foreign enforcement bodies. Since such laws are made in the interest of furthering the economic development of the country, they cannot be waived by the traders concerned or their banks so as to allow an outside body to obtain documents necessary to establish its claim.

[27] See H. L. Silets, "Prying Open Swiss Vaults: The SEC's Investigation of Insider Trading in the Santa Fe Case" (1986) Am. U.J. Int'l L. & Pol'y 259. The Santa Fe case involved lengthy negotiations and was appealed to the highest court in Switzerland. Eventually, the banks released the required information. A colossal amount of time and money was spent in the negotiation. The amount spent could be justified on the ground that the SEC was able to recover $7.8 million, but the same amount of time and energy would still have been spent if the amount in question were smaller. In such instance it is necessary to quare the economic wisdom in the enforcement efforts. For this reason, enforcement of the regulations is selective and at times discriminatory.

[28] See M.S. Klock, "A Comparative Analysis of Recent Accords Which Facilitate Transnational SEC Investigations of Insider Trading" (1987) M.D. J. Int'l L. & Trade 243 at 264. The writer notes that the M.O.U.s will only force investors who rely on anonymous bank accounts to move their money from Switzerland to other countries which have bank secrecy laws. While this may reduce the use of foreign secret bank accounts he raises the question of how significant the reduction would be vis-a-vis the resources spent in negotiating the agreements and the effect on the capital market. Cf. G.R. Raifman "The Effect of the U.S. - Swiss Agreement on Swiss Banking Secrecy and Insider Trading" (1985) 15 Law & Policy Int'l L. 565.

cooperation once the agreements have been signed, but countries do not generally sacrifice their economic development interests to aid the apprehension of an insider trader by another country. There is no recommendation for Nigeria to enter into any of such agreements. Several factors already combine to drive foreign investors away from Nigeria and there is no sense in adding to this.

The use of secret accounts would not present problems of enforcement in Nigeria. While banks have the general duty of protecting their customers' confidences, they are required to reveal the identity of the owner and activities in an account if it is in the public interest to do so. Since insider trading is a crime in Nigeria and the prevention of crimes is in the public interest, the court would be prevented from examining the interesting point of whether the insider trading regulations are in the public interest. The use of foreign intermediaries to trade and trading in an internationalised market will hardly arise as a problem in Nigeria. Securities of Nigerian companies are not traded in exchanges outside Nigeria and there is no globalised electronic trading system in operation. However, trading through a multi-layered international route is not unknown. In the course of the current privatisation and commercialisation exercise[29] some businessmen who had foreknowledge that certain corporations were to be privatised had formed companies outside Nigeria and bid through them so as to hold a controlling interest in the corporations[30] and, indeed, in the industry in which the corporation is

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[29] Nigeria is in the process of turning over some government owned companies to private hands. This involves the government selling off majority of its shares in the targeted corporations.

[30] Under the *Privatisation and Commercialisation Decree*, 1988 the percentage of shareholding was restricted to 1% by any particular shareholder, either by himself or his nominees.

engaged.[31]

Other evasive devices are in regular use. The use of nominees presents one of the most formidable obstacles to detection. The extended family system and the expanded range of social relationships makes it possible to trade through persons who can hardly be linked to the insider trader.

The sophistication of insiders is such that the cases that are detected are those which do not cause much harm to the society.[32] Only the most blatant cases of insider trading are detected.[33] The number of prosecutions brought by the SEC in the U.S. is a mere drop in the ocean compared to the incidence of the practice there.[34]

Confidentiality is the hallmark of business acumen. An omerta need not be

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[31] The most prominent example was the attempt of a group of businessmen to acquire some insurance companies being privatised through the medium of foreign companies which they had formed off shore using foreign nominees. The attempt was, however, aborted by the Technical Committee on Privatisation and Commercialisation, the body set up to monitor the sales. There was conscious attempt in the enabling decree to plug the holes which enabled insider traders to take advantage of the indigenisation exercise in 1972, when the government divested foreign investors of their controlling interest in certain types of companies. See E.K. Aigbekaen, "Insider Trading and the Privatisation of Public Enterprises in Nigeria" (unpublished seminar paper delivered at the university of Benin faculty of law seminar series, 13th February 1992.)

[32] J.J. Fishman, "Enforcement of Securities Law Violations in the United Kingdom" (1991) 9 Int'l Tax and Bus. Law. 131 discusses the many problems facing enforcement agencies. On insider trading he comments at 169,

> "Many reasons exist for these enforcement problems, not the least of which are the difficulties inherent in the prosecution of securities fraud. First, such schemes are usually sophisticated, complex, difficult to unravel, international, and are often discovered only after the fact, when the money - and occasionally the perpetrators - have long disappeared. Investigation of fraud is labour intensive, time consuming, and burdensome on the understaffed and underfunded investigatory bodies, who may face the formidable task of examining thousands of documents in different venues".

[33] Such trading is often inadvertent or made by persons who were not aware of the regulations or the fact that they were within the prohibition.

[34] M.P. Dooley, "Enforcement of Insider Trading Restrictions" (1980) 66 Va. L.R. 1 at 6 and the appendix of cases at 74-83. Cf. R.S. Janvey, "Criminal Prosecution of Insider Trading" (1987 - 88) 15 Sec. Reg. L.J. 136.

administered for businessmen to maintain sealed lips. A squealing businessman will soon find himself bereft of persons with whom to do business. The like of Secrist[35] is not the everyday businessman. Due to the secret nature of insider trades, only two persons or tw... ...os of persons are generally aware that an insider trade has taken place: the inf... ...ants and the insider traders. Sometimes there is no informant as the insider trade is done by the persons possessing the information initially. Since the two groups are usually in on the deal, there is little likelihood that the information that an insider trade has occurred will be passed on to the investigatory bodies.[36] For most part, short of the staff of the regulating bodies, it is difficult to get persons to testify about an insider trade.

One way to get around this problem has been to provide a monetary incentive to persons in possession of such information to report to the regulatory bodies.[37] In the U.S. it is provided that 10% of the money recovered may be given to the persons who provide the information that leads to the prosecution.[38] There is a similar provision in the CAMA for the payment of part of the fines recovered in a proceeding under the Act

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[35] The employee of Equity Funding Inc. who revealed the fraud in the company to Dirks.

[36] Fishman, *supra*, note 32 at 174.

[37] It was thought that when insiders know that persons close to them have a dollar incentive to report the crime they will be less willing to take the risk; see Report of the House Energy and Commerce Committee on the proposal for the *Insider Trading Securities Fraud Enforcement Act*, H.R. Rep. #100 - 910 (1988); cited A.R Bromberg and L.D. Lowenfels, eds, *Securities Fraud and Commodities Fraud* vol. 3 (Colorado Springs, Colorado: Shepherd/McGraw-Hill Inc., 1990) para. 7.4.(1034) This appears to be a sanguine expectation since those who are close enough to the insiders as to know of the deal and the details necessary for conviction will invariably be part of the deal.

[38] Section 21A(e) of the *Securities Exchange Act*, 1934 introduced by the *Insider Trading Securities Fraud Enforcement Act*, 1988.

to persons who provide the information that lead to the prosecution.[39]

There is nothing basically objectionable in providing a reward to persons who aid in the enforcement of the laws, but where the bounty provision is in the nature of an "invitation to whistle blowers"[40] its ramifications ought to be examined. There has been little clarification of the provisions in the U.S., but the SEC itself has not been convinced of its wisdom.[41] Who is to get the reward? Is it the person who provides the initial information that a trade has taken place or the person who gives the details of the trade? The monetary incentive may encourage persons to pass on vague information of a trade to the regulatory bodies. This might involve the alleged wrongdoer in the expense of defending himself, not to talk of the cost of a useless investigation by the investigatory body. Thirdly, the provision of the incentive may stultify rather than aid the prevention of insider trading. There is no reward for the prevention of an insider trade, but only for information leading to the prosecution of an insider trade. Thus a person who detects that an insider trade is about to be made would rather wait until the trade is made before reporting it instead of doing so immediately. This is because if he reports the trade before it is made and, therefore, prevents it, he gets nothing, but if he reports after the trade is made and there is a successful prosecution, he stands a chance of getting 10% of the recovered amount. There is even the possibility that investigatory personnel who

[39] Section 645, *CAMA*. The section is not specifically directed at reports leading to insider trading prosecution, but its general tenor shows that it can be used for the same purpose.

[40] Comment of Representative Markey; see Bromberg and Lowenfels, *supra*, note 37.

[41] See B. Franklin, "Mutiny Over the Bounty, SEC Lukewarm on New Investigatory Tool From Congress" (1988) November 17, New York Law Journal 5.

know of a likely trade may allow it to take place, tip off some other person to report the trade to the body and then share the reward with the 'tippee'.[42] Lastly there is the question of the evidential value of such information. The person who provides the information ought to be a vital witness for the prosecution, but because a person who has a pecuniary interest in the outcome of a prosecution is a tainted witness, whose evidence is treated with great caution,[43] his testimony would be of little evidential value and will at least require corroboration.

Allied to the problem of detection is the investigation of insider trades. The use of the stock exchange as a monitoring device has been noted earlier.[44] For there to be effective investigation of insider trading infractions, the regulatory body must have wide powers of investigation. The SEC in the U.S. has the power to investigate cases of insider trading, to take depositions and to summon witnesses. It can also search for and seize documents which are relevant to the investigations. In most of the provinces in Canada, the Securities Commission is given power to appoint investigators to investigate infringements of the securities regulations. The investigator when appointed, usually has most of the powers of a Judge of the Queen's bench.[45] In Nigeria, the SEC is not endowed with such powers. When insider trading regulations were first enacted in

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[42] The *Insider Trading Securities Fraud Enforcement Act*, bars awards to members, officers and employees of regulatory agencies, department of Justice and self regulatory organisations as their usual duties oblige them to report insider trading violations.

[43] *Idahosa* v. *State* [1965] N.M.L.R. 85.

[44] Pages 173-175.

[45] Under section 11(4) of the *Securities Act* R.S.O. 1980, c.466, an investigator has the power to summon and enforce the attendance of witnesses and compel them to give evidence as is vested in the Supreme Court of the province.

Britain, the Department of Trade was not given investigatory powers and this greatly hampered initial efforts to enforce the regulations. This lacuna has now been plugged by section 177 of the *Financial Services Act* of 1986.[46] The Securities and Investment Board was given wide powers of investigation to complement that of the Department of Trade and Industry. The body can summon witnesses and require persons to reveal identities of traders or tippees if the revelation is necessary to prevent the commission of the offence. Refusal to cooperate with the investigators may be regarded as contempt of a Court of Queen's Bench.[47] As the regulations in *CAMA* reflect the provisions of the British regulations, the omission in the initial Act is also reflected in Nigeria. The *CAMA* did not give powers of investigation to the SEC.[48] Although the Corporate Affairs Commission has the power to appoint investigators, with powers similar to those of a Judge of a superior court, to investigate the affairs of a company,[49] it is doubtful if this can be used for the purposes of investigating allegations of insider trading.[50]

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[46] (U.K.), 1986, c.30. See R.R. Pennington "Insider Dealing and the Financial Services Act" (1987) 131 Sol. J. 206.

[47] Section 178 *Financial Services Act*. See *In Re an Inquiry Under The Companies Securities (insider dealing) Act 1985* [1987] B.C.L.C. 76. For commentary on the case, see P. Tridimas, "The Financial Services Act and the Detection of Insider Trading" (1987) 8 Co. Law. 162.

[48] Whether this was an oversight is unclear. Perhaps, such an express power might have been thought unnecessary in view of section 15 of the *Securities and Exchange Commission Decree* 1988, which authorises the Commission to examine records and affairs of and call for information from any company, enterprise, exchange, register, issuing house, stockbroker or any other person covered under the decree. The SEC may be able to rely on this power to initiate investigations of insider trading, but the extent of its powers are unclear. It is not stated that it can administer oaths or issue subpoenas and what the effect would be of failure to comply with a direction of the board.

[49] Sections 314 - 315 *CAMA*.

[50] There is nothing to prevent the SEC and the Corporate Affairs Commission from cooperating to investigate insider trading allegations. The Corporate Affairs Commission may in the course of its investigations into the affairs of a company, look into allegations of insider trading and pass on the result

trading regulations are beyond the powers of the Corporate Affairs Commission. Enabling legislation is needed that would empower, or at least clarify the powers of, the SEC to carry out the investigations necessary for an insider trading prosecution. The question of investigation is at the core of the enforcement of the regulations and until the problems of detection and investigation are properly addressed attempts to prohibit insider trading will remain illusory.[51]

6.2 Social, Political and Economic Impediments.

Social, political and economic factors in a society have a direct bearing on the effectiveness of laws in the society. In Nigeria, several of these factors point to the unworkability of the insider trading regulations.

The social factor here refers to the consciousness of the persons whom the regulations are directed at. The securities market in Nigeria is still very much undeveloped. Several investors lack the business sophistication that would make them concerned with, or even understand, the concept of insider trading. Despite this lack of sophistication, underneath, the society is capitalist to the core and people are generally concerned with how to maximise profits by taking advantage of any available opportunity. Most people would regard with amazement any suggestion that use of information in the manner prohibited by the regulations deserves punishment. As such, attempts to enforce the regulations, except in the most brazen instances of abuse, will likely meet with rebuff from the society.

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to the SEC for the necessary action.

[51] D. Sugarman, "The *Companies Act* 1980(5)" (1981) 2 Co. Law. 13 at 20.

In Nigeria, considerations of a political nature will affect the enforcement of the regulations. In a society where the decision to prosecute is affected by the social status of the alleged offender, persons with a lot of influence are likely to escape prosecution. This factor of godfatherism even affects the outcome of allegations of crimes as serious as murder, without causing too much societal furor. Invariably, directors and senior officers of regulated companies are likely to have enough influence in the society to manipulate the outcome of an investigation. If it is possible to evade prosecution for acts that are considered inherently criminal, then it can be imagined the ease with which enforcement attempts of an act which majority of the society are not concerned with can be stopped. Those who may be prosecuted are the small fry who have been used as pawns by the influential actors.[52] These political considerations are fuelled by economic factors. Because of the meagre resources at the disposal of the SEC, it has to allocate its funds to selected cases.[53] Not all reports of insider trading are investigated or prosecuted. The decision to investigate or prosecute is at the discretion of the Commission. There is no provision for the control of the discretion. Political considerations would invariably affect the selection of cases to be investigated. When the decisions to investigate establish a pattern of preferential or discriminatory treatment, the regulations will attract public ridicule.[54]

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[52] Even in the U.S. where such considerations are watered down, it is easy to detect the role of political influence in certain prosecutions. See for example *SEC.* v. *Platt* 565 F. Supp 1244 (W.D. Okla. 1983).

[53] Dooley, *supra*, note 34 at 26 notes that the most serious cases of insider trading are not prosecuted and budgetary constraints force the SEC to follow the path of least resistance in selecting cases for enforcement.

[54] H.G. Manne, "Insider Trading and the Law Professors" (1967) 23 Vand. L.R. 547 at 554 and 555.

Perhaps the greatest obstacle to effective enforcement is the economic cost of investigation and prosecution. If the regulatory body is to effectively monitor compliance with the regulations, it has to set up an advanced computerised network to monitor trades. In a country with dwindling economic fortunes, the cost of setting up such a system is beyond the reach of national resources. The SEC in Nigeria is just an office of the Ministry of Trade whose entire budget for a year comes to about 3,000,000 naira.[55] The cost of establishing a host monitoring system would run into millions of naira, far in excess of the annual budget of the SEC.[56] Add to this the fact that the function of the SEC is not restricted to the regulation of insider trading, and it becomes clear that attempts at enforcement can only be haphazard and ineffective.

If a breach of the regulations is detected, the Commission has to incur the cost of investigation. For this it will need to employ lawyers and investigators. Due to the manner in which records are kept, the process of investigation would be a lengthy one.[57] Understaffing is a general problem with securities regulatory bodies everywhere

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[55] As at May 1st 1992, this would amount to approximately $16,500,000.

[56] This does not take into consideration the amount needed to maintain the system and the hiring of expert personnel to operate it.

[57] In the U.S. when an insider trade is suspected, an officer of the SEC may start informal investigations without a formal order. If the informal investigation reveals ground for full investigation, a formal order is applied, and it is this that would inform the defendant of the investigations against him and also entitle the investigator to exercise the powers of investigators under the Act. Certain privileges may be claimed by the accused. After the investigations, a Wells submission is held where the investigator notes the defences and explanations which the defendant might have. When the investigation is over, the SEC will decide to do one of four things: (a) take no further action, (b) settle the proceedings, (c) institute a civil injunctive action, (d) refer the matter for criminal proceedings to the Department of Justice. It is not uncommon that the defendant might institute some interlocutory applications during the proceedings to challenge the investigations or some procedural matters. See R.S. Janvey, "SEC Investigation of Insider Trading" (1985 - 86) 13 Sec. Reg. L.J. 299 and generally W.R. Lucas et al., "An Overview of Various Procedural Considerations Associated With The Securities and Exchange Commission's Investigative Process" (1990) 45 Bus. Law. 625. In Nigeria, it would take considerably longer time and effort to

due to the wide range of functions which they are required to perform. The SEC can ill afford the man hours that would be required for a thorough investigation.[58]

Where a successful investigation is carried out, the plaintiff has to incur the extra cost of filing and prosecuting a civil suit.[59] If he stands to gain little from the suit, he might refuse to file a civil suit[60] and the effort of the SEC will come to nought unless the state decides to file an information for a criminal trial. If criminal action is contemplated, the state incurs the cost of prosecuting the action. Given the slow pace at which the judicial system in Nigeria works, a suit may last for up to three years. Suits lasting over five years are not uncommon. And this does not include any appeals that

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accomplish all the processes. If a civil suit is contemplated, the action is likely to be statute barred by the time the investigations are completed because of the limitation in section 620(2) that a civil suit must be commenced within two years from the date of the completion of the transaction that gave rise to the cause of action.

[58] See M.A. Spitz, "Recent Developments in Insider Trading Law and Problems of Enforcement in Great Britain" (1989) 12 B.C. Int'l & Comp. L.R. 265.

[59] This is not a restriction in the U.S. or Canada, as the regulatory bodies there have the power to commence civil suits against violators of the regulation and claim on behalf of the shareholders who allege loss. In the U.S., however, the SEC has no authority to enforce a section 16(b) violation and it is the company or a shareholder suing derivatively that incurs the cost of the suit.

[60] This is another factor that would affect the enforcement of the regulations. As the regulations stand now, the SEC in Nigeria has no power to commence a civil or criminal action. Civil recovery is open only to the persons who suffer a loss from the transaction or the company whose securities are involved. Thus after an investigation, the decision to file a civil suit lies with the persons who suffer loss or the company concerned. It may be that plaintiffs would use the SEC as an investigatory machinery for the purpose of filing a private suit. The state incurs the cost of investigation, but the plaintiff takes the money. Although section 28 of the *Securities and Exchange Commission Decree* of 1988 gives the Commission power to apply for injunction and prosecute offences where it finds that the provisions of the Decree or the regulations have been violated or about to be violated, this cannot be used for insider trading violations since the insider trading regulations are a part of the *CAMA* and not the Decree. It is only where the Commission has exercised its rule making powers under section 6(e) of the Decree, whereby an infringement of a rule would be a violation of the Decree, that it may bring a civil injunctive suit. The question of whether this provision is still valid is discussed in chapter 7. Thus, it would appear that an SEC investigation in Nigeria is likely to lead to a criminal trial from which the state may recover some money in the form of a fine.

might result from the action.[61] Thus it may take ten years or more to conclude a prosecution. A successful prosecution might only be a Pyrrhic victory, for the state spends more money to prosecute an insider trading case than it is likely to recover. The question must be posed again: for whose benefit? A successful prosecution does not result in a financial gain for the society. Neither does it secure a moral victory, for the act is not considered immoral in itself. Moreover, it does not improve the market or the economy as it has the probability of scaring away foreign investors. The process would only enrich an unmeritorious plaintiff or some defense counsel.

Instead of spending the little resources at its disposal for the enforcement of behaviour which people do not generally care about, there are other more pressing security matters, such as the regulation of public issue of shares, alien participation in private companies, takeovers and mergers, that should be more closely monitored.

6.3. Standard of Proof in Civil and Criminal Cases.

The detection and investigation of an insider trading case is not a guarantee that the regulations will be enforced. The plaintiff in a civil suit and the prosecution in a criminal case have a formidable burden of proof under the regulations. Under the regulations, the facts have to be pleaded with specificity and the various elements proved severally. The plaintiff who does not have the benefit of an SEC investigation is unlikely to be able to unearth the facts necessary to prove his allegations on a balance of

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[61] In discussing the economic cost of enforcement to society, the cost incurred by the defendant in defending the action is discounted. Legal fees are usually high in Nigeria. If the action is successfully defended, the cost awarded by the court is often insignificant compared to the legal fees. The cost to the society of the spiralling effect of the disruption of the financial affairs of the defendant ought to be considered.

probability. The basic problem will be to satisfy all the knowledge requirements needed to find liability.[62]

With regard to the insiders as defined in section 614, there is a burden on the plaintiff to show that the defendant knew that he was connected with the company, that he got the information by virtue of his being so connected and that he knew that the information was one which he was not reasonably expected to disclose except for the proper performance of the duties attaching to his office. Sometimes, it might be difficult to show the capacity in which the defendant got the information. Again the defendant might believe reasonably that the information was not one which he would not be expected to disclose except for the proper performance of the duties attaching to his office. The plaintiff also has to prove the materiality of the information and the fact that it had not been published and was not generally known to persons who are accustomed to deal in those securities. Lastly the plaintiff has to show that he suffered a direct loss from the trade by the insider. Here the question of causation becomes relevant. Since the loss must be a direct loss, special damages must be pleaded and proved. For this, the plaintiff must show causation in law and in fact. As there is no ground to raise a presumption that the defendant's trade caused the plaintiff's loss, it would be extremely difficult to sustain a civil suit where the transaction took place on an impersonal market.

It has already been shown that, except in relation to tippees of public officers, tippees are not liable in civil suits,[63] but if they were, the plaintiff must show that the

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[62] See generally sections [illegible] 6 of *CAMA*.

[63] Pages 148-149.

tippee knowingly obtained the information from the insider. It would be difficult to prove this fact by direct evidence, since the communication of the information is not often done in a public place. The plaintiff often relies on circumstantial evidence to prove this. This can be done by showing that the insider made a call to the tippee at or about the time when the trade took place. However, in Nigeria, facilities for call tracing are hardly available. The plaintiff would have to rely on written correspondence between the insider and the tippee or a witness who overheard a conversation between them. The fact that a person, connected to one of the several insiders in a company, traded when the insiders were in possession of confidential information is not a ground for finding the tippee liable, for the plaintiff must show the particular insider from whom he obtained the information. The plaintiff would also need to show that the tippee knew of the connected position of the insider[64] and that he knew that the information passed to him was one which the insider would not be reasonably expected to reveal except for the proper performance of his duty. Actual knowledge would, however, not be necessary. Certain presumptions may be drawn from the conduct of the tippee.[65]

It is only if the plaintiff is able to discharge the burden of proof, that the burden would shift to the defendant to prove one of the many defences available to him under the Act.[66] It is, perhaps, this formidable burden of proof that accounts for the rarity of civil private suits for breach of the insider trading regulations. In the U.S., although

[64] See *R.* v. *Kean and Floyd* (1991) unrep. but noted in Ashe *supra*, note 23 at 17 and contrast *SEC* v. *Musella* 578 F. Supp. 428 (1984).

[65] See page 98.

[66] See sections 617 and 618 *CAMA*.

several successful suits for breach of Rule 10b-5 exist, this is because of the open ended nature of the provision, and most of the successful suits dealt with manipulation rather than pure trading on inside information. In countries with pure insider trading regulation, such as Canada and Britain, only a few scattered suits have succeeded.[67]

In a prosecution for breach of the provisions, the prosecution must prove all the above facts, but with a burden to prove beyond a reasonable doubt.[68] The burden of proof remains at all times on the prosecution, and unlike in a civil suit, the accused does not bear the burden of proving the defences available to him. All he has to do is to introduce facts which point to the defence and the onus is on the prosecution to show that the defence is not available to him.[69] The fact that the elements of the offence are within the peculiar knowledge of the accused does not shift the burden of proving that he did not commit the offence to him.[70] Moreover as the accused is neither a competent[71] nor compellable witness for the prosecution,[72] the evidential burden on

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[67] The notable Canadian decisions are discussed in M.R. Gillen, "Sanctions Against Insider Trading: A Proposal For Reform" (1991) 70 Can. Bar Rev. 215. The prominent British decisions include *R* v. *Collier* unrep. noted B. Rider, "Determined Efforts Being Made to Enforce Law on Insider Trading" (1982) 3 Co. Law 185, *R.* v. *Titheridge* unrep., noted B. Rider, "The First Case of Secondary Insider Trading" (1983) 4 Co. Law. 117, *R* v. *Kettle and Thorneywork* unrep, noted D. Chaikin, "Unsuccessful Insider Trading Prosecution" (1985) 6 Co. Law. 97; see generally B. Hannigan, *Insider Dealing* (London: Kluwer Law Publishers, 1988) at 22-29.

[68] Section 137, *Evidence Act*, cap. 62 Laws of the Federation 1958, *Woolmington* v. *D.P.P.* [1935] A.C. 462.

[69] C.O. Okonkwo ed., *Okonkwo and Naish on Criminal Law in Nigeria*, 2nd ed. (London: Sweet and Maxwell, 1980) at 97.

[70] *Mandilas and Karabelis Ltd.* v. *I.G.P.* (1958), 3 F.S.C. 20.

[71] Section 159, *Evidence Act*, 1958; *R.* v. *Omisade* [1964] N.M.L.R. 67.

[72] Section 33(11) of the Constitution of the Federal Republic of Nigeria, 1979 as amended; *Agbachom* v. *State* [1970] 1 All N.L.R. 69.

the prosecution is compounded. In the end only the most blatant cases of insider trading are likely to result in a successful prosecution.[73]

The numerous facts needed to be proved before a person can be found liable acts as a form of insurance against frivolous suits. It may also be an unconscious acceptance that there is little merit in the cause of action. There is little reason to give a cause of action that would hardly succeed, unless it is meant to comfort those clamouring for regulation that something at least exist in the statute books without deviating from the interest of the majority that the conduct should be free of governmental interference.[74] Such an exercise in self deception can only lead to ridicule before the international public.

[73] See M.R. Gillen, "Sanctions Against Insider Trading: A Proposal For Reform" (1991) 70 Can. Bar Rev. 215.

[74] Rider's comment is apposite here. He wrote "it is hard to escape the notion that in some jurisdictions legislation has been enacted and fancy supervisory authorities established, more to generate an appearance of sophistication than for any meaningful purpose". See B.A.K. Rider, "Policing the City - Combating Fraud and Other Abuses in the Corporate Securities Industry" [1988] C.L.P. 47 at 48.

CHAPTER 7.

COMMENTARY: THE INSIDER TRADING REGULATIONS IN *CAMA*: AN OVERKILL?

A law is usually directed at filling a gap in the regulation of activities in the society. The legislature has to determine whether there is a mischief which threatens society and, therefore, calls for regulation. Next it has to be determined whether there is an adequate existing legal framework directed at curing the mischief. If there is none, the legislature then has to determine the effective remedy for the mischief which it has identified. The remedy must necessarily be suitable to correct the alleged mischief without being excessive.

It was shown in chapter 2 that the mischief which insider trading regulations aim to cure is the fraudulent abuse of confidence by those in a position of trust.[1] This chapter examines the question first, whether the regulations which have been adopted to remedy the mischief are adequate without being excessive and, second whether the pre-existing legal framework was adequate to deal with the mischief thereby making the regulations unnecessary.

7.1. General Considerations.

The nature of the insider trading regulations in Nigeria must be set against the background of the level of economic development in the country and other socio-political factors, to determine whether they go beyond the bounds necessary to cure the mischief. Although insider trading regulations are often steeped in morality, the determination of

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[1] Chap. 2.4.

those caught within the regulatory web depends on technical legal analysis. Two persons might engage in the act of trading on the same confidential information, and while one may infringe the regulations, the other would not, because, technically, he is not within the category of prohibited persons. Thus for the regulations to achieve fairness in application, they must be reasonably precise, so that persons wishing to embark on a transaction are certain of the possible liabilities they are open to. An advocate for a moral content in laws also agrees that for a law to be good law it must meet the basic requirements of internal morality, one of which is that it must be sufficiently precise.[2]

Insider trading regulations fall foul of the certainty requirement. In the United States, the problem is more acute due to the open ended nature of the regulations. There insiders are not statutorily defined for the purposes of the wider prescription in rule 10b-5. Calls for a statutory definition in the *Insider Trading Sanctions Act* and the *Insider Trading Securities Fraud Enforcement Act* were rejected. The basic ground for objection was that statutorily defining insiders would enable persons to exploit the possible loopholes in the definition to evade the regulations. This is undoubtedly true. But while it is permissible to prevent subtle evasions of the law by making wide prescriptions, it is also necessary to provide a guide for those who necessarily have to perform certain function, to prevent an inadvertent breach of the regulations.[3] The open ended nature of the U.S. regulation surely puts businessmen in an uncertain position when entering into

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[2] See L.L. Fuller, *The Morality of Law* (New Haven, Connecticut: Yale University Press, 1964) at 63-65.

[3] R.L. Baribeault Jr., "Insider Trading: The Current Move Toward Increasing Civil and Criminal Liability for an Ill Defined Crime and the Need for a Definition" (1989) 14 Vermont L.R. 79 at 80-81.

transactions, for a person who is doing what he perceived to be perfectly normal, may find himself as a defendant in a civil suit or an accused in a criminal prosecution for insider trading.[4] The *CAMA* aimed to avoid this uncertainty by making the definition of insiders statutory. This did not, however, fully cure the uncertain nature of the persons covered by the regulation.

The definition of connected persons in section 614 may lead to an inadvertent violation of the regulations for those who occupy an executive position in a large holding company with many subsidiaries and sub-subsidiaries.[5] Although the law is restricted by stipulating that the person must know that he is a connected person,[6] knowledge here is not limited to actual knowledge and a person would be deemed to know of his connection if in the circumstances he is reasonably expected to know that he is so connected.[7] Persons in a professional or business relationship with the company, face a stronger peril of unwittingly violating the provisions. For a person to assume such a relationship, his position must be such as would reasonably be expected to give him access to confidential information about the company. But unlike the case of the other insiders defined in section 614, the information which he uses to trade need not come to him by virtue of his being so connected. Once a person is regarded as connected, he is prohibited from dealing no matter how he acquired the information. The dilemma of such a person would

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[4] F.J. Flaherty, "Should Insider Trading be Defined" (1984) 4 National Law Journal 3 at 28.

[5] See chapter 4 note 46.

[6] Section 614(a) of *CAMA*.

[7] See pages 121-122.

be to determine with certainty whether he is so connected.[8] The definition of connected persons is open ended and the question of whether a person is connected is one of fact for the court to decide. And like all such questions, the categories of connected persons can be expanded according to the circumstances of the case, to cover novel situations as they arise. With tippees, the question becomes more problematic. The tippee may be imputed with the knowledge requirements in the Act. Given the manner in which information is freely exchanged in Nigeria, some persons who received and traded on what they regarded as innocuous information may be held liable for breach of the regulations. For example, it would be most shocking for the in-law of a company executive who traded on the basis of information revealed by the executive at a family gathering to find that he is liable for breach of the insider trading regulations.[9] Indeed

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[8] P.L. Davies, "The European Community Directive on Insider Trading: From Company Law to Securities Market Regulation" (1991) 11 Oxford J. Legal Stud. 92 at 104.

[9] There is the specific issue of knowledge of the regulations. Most laws in Nigeria are not extensively publicised. The laws are in the nature of decrees are made by the body responsible for legislation, without the benefit of public legislative debates. The *CAMA* is one of the few examples where people were invited to submit memoranda and discussions were held before the law was promulgated. This is because it was handled by the Law Reform Commission. Even then those who contributed to the discussion were the academics who were invited to do so. Many people in business were grievously ignorant of the existence of the decree for sometime after its promulgation. Added to this is the problem of accessibility of the law. Most laws only adorn the shelves of the Ministry of Justice. Even in societies where there is active legislative debate before laws are made a majority of the people are still ignorant of the existence of the law, or at least, of the basic provisions. Apart from the problem of scarcity of the law, the question of illiteracy ought to be a pertinent consideration. The illiteracy rate amongst adults is about 70%. How are these people to understand that to trade on the basis of information freely passed on to them with a tip that they would make profit by trading on it is in breach of a law of the country. In societies with a large illiterate population, crimes are fashioned in a way to tally with the sense of justice of the people. It is easy for them to understand prohibitions that are inherently criminal and without being aware of specific laws prohibiting the conduct, there is general abstinence. For example most persons in Southern Nigeria, would refrain from committing adultery in the belief that it is a crime, even though under the law it is not. As has been pointed out in several parts of the thesis, trading on confidential information would not be regarded as criminal by a majority of Nigerians. Yet the maxim *ignorantia iuris non excusat* applies with full force in Nigeria. What is more, the fact that persons have been violating the law without prosecution is not a defence for a person who the state decides to prosecute. The *ignorantia iuris* principle has a fallacious application in Nigeria, and what is why the law must be modelled in a manner that is easily

persons in such proximate relationships with the executive, expect a moral obligation on the part of the executive to reveal such information to them. *Re Attorney General's Reference (#1 of 1988)*[10] shows that the meaning of the word "obtain" in the provision possibily covers a person who assumed that he had received the information in a perfectly legitimate manner. With takeover bidders, the problem as revealed in chapter 3 is to determine when a person can be said to be contemplating a takeover bid.[11]

Leaving the problem of determining beforehand whether a person falls within the category of prohibited persons, one enters into deep waters in considering the nature of the prohibited information upon which a person can trade. The information upon which the insider trades must be price sensitive, i.e., information that would materially affect the price of the securities.[12] The amount of change which the information has to have on the value of the securities to be considered material is not stated by the Act. Information that would change the price at which the securities trade is not necessarily price sensitive. The change has to be material. Thus, an insider who knows that the information will cause a slight change in the price of the securities[13] will be liable if

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understandable by the citizens.

[10] [1989] A.C. 971.

[11] Chap. 3.4.b.

[12] Section 614(2)(c)(ii) *CAMA*.

[13] It is uncertain whether a particular information has to be price sensitive in itself before the prohibitions will apply. A piece of information taken in itself may a effect slight change in the price of the securities, but may have a more significant impact when combined with other information which the person trading knows, notwithstanding that the other information was acquired by him through his diligence and industry. For example, an investment analyst may know from investigation that company A is unable to pay off its debts and that creditors are threatening to foreclose. He also knows that foreclosure would not occur if the company gets a tax concession which it has applied for, as this will ensure enough money to pay the outstanding interests on the loans. He then stumbles on confidential information that the application

contrary to his belief the price change happens to be significant. The insider would remain liable even if some other factors combine with the information to cause the price change.[14] While the likely effect of some information on the price of the securities may be easily predicted, there are grey areas where the insider would be unsure whether the price change would be regarded as significant or not. In such instances he is left in a dilemma whether to trade or not. It has been suggested that to avoid liability it is better to err on the side of disclosure. But this involves another problem: the nature of disclosure.

For the insider to trade, the information must be disclosed to the public or must be such that it is generally known to persons who are accustomed to deal in the type of securities in question. Disclosure to the other party to the trade will not be enough,[15] for the information must be available to the general public.[16] The purport of such a requirement is to prevent selective disclosure by insider traders,[17] and while this is

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for tax concessions will be turned down. This in itself is not price sensitive as similar applications have been turned down in the past with little effect on the company's business. But coupled with what he already knows, it becomes highly significant, and he may be precluded from trading. Ironically, an ordinary investor (not diligent in investigation) who knows only of the impending refusal of the tax concession would be allowed to trade as what he knows, ordinarily, would not materially affect the price of the securities of the company, even though in this case, it would. Will it not be then that the regulations will defeat beneficial market activity?

[14] See text accompanying note 32, chapter 5.

[15] This will be so only if the suit against the insider is brought by the company or the insider is being prosecuted for a criminal breach of the regulations. In a private civil action, the insider is not liable if the information was known to the other party or if with due diligence, it would have been known to him.

[16] *Securities and Exchange Commission v. Salmon and Co.* (SDNY 1975), cited A.R. Bromberg and L.D. Lowenfels, *Securities Fraud and Commodities Fraud* vol. 3 (Colorado Springs, Colorado: Shepherd/McGraw-Hill Inc., 1990) para. 7.4(1021).

[17] P. Anisman, *Insider Trading Regulation For Australia: An Outline of the Issues and Alternatives* (Camberra: Australian Government Publishing Service, 1986) at 76-77.

justifiable, the cost of disclosure by the insider must be examined. In some cases, disclosure to the other party would be enough, especially where the transaction is of a private concern between the parties, but the insider would still be technically in breach of the regulations. And because deposition of a document with the SEC or the Corporate Affairs Commission is not public disclosure, for this purpose, companies that are already cash strapped have to spend huge sums of money to make additional disclosure to the public. The question of when information is to be regarded as public was dealt with in chapter 4.[18] Due to uncertainty as to whether there has been sufficient public disclosure, an insider who trades may never be sure that he has discharged his obligations until the matter is litigated. And he may well find that he had failed to meet the public disclosure requirement of the Act.

Due to the uncertain and vagarious nature of the regulations, knowledgeable persons are likely to refuse executive positions in companies. This would be against one of the aims of the Law Reform Commission. The Commission had complained that the bad performance of most companies in Nigeria was due to the fact that persons who had no business being on the board were appointed directors of companies.[19] It stressed the need to fashion the law in such a way as to ensure that only persons knowledgeable about the responsibilities inherent in the office, occupy executive positions in a company.[20]

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[18] See pages 115-117.

[19] Report of the Nigerian Law Reform Commission on Company Law Vol. 1 at page 172 - 173.

[20] The Law Reform Commission berated the lax nature of the duty of care and skill on a director as laid down by Romer J. in *Re City Equitable Fire Insurance Company* [1925] Ch. 407, and went on to prescribe a duty of care and skill based on the standard which a reasonable director would exercise in comparable circumstances. See also section 122(1)(b) *CBCA*.

It is anomalous that it made recommendations for insider trading which would work to ensure that only persons who do not understand the risk they would be taking in accepting managerial position would be appointed directors. This will not be the inescapable effect, but competent persons who are ready to accept directorships will likely include in their salary calculation payment to take care of a possible breach of the regulations or for promising to not to trade on insider information. The added cost of running the companies, from increased executive remuneration and disclosure requirements, will be reflected in the price of goods which they produce. This increase will be passed on to the consumers. In a period of sky-rocketing prices and uncontrolled inflation, there is no justification for increasing, albeit unwittingly, the price which the consumers have to pay for services. Investors are few, but consumers are many. Not only will the regulations protect one group of investors to the detriment of other investors, tagged insiders, they protect them to the detriment of the general body of consumers who have to pay higher prices for goods to ensure that a few investors reap the benefit of the market.

The effect which insider trading regulations may have on foreign investment was noted in chapter 6.[21] In 1972, the federal government decided to restructure businesses to give control to Nigerians.[22] Although foreign businessmen evaded the law by the use

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[21] See pages 180-181.

[22] See the *Nigerian Enterprises Promotion Decree*, 1972. Businesses were divided into three schedules. For simple businesses in schedule 1, foreigners were excluded from taking part. For the more complicated businesses in schedules 2 and 3 alien participation was restricted to 40 and 60% respectively.

of nominees and weighted votes,[23] it had the effect of scaring away some foreign investors from Nigeria. The importance of foreign investments has since been realised and the indigenisation laws have been progressively watered down to attract foreign investors.[24] As insider trading regulations would have the effect of scaring away foreign investors, the regulations are in direct opposition to the efforts of the federal government. Where investors who are willing to take the added burden of complying with the regulations decide to set up businesses in Nigeria, the cost of the added burden will be reflected in their services, to the prejudice of consumers.

7.2. Company Law Principles and Contractual Liability at Common Law.

As noted at the beginning of this chapter, a new remedy to cure a mischief is only justified if the existing legal framework is inadequate to take care of the situation. This is not the case with the insider trading regulations in Nigeria. The mischief which the regulations are directed at was well taken care of by the common law and the statutory rule making power of the SEC.

The common law has always regarded directors as fiduciaries of the company.

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[23] See *Lasisi* v. *Registrar of Companies* [1976] 7 S.C. 73, *Kehinde* v. *Registrar of Companies* [1979] L.R.N. 213. In the later case, the company adopted the scheme in *Bushell* v. *Faith* [1969] 2 Ch. 438 by giving the foreign partners weighted votes to enable them control corporate decision making despite their smaller percentage of shareholdings. The *CAMA* in section 116 attempted to remedy the situation by restricting the issuance of weighted and non-voting shares, but it is doubtful if the Act achieved the full desired effect in view of the loophole in section 143 of the Act. See V. Onwaeze, "Some Recent Changes in Nigerian Company Law" (Forthcoming J.B.L.)

[24] The 1972 Decree has been repealed. The current statute is the *Nigerian Enterprises Promotion Decree*, 1989. Under the new Decree there is only one schedule of businesses reserved for Nigerians. Outside of these, there is no restriction on the percentage of participation by foreigners and even for the scheduled businesses, foreign participation without limit is allowed if the foreigner is willing to invest up to 2,000,000 naira.

This rule is now codified in the *CAMA*.[25] Several fiduciary duties have been placed on directors and officers of the company. The director is not expected to put himself in a position where his personal interest conflicts with that of the company.[26] This rule has been made somewhat inexorable in that once the director puts himself in a position of conflict, he is liable, without the need to prove that a conflict actually arose.[27] A director who trades on confidential information to the detriment of the company will be liable at common law and some of the cases that would be regarded as insider trading cases have been decided on this ground.[28] Where a director refrains from trading but tips the information to another person, he will still be liable on at least two grounds. The first is the expropriation of corporate property.[29] The confidential information belongs to the company even if produced by the director, unless there is an agreement for the company to forego patent rights to the employee. In most cases, this would not be so and moreover, most confidential information used for insider trading is not of the kind that qualify for the protection of the producer. The director who tips the information would be in breach of his fiduciary duties to the company to act in its best interest and to protect its property. The director is liable to the company for any loss which it suffers

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[25] Section 279(1).

[26] *Bray* v. *Ford* [1896] A.C. 44 at 51.

[27] *Aberdeen Rly.* v. *Blaikie Brothers* (1854), 2 Eq. Rep. 128.

[28] *Diamond* v. *Oreamuno* 248 N.E.2d 910 (N.Y. 1969). Contrast *Freeman* v. *Decio* 548 f. 2d 180 (7th cir. 1978) and *Schein* v. *Chasen* 478 F. 2d 817 (2nd cir. 1973). See J.D. Bauman and R.H. Rosenblum, "The Resurgence of Common Law Restrictions on Insider Trading" (1986) 32(5) The Practical Lawyer 43.

[29] *Menier* v. *Hooper's Telegraph Works* (1874) L.R. 9 Ch. App. 350.

from the dealing by the tippee.[30] Under the expropriation of corporate opportunity doctrine, the insider remains liable even if the company cannot exploit the information.[31] The company may also be able to sue the tippee. Directors of the company are sometimes regarded as trustees of the company and any person who receives property of the company from the director with knowledge of his status and the fact that the property is given to him in breach of the director's fiduciary duties becomes a constructive trustee of the property. Such a person is liable for expropriation on the same basis as the director provided the knowledge elements can be proved.[32] If the director expects a return from tipping the information, his liability will be increased. Reward here is not restricted to monetary returns[33] and may include such intangible things as gaining the confidence or affection of a relative or confidant. If the information is one which the company can properly exploit[34] the officer will be liable for expropriation of a corporate opportunity.[35] Thus, the company is well protected by the common law against abuse of confidence by its directors and officers.[36]

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[30] R.R. Pennington, *Pennington's Company Law*, 6th ed. (London: Butterworths, 1990) at 588-589.

[31] *Regal (Hastings) Limited* v. *Gulliver* [1942] 1 All E.R. 378, section 280(4) *CAMA*.

[32] *Selangor United Rubber Estates Ltd* v. *Craddock (#3)* [1968] 2 All E.R. 1073 at 1104.

[33] If the director receives a monetary return, he is liable in damages for breach of his duties, in addition to being made to return the monies received to the company. *Boston Deep Sea Fishing Company* v. *Ansell* (1888), 39 Ch.D. 339.

[34] In most cases, this will not be so, as the company being an insider also cannot use the information. On the question whether the company should be regarded as an insider in Nigeria, see chap. 3.3.a.

[35] *Canadian Aero Services* v. *O'Malley* (1973), 40 D.L.R. (3d) 471, *Industrial Development Consultants Limited* v. *Cooley* [1972] 1 W.L.R. 443.

[36] Other ways in which a cause of action can be implied in favour of a third party against the company or its directors are discussed on pages 211-212.

The major complaint in this area is the liability of directors to persons other than the company. It is the law that generally, directors owe their fiduciary duties to the company and do not act as agent of the general body of shareholders.[37] They owe no general fiduciary duties to individual members of the company or other persons when carrying out a transaction with the member or the other person whether they act as agent of the company or in their personal capacity.[38] But this is only a general rule. The fiduciary duties of directors are not foreclosed by their duty to the company. They remain subject to the general fiduciary concept, whereby if a special relationship exists between two persons and one occupies a superior position and the other places trust and confidence in him, the former assumes a fiduciary position in relation to the latter in financial transaction.[39] There are no set rules for the assumption of the fiduciary position and the law infers the existence of a fiduciary relationship from the circumstances of the case. Certain presumptions have been set up to strengthen the position of the person placing trust in the other. Indeed, the fiduciary is not expected to enter into the transaction and there is a presumption that the fiduciary abused his position[40] unless he can show that the other person received independent advise.[41] It is not necessary that the fiduciary be remunerated for him to assume this position. The

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[37] *Percival* v. *Wright* [1902] 2 Ch. 421.

[38] *Multinational Gas and Petrochemical Company* v. *Multinational Gas and Petrochemical Services Limited* [1983] B.C.L.C. 461 at 487. Cf. *Ferguson* v. *Wilson* [1866] 2 Ch. App. 77.

[39] *Tate* v. *Williamson* (1866), L.R. 2 Ch. App. 55 at 81.

[40] *Allcard* v. *Skinner* (1887), 36 Ch.D. 145, *Turton* v. *Sperni* [1952] 2 T.L.R. 516.

[41] *Inche Noriah* v. *Shaik Allie Bin Omar* [1929] A.C. 127, *Williams* v. *Franklin* [1961] 1 All N.L.R. 218.

special relationship existing between the director and the shareholders account for the decisions where directors have been held liable for trading on confidential information when dealing with the shareholders.[42] The placing of confidence in the officer need not be expressed. There is no reason why a director may not be held to a fiduciary duty to a poor and ignorant shareholder who wishes to dispose of his share if the director has information which would affect the value of the shares,[43] but such a duty may not be owed to a sophisticated investor who can adequately take care of himself. The relevant factor is the merit of the plaintiff's claim. In the former situation, the director has a duty at least to advise the shareholder to seek independent advice, before entering into the transaction. For a sophisticated investor, such advice need not be given, for his position is one which justifies the director in assuming that he already had such advice.

The fiduciary concept is a veritable tool for finding liability at common law where there is a disparity in the possession of information. It is remarkable that after many years of expanding the scope of liability,[44] the fiduciary concept is coming back as the basis for determining liability for breach of rule 10b-5.[45] If the courts in the United States, where the incidence of insider trading is more prevalent, are content to rest

[42] *Strong* v. *Repide* 213 U.S. 419 (1909). *Coleman* v. *Myers* [1977] 2 N.Z.L.R. 225.

[43] Compare for example *Fry* v. *Lane* (1880). 40 Ch.D. 312 at 322

[44] Even in the era of expansion of liability, the cases with the possible exception of *Re Cady, Roberts and Co.* 40 SEC 907 (1961), had a tinge of the common law behind the decisions. *Kardon* v. *National Gypsum Co.* 69 F. supp. 512 (1948) involved some affirmative misrepresentation, most of the defendants in *SEC* v. *Texas Gulf Sulphur Co.* 401 F.2d 833 (2d Cir. 1968) where persons who could be said to owe the company a fiduciary duty at common law.

[45] See T.E. Hazen. "Corporate Insider Trading: Reawakening the Common Law" (1982) 39 Wash & Lee L.R. 845. The writer notes at 852 that most of the insider trading cases where there has been recovery are not novel, but were based on recognised and antiquarian principles of the common law.

liability on recognised common law fiduciary principles[46] then there is some justification in assuming the relevance and adequacy of the principles. The fiduciary concept is wide enough to tie in tippees. The constructive trustee concept has been referred to above,[47] and it is only to be reiterated that where a director who cannot enter into a transaction with a trader due to the fiduciary duties diverts the trade to a tippee who is aware of the circumstances, the tippee ought to be held to a fiduciary duty to the trader. The same rules that apply to tippees can also be used in the case of persons in a business or professional relationship with the company. Where the relationship of the person is such that the company relies on his skills and places trust in him, the person assumes a fiduciary relationship with the company. As a fiduciary he may not use the property of the company to its detriment. And as information is regarded as corporate property,[48] his trading on such information may amount to expropriation of corporate property or opportunity as the case may be. It is also possible for the person in a professional or business relationship to the company to assume a fiduciary relationship with an individual trader when he enters into a deal with the shareholder in circumstances that give rise to a special relationship.

The position of directors has been made more stringent by section 279(2) of the *CAMA*. By that section the director owes a fiduciary duty to the company whenever any person is dealing in the securities of the company. The duty is not limited to situations

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[46] See *Dirks* v. *SEC* 463 U.S. 646 (1983), *United States* v. *Chiarella* 445 U.S. 222 (1980).

[47] Page 206.

[48] *Phipps* v. *Boardman* [1967] 2 A.C. 46

when an existing shareholder is dealing[49] and it does not seem to be necessary that the director be a party to the transaction.[50] This is a wide provision and its exact extent is unknown, but in itself, it would be enough to deal with cases of misuse of the position which directors occupy. The tippee may also be caught as a constructive trustee. This is better than the insider trading provisions, because liability is based on the recognised common law fiduciary concept and not on the legalistic categorisation of the transaction by the law.

It may have been detected that the advocated fiduciary duties can only arise in face-to-face transactions. This is in line with the earlier arguments that the focus of the law should be the prevention of an abuse of a position of trust. As far as private actions are concerned, the fiduciary duty which is advocated cannot arise if the deal takes place on an impersonal market. There is no way the director would know the identity of the other party so as to enable him fulfil his fiduciary obligations. In such a situation the company would still be able to sue the insider on the basis of section 279(2). In the corporate action, it is unnecessary for the company to prove loss to itself or by a third party before the officer is held in breach of his fiduciary duties. It would also be possible to institute a state action against the insider on the basis of breach, of a loose concept of,

[49] This is in opposition to such cases as *Goodwin* v. *Agassiz* 283 Mass. 358 (1933), and reflects a change in the common law position.

[50] As printed out on page 124, this does not give the other party to the transaction the right to bring a suit to enforce the fiduciary duties against the director. Only the company can do so. It is possible for the other party where he is a shareholder to institute a derivative action under section 303 or sue on the ground of unfairly prejudicial and oppressive conduct under section 310 of *CAMA*; see Pennington, ***supra***, note 26 at 584 - 585. For a trader who is not already a shareholder of the company, this remedy is not open to him. It is unclear if the company has any obligation to transfer the money recovered from the director to the other party to the transaction.

a public trust.

Where the company fails to sue a director or officer in breach of the fiduciary duties, a shareholder may be able to bring a derivative action if he can satisfy all the requirements in section 303(2) of the *CAMA*.[51] The rule in *Foss* v. *Harbottle* which was codified in section 299 of the *CAMA* has been considerably watered down by statute.[52] It may also be possible to imply a cause of action in favour of the third party who is prejudiced by an employee's breach under the unfairly prejudicial or oppressive conduct remedy. The categories of persons who can bring the action has been expanded by section 310(1)(e) to include any person who in the discretion of the court is a proper person to make an application under section 311. Section 311(2)(b) allows the action if the person shows that the affairs of the company are being conducted in a manner that is oppressive or unfairly prejudicial to or discriminatory against or in a manner in disregard of the interests of that person, or that an act or proposed act or omission, was

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[51] These requirements are,

(a) that the wrongdoers are the directors who are in control and will not take the necessary action,

(b) the applicant has given reasonable notice to the directors of the company of his intention to apply to court if the directors do not bring the action,

(c) the applicant is acting in good faith,

(d) it appears to be in the best interest of the company that the action be brought.

The incentive for the member to bring the action will hardly be there unless the activities of the officers depress the value of the company's shares. If the in house insider trading rules are in the articles of association of the company, then they would constitute a contract between the company and its members and between the members and the officers, so that a member can sue the officers directly for breach of the rules, without having to satisfy the requirements of section 303(2).

[52] Section 300 of *CAMA*. A member may be able to sue a director for insider trading under section 300(f) which allows a member's action where the directors are likely to profit or benefit or have profited or benefitted from their breach of duty. However, it would not be possible to recover any insider trading profits as the power of the court under sections 300 and 301 is limited to granting an injunction or making a declaration. The only benefit of such a suit is that an injunction would prevent the directors from further breach of duty and any future trade in defiance of the injunction would amount to a contempt of the court for which an information can be filed.

or would be oppressive or unfairly prejudicial to, or unfairly discriminatory against or in a manner in disregard of the interests of that person. The court has wide ranging powers to grant relief under section 312 for a successful action under section 311. The right of the third party may also be enforced indirectly by the Corporate Affairs Commission which is empowered to bring an action under section 311(c) if the affairs of the company are being conducted in a manner, or an act or proposed act or omission of the company is, in disregard of the public interest. The problem that would face such a complainant is to convince the Commission to institute an action on his behalf, for the Commission cannot sue for an injury to one person unless that person's injury can be equated with the public interest. It is unclear if the Commission is obliged to turn over the sum recovered in the suit to the person alleging an injury.[53]

However, it is clearly possible for the Commission to bring an action, in its own right, against a company in this circumstance, without the need to specifically identify an injured person as, for example, where the deal is done on an impersonal market, on the ground that the affairs of the company are being conducted in disregard of the public interest.

Most of the instances described above have not been recognised as giving rise to liability. That is not reason, however, to conclude that they are not feasible. The common law is an ever changing body of law, and where conduct threatens to disrupt society, the courts have the power to use their inherent jurisdiction to develop the law.[54]

[53] There is still uncertainty in the U.S. as to the fate of disgorged profits in an SEC proceedings.

[54] The ability of the common law to continue to prevent fraudulent abuse of confidence would depend on the willingness of the courts to extend existing principles to novel cases as they arise.

Although it is often argued that courts have no power to make laws,[55] that notion does not tally with the reality of judicial practice. Indeed it is only by recognising the power of the judges to expound and expand the law that the concept of a common law can be justified.[56] The courts lay down general principles to which the peculiar facts of each case is fitted. It is true that the malleable nature of the common law offends the principle of predictability, i.e., a person embarking on an act should be able to predict the legal outcome of his action at the time of acting, but giving the courts the power to develop the law in this manner to meet arising needs in the society, helps them to avoid cases of crass legalism.

Aside from the common law concept of fiduciary duties and company law principles, special rules of contract can come to the aid of a person who deals with an insider who was in possession of insider information. The usual grounds for complaint are misrepresentation, mistake, duress and undue influence.

Misrepresentation will not succeed unless the insider had made active representations to the other party. The insider will be guilty of misrepresentation if the other party asked specific questions of the insider to which he gave false answers. This is unlikely to arise, as the ground of complaint is usually the failure to speak rather than anything that is said. And there is no duty to speak unless there is a special relationship

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[55] *Knuller* v. *D.P.P.* [1973] A.C. 435 at 457-8, 464-5, 490 and 496; A. Karibi-Whyte, *Reshaping Our Criminal Laws: Fourth Idigbe Memorial Lectures* (Benin, Nigeria: University of Benin Press, 1990) at 6 and 26.

[56] See *Shaw* v. *D.P.P.* [1962] A.C. 220 at 267 - 8; H.L.A. Hart, "Positivism and the Separation of Law and Morals" (1958) 71 Harv. L.R. 593 at 606 - 614 especially 612.

between the parties.[57] The situations where such special relationships exist will be covered by the fiduciary concept discussed earlier. It was suggested by the Justice Committee in England that a securities transaction should be treated as one *Uberrima fides*, thereby imposing a duty of full disclosure on the parties.[58] This suggestion must be rejected for three reasons. Firstly, there is nothing in the nature of securities that warrants treating it in this manner. Utmost good faith is required only in special contracts where a failure to disclose would have far reaching consequences on the consent expressed by the parties.[59] Secondly, such a rule would introduce more injustice than it aims to cure. A contract *uberrima fides* can be avoided on the simple ground of failure to disclose even if this did not have any appreciable effect on the contract. The only attractiveness in the suggestion is that in a contract of utmost good faith, the duty to disclose is imposed on both parties to the contract, so that the obligation of the insider to disclose all that he knows is matched by a corresponding obligation on the other party, but this alone does not justify the introduction of the requirement in securities transactions. Lastly, it would be impossible to meet this requirement in the context of a stock exchange or other large impersonal trading medium.[60]

Of the classes of mistake the only good ground of complaint would be a unilateral

[57] *United States* v. *Chiarella*, *supra*, note 42. Cf. I.E. Sagay, *Nigerian Law of Contract* (London: Sweet and Maxwell, 1985) 239-240.

[58] Justice (Society), *Insider Trading: A Report* (1980), para 33.

[59] See chap. 2.3.e.

[60] The Justice Committee did restrict the suggestion to situations where the parties are in direct contact, but the first two objections still stand.

mistake on the part of the other party.[61] To succeed the person must prove that he entered the contract under a mistaken notion of the true position and that his mistake was known to the other party.[62] In an insider deal, it would be apparent to the insider that the consideration which the other party is offering for the transaction is based on a false notion of what the securities were worth. This will hardly qualify as a unilateral mistake on the part of the other party for he would not know that he was making a mistake. The mistake must be involuntary rather than voluntary. However, it is recognised that failure to prove mistake in its strict sense does not leave the complaining party destitute of a remedy. The courts have the equitable jurisdiction to impose terms on the parties.[63] The court may, for example, order that the insider give the other party the choice of rescinding the contract or entering into a new one at a price assessed by the courts.[64] It may also order the return of the securities plus any dividends received to the trader for the price of the securities and interest at the prevailing bank rate or a rate fixed by the court from the date of the transaction to the date of judgement. Duress is an unlikely ground for complaint because of the need to prove a "coercion of the will which vitiates

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[61] There is a disagreement amongst writers as to whether there two classes of mistake or three, but all are accept the doctrine of unilateral mistake. See Sagay, *supra*, note 57 at 189-190.

[62] *Webster* v. *Cecil* (1861), 30 Beav. 62, *Abdul Yusuf* v. *Nigerian Tobacco Company* unrep. CAS/39/74, I.E. Sagay, *Casebook on the Nigerian Law of Contract* (London: Sweet and Maxwell, 1981) at 256.

[63] See *Solle* v. *Butcher* [1950] 1 K.B. 671.

[64] In *Harris* v. *Pepperell* (1867) LR 5 Eq 1, the party who was aware of the mistake was given the option of having the contract set aside or submitting to it with the mistake rectified. See M.P. Furmston ed., *Cheshire and Fifoot's Law of Contract* 10th ed. (London: Butterworths, 1981) at 228.

consent".[65] The elements of undue influence are almost the same as those for duress. Where there is a special relationship, the fiduciary rules discussed earlier would apply. In cases of no special relationship, it would be difficult to prove the required coercion.

Aside from these common grounds of complaint, the courts have in recent times developed extended equitable rules enabling a party to resile from his contract. The most relevant for present purposes is the principle of inequality of bargaining power formulated by Lord Denning in *Lloyd's Bank* v. *Bundy*.[66] The parameters of the doctrine have not been fully explored. Inequality of bargaining power is not synonymous with inequality of bargaining skills[67] nor is possession of superior bargaining power enough. The transaction must be accompanied by exploitation and unjust enrichment of the stronger party who can control the negotiations due to the other party's ignorance, feebleness, hopelessness or general naivete.[68] Where the contract is fair on its face there ought to be no ground for overturning the bargain of the parties. The purpose of striking down such bargains is the protection of those whose bargaining power is weak from being made by those whose bargaining power is stronger to enter into bargains that are unconscionable.[69] This would arise, for example, when one, who, without independent advice enters into a contract on terms which are very unfair or transfers property for a

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[65] *Pao On* v. *Lau Yui Long* [1980] A.C. 614 at 636 and, generally, *Barton* v. *Armstrong* [1976] A.C. 104.

[66] [1974] 3 All E.R. 757 at 765.

[67] Furmston, *supra*, note 64 at 20.

[68] J.D. Calamari and J.M. Perillo, *Contracts*, 2nd ed. (St. Paul, Minn.: West Publishing Company, 1977) at 326.

[69] *Schroeder Music Publishing Company Ltd.* v. *Macaulay* [1974] 1 W.L.R. 1308 at 1315.

consideration which is grossly inadequate[70] when his bargaining power is impaired by reasons of his own needs or desires or by his ignorance or infirmity coupled with undue influence or pressure brought to bear on him by or for the benefit of the other.[71]

In the U.S. a corresponding doctrine of unconscionability has grown to match the nascent doctrine of inequality of bargaining power in Britain. The courts have assumed the power to restrict the enforcement of contracts which are in themselves oppressive in the circumstances or where the conduct of one of the parties is otherwise unconscionable.[72] The duty of the court is to examine the conduct of both parties to the contract and where it finds the conduct of one of them sufficiently odious, it may refuse to enforce the contract, or it may grant a relief to the complaining party. The inquiry would not be restricted to the conduct of the insider, but extends to that of the other party, and where turpitude is found on his part, he cannot get relief. The argument made here may appear in conflict with the discussion in chapter 2 on the freedom of parties to enter into contracts.[73] This is not necessarily so. Freedom of contract is desirable but the intervention of government and the courts for the prevention of fraudulent practices is not totally without merit. Freedom of contract "... is not such an immutable doctrine as to admit of no qualification, but is subject to changes in the general public policy as

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[70] "The foremost indicator of undue influence is an unnatural transaction resulting in the enrichment of one party at the expense of the other": Calamari and Perillo, *ibid.* at 275.

[71] *Lloyd's Bank* v. *Bundy supra*, note 66. For a commentary on this passage see L.S. Sealy, "Undue Influence and Inequality of Bargaining Power" (1975) Camb. L.J. 21, C. Carr, "Inequality of Bargaining Power" (1975) 38 M.L.R. 463.

[72] For a general reading see Calamari and Perillo, *supra*, note 68 at 259-277.

[73] Chap. 2.3.f.

a result of new economic conditions and commercial practices".[74] The doctrine of inequality of bargaining power has not been adopted in Nigeria, neither has a principle of unconscionability. Indeed in the few cases which would have justified its application, the courts have adopted a restrictive approach.[75] It is advocated that the courts recognise this concept and apply it, if necessary, to prevent fraudulent abuse of confidence.[76]

It may also be possible for the plaintiff to recover on the principle of unjust enrichment. By this principle a person has a right to have restored to him money or benefit gained at his expense if it would be unjust to allow the other party to retain the benefit.[77] Here again, the law focuses on the conduct of the parties to the transaction. The relevance of the unjust enrichment principle is that its application is not dependent on any pre-existing fiduciary relationship between the parties. The courts would necessarily need to exercise a lot of restraint before invoking the doctrine, but in appropriate cases of misuse of confidential information, to the detriment of a meritorious

[74] *Henningsen* v. *Bloomfield Motors Company* (1961) 75 A.L.R. 2d 1.

[75] See V. Onwaeze, "Unconscionability in Contract: What Protection in Nigeria?" (unpublished seminar paper, University of Benin seminar series, December 1989)

[76] This is not to advocate a nebulous principle of inequality of bargaining power. It is the abusive conduct of the superior party that should be of primary inquiry. The fact that the bargain turns out to be 'unfair' or the consideration little is not ground for relief if there is no turpitude on the part of the party with superior bargaining power. What the law should focus on is the bargaining process leading up to the transaction, and not the outcome. See S.N. Thal, "The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness" (1988) 8 Oxford J. Legal Stud. 17 at 24 and 26. The necessity of the inequality of bargaining power doctrine arose from the restrictive application of the duress and undue influence concepts and if these are widened appreciably, there would be no need for the doctrine; see G.H. Treitel, *The Law of Contract*, 8th ed. (London: Sweet and Maxwell and Stevens and Sons, 1991) 371-373.

[77] *Seager* v. *Copydex Ltd.* [1967] 1 W.L.R. 923. Goff and Jones, *Law of Restitution*, 3rd ed. (London: Sweet and Maxwell, 1986) at 12-51.

plaintiff, it could be used to catch insiders and their tippees.[78] Agency[79] and restitutionary principles[80] have also been useful in checking insider trading cases.

As the common law is adequate to take care of trading by a director to the detriment of the company, with shareholders and other persons in face-to-face transactions and to a certain extent impersonal transactions,[81] there is no need to superimpose the regulatory framework on the existing common law principles. Whatever gap that is left by the common law with regards to the impersonal market could be taken care of by the rule making power of the SEC.

7.3. Section 6(e) of the *Securities and Exchange Commission Decree.*

Section 6(e) of the *Securities and Exchange Commission Decree* gave the Commission power to make rules to regulate the incidence of insider trading. The opinion of the Commission at the discussion stage of the *CAMA* was that the rule making power rather than express legislation was appropriate for regulating insider trading. This rule making power is seen as a compromise between over regulation and an open cheque for abuse. The Commission never made elaborate rules to regulate conduct, perhaps in the belief that the conduct did not yet merit close regulation. It did however make regulation 7, which is along the line of rule 10b-5. This regulation makes it unlawful

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[78] P.L.R. Mitchell, *Directors Duties and Insider Trading* (London: Butterworths, 1982) at 115.

[79] *Allen* v. *Hyatt* (1940), 30 T.L.R. 444.

[80] *Brophy* v. *Cities Services ltd.* 70 A.2d 5 (Del. Ch. 1949).

[81] R.W. Dickerson, J.L. Howard & L. Getz *Proposals for a New Business Corporations Law for Canada* (Ottawa: Information Canada, 1971) 90 cited in M. Yontef, "Insider Trading" in P. Anisman et al., *Proposals For a Securities Market in Canada* vol. 3 (Ottawa: Consumer and Corporate Affairs Canada, 1979).

for any person involved in securities trading to directly or indirectly employ any device, scheme or artifice to defraud, make any untrue statement of a material fact or omit to state a material fact necessary in order to render the statement made in the light of the circumstances under which they were made not misleading or engage in any act, practice or deceit (upon any person) in connection with the purchase or sale of any security.[82] The regulation is aimed at manipulative and deceptive devices. There has been no litigation based on this regulation, but it is safe to assume that its interpretation would be along the line of the interpretation of rule 10b-5.[83] A necessary requirement would be a finding of scienter before a person can be liable under the regulation.

As it stands now, the continued validity of regulation 7 and the rule making power of the SEC under section 6(e) of the *Securities and Exchange Commission Decree* is in doubt. At the time the SEC was given this rule making power, there was no specific insider trading regulation in place. The preamble to the *Securities and Exchange Commission Decree* states that the decree shall have effect notwithstanding anything to the contrary in the *Companies Act 1968*. The 1968 Act was repealed and replaced by the *CAMA*. It is unclear if the preamble in the *Securities and Exchange Commission Decree* can be automatically said to refer to the *CAMA*. A new statute is not taken to have

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[82] See SEC *A Handbook on Securities and Exchange Commission Decree 1988 and SEC Regulations* (Lagos, Nigeria: Securities and Exchange Commission, 1989) at 17.

[83] There is some merit in such a provision. It gives the Commission more power to tackle manipulative trading, with or without confidential information. In certain of these instances clear evidence of fraudulent conduct exists, but the present regulations on insider trading in *CAMA* do not in any way go to prevent such fraudulent practices. Here reference is being made to such devices as wash trading. As far as trading on confidential information *simpliciter* is concerned, the approach in the U.S. is acceptable in so far as the decisions remain tied to the fiduciary concept in the fashion initiated in *Chiarella* and *Dirks*.

repealed an earlier statute or parts of it, unless there is express repealing provision or a repeal can be inferred by necessary implication from the words used in the new statute. Before this implication can arise, the two enactments would generally have to be inconsistent with each other[84] or the provisions of the new statute make the continued application of the former superfluous. The fact that the Law Reform Commission went ahead and made specific regulations despite the suggestion by SEC that its rule making power was enough to take care of cases that might arise, would seem to be a negation of the rule making power of the SEC. On the other hand, it may be argued that the provisions of the *CAMA* are meant to complement the rule making power of the SEC. This is because section 542 of the *CAMA* gives the SEC power to make rules for the purpose of carrying out the functions given to it by the decree. It may be safely said that the SEC no longer has the power to make rules for the regulation of insider trading by relying on section 6(e) of the *Securities and Exchange Commission Decree*. The rule making power of the SEC under section 542 must be used by reference to the *CAMA*, and as such it does not have a general power of rule making as under section 6(e) of the *Securities and Exchange Commission Decree*.

From the discussion above it is submitted that there was an adequate existing legal framework to tackle issues of insider trading.[85] There was no pressing need for the

[84] *White* v. *Islington* [1909] 1 K.B. 133.

[85] Insider trading is used in this sense not to refer to its general connotation of trading on confidential information simpliciter, but in its restrictive meaning of fraudulent abuse of confidence by trading on information acquired in, or from a person in, a position of trust as per the conclusion in chapter 2. In those instances of fraudulent trading, the common law has not allowed a person to benefit from his fraud or breach of confidence. Where no fraud or breach of fiduciary duty is proved, this is not to be regarded as insider trading and that is how the common law has always taken it.

regulations. To reinforce the protection of the common law, it may be necessary to expand the scope of disclosure requirement in the *CAMA*, so as to prevent the abuse of confidence by persons in a position of trust.

7.4. Expanding The Scope of Disclosure and Publicity Requirements in *CAMA*.

The remedy which was recommended to cure the fraudulent practices in the early Joint Stock Companies was disclosure and publicity of the business and of names of those managing the affairs of the company. It was thought that by disclosing the business of the company, investors would be able to know whether the company was engaged in legitimate business or a scam.[86] It was also felt that if the names of those managing the business is known, reputable persons would not want to lend their names to the prospectus of companies which were not going to engage in lawful business.[87] The bottom line of the disclosure philosophy is that people would be more careful of their conduct if they know that this conduct is open to public scrutiny.[88]

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[86] As Gladstone noted in the introduction of Joint Stock Companies Registration and Regulation bill, "publicity is all that is necessary. Show up the roguery and it is harmless". See B.C. Hunt, *The Development of the Business Corporation in England 1800 - 1867* (Cambridge, Mass: Harvard University Press, 1936) at 95 n12.

[87] The Gladstone Committee identified three kinds of bubble companies and the remedy for each. The first type were those faulty in their formation, the remedy for which was extensive publicity in the prospectus to give investors an insight into the real nature of the company's venture. Second were companies well or badly formed, but marred by mismanagement, the cure for which included periodical meetings, publicity of accounts and making directors more immediately responsible to shareholders. The third were companies fraudulent in object. The remedy for these was the publicity of the names of directors, deeds of settlement and other information that would give the public the benefit of knowing with whom they were dealing. See Hunt, *ibid* at 92 - 94. It is the third type that approximates to the discussion here.

[88] V. Brudney, "Insiders, Outsiders and Informational Advantage Under the Federal Securities Law" (1979) 93 Harv. L.R. 322 at 335 noted,

> "People will refrain from engaging in some kinds of conduct of corporate affairs which may or may not be illegal but which will embarrass them if disclosed. Hence they will divert less to themselves in self dealing transactions than they would if there were no

The *Joint Stock Companies Registration and Regulations Act* of 1844[89] which adopted this disclosure philosophy did not anticipate the kind of financial market which exists now. The scope of disclosure which it advocated in the Act is inadequate to take care of new forms of abuse which have developed since it was enacted.

It will be noted that the sub-heading refers to expanding the scope of disclosure and publicity requirements in the Act. There is a slight difference between the requirement of disclosure and the requirement of publicity. Disclosure deals with the type of information that needs to be revealed. Publicity relates to the manner in which the information is brought to the attention of the public. It is the publicity aspect that is more relevant for the prevention of fraudulent use of confidential information.

The purpose of expanding the publicity requirement is to reduce the burden on investors in investigating companies with which they wish to do business. Initially, it was strictly the duty of the investor to gather enough information that would aid him in making a good business judgement and no regulatory system could relieve him from the responsibility of exercising care in his investment decisions. The expansion of the market made this "caveat investor" rule antiquated. It was impossible even for the diligent investor to get all the facts he needed to be able to evaluate the prospect of a business proposition without the aid of regulations forcing disclosure. Increased publicity did not,

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disclosure. The sooner information about corporate prospects must be disclosed and the more information insiders must disclose about their dealings in the corporate securities, the less will be the temptation to manipulate the affairs of the company and the release of its information in order to create an impression of value that will facilitate insiders' personal trading in securities" (footnotes omitted).

[89] 7 - 8 Vict. cc 110 & 111, 1844.

however, provide an insurance against bad business judgement. It only ensured that no one makes a fool of the diligent investor, but it preserved the liberty of the indolent investor to make a fool of himself.[90]

As regards directors, the only requirement in the *CAMA* is for the company to maintain a register of the directors' holdings in the company.[91] This should be expanded to require the filing of insider reports[92] by persons in executive positions in companies that show their initial holdings and details of subsequent trades not only in the securities of the companies in which they occupy executive positions, but their entire securities transactions. In addition to filing report of their own transactions, these officers would be required to reveal transactions executed by other persons acting as their nominees.[93] The report would be filed with the SEC. It should also be required that executives show the holdings of persons connected to them such as their spouse and children. This is necessary for the detection of possible incidents of tipping. The present requirement for substantial shareholders to report the detail of their holdings and any changes therein to the company should be amended to require disclosure to the SEC or the Corporate Affairs Commission.

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[90] L. Loss, "The Protection of Investors" (1963) 80 S.A.L.J. 53.

[91] Section 275.

[92] Section 16(a) *Securities Exchange Act* 1934, section 127 of *CBCA*.

[93] There is a provision in section 94 of the *CAMA* which empowers a company to require persons holding shares other than as beneficial owner, to report the number of shares which he holds as nominee and the person on whose behalf he holds the shares. Because the report is made to the company and it is within the power of the company to dispense with the report, this does not aid adequate publicity. It should be required of the beneficial owners (where they occupy executive positions in the company) to file a report with the SEC.

There should also be a requirement for companies to report facts which would or are likely to have a material impact on the affairs of the company and on the price of its securities. Material changes cannot be fully listed, but such things as the award of a major contract, the development of a new product, decrease in expected revenue, the resignation of an important member of the board and a proposed merger with or take over of another company would clearly qualify as material facts. There should be an obligation on the company to report such facts in a timely fashion, so that companies may not delay the release of such information to allow its insiders to trade ahead of the release. It is important to enact penalties for companies that fail to make these timely disclosures. The monetary penalties must not be so little that the company can discount them merely as a cost of doing business. The penalty must have the ability to force disclosure.[94] The *CAMA* seems to have realised this fact for, in most cases, failure to disclose or file required information is treated as an offence for which a fine or a term of imprisonment can be imposed. In most cases, the court may be minded to impose a fine, but that does not detract from the criminal nature of the act and the consequences attendant on a criminal conviction on certain activities in which the person might wish to engage in future.[95]

If the publicity of dealing by insiders and material changes in corporate affairs are adhered to it would be possible to match the timing of deals by insiders with the announcement of material changes by the company. This would make it easier to infer

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[94] Brudney, *supra*, note 88 at 337-338.

[95] See note 68, chapter 5.

to engage in future.[95]

If the publicity of dealing by insiders and material changes in corporate affairs are adhered to it would be possible to match the timing of deals by insiders with the announcement of material changes by the company. This would make it easier to infer dealing on confidential information where deals usually precede the announcement of information by the company.

Certain documents which companies are required to keep are open to public inspection. Also the documents filed at the Corporate Affairs Commission are public documents and are open to inspection by anyone on the payment of the appropriate fees. To aid the protection of the public and the prevention of fraudulent conduct, these public documents should be made more easily accessible to members of the public. The bureaucratic bottlenecks which mar access to information would have to be removed. Also it would be necessary to overhaul the information gathering and storage method now used by the SEC and the Corporate Affairs Commission. Information must be stored in an orderly manner so as to reduce the time which is spent in searching for relevant information. Luckily the number of public companies in Nigeria is within manageable proportion and it would not require more than a few computers to store the reports which will be required to be filed under the suggested arrangement.

The ultimate responsibility will then rest with the investor. Any investor, who

[95] See note 68, chapter 5.

Admittedly, increasing the scope of disclosure and publicity would increase the cost of doing business and the company is sure to discount this in the price of its services to the public. However, price increases in the services of companies to consumers would be less than what the public would pay for the present regulatory scheme. Funding insider trading regulations by the SEC from public funds would mean increased taxes or the diversion of funds necessary for more needed social services.

The proposed disclosure framework would not totally eliminate the incidence of use of insider information, for persons bent on evading the scheme may still be able to do so. For now, computerised trading is not available in Nigeria, but when it is, it may be possible to execute a trade without showing the person who executed the trade. The recourse to multi-layered transactions may also affect the efficacy of the present framework. The utility of the approach in this chapter is that in term of economic considerations, it is more attractive than the present insider trading regulations. It also tallies with the level of economic advancement of the country and the consciousness of the citizens. Before generalised regulations such as the ones in the *CAMA* can be made two things must happen. First, there must be an increase in the number of persons taking part in securities transaction so as to justify the expenditure of public funds in the regulations. Secondly, the consciousness of the people must be raised to the level of appreciating the need for insider trading regulations, so as to ensure the effective implementation of the regulations. Several factors are needed to effect the first and these cannot be discussed here. Brief reference can be made to the second.

7.5. Public Enlightenment.

One factor which has militated against the success of insider trading regulations, even in advanced countries, is that the regulations are ahead of accepted social and moral principles. The majority of persons have not come to grips with the concept of insider trading. While a few may have a vague idea of what the regulations aim to achieve, most fail to understand why the government should be bothered with such behaviour. It is not enough to make abstract rules in the hope that people would abide by them even if they do not understand them. It is easy to legislate a change in morality, but it is more difficult to change a business culture and instill new norms and patterns of behaviour.[97] It is regrettable that securities regulatory bodies have not deemed it necessary to educate the public of what the regulations are all about. Perhaps if this had been done, it would have ensured public approval of the efforts to prevent the practice.[98] This would surely ensure more public cooperation in tracking down insider trading violators. It would also ensure that people do not inadvertently breach the regulations.

In countries with advanced information systems, and where the literacy level is high, it is possible to attempt educating the entire populace, or, at least, those minded to listen. In Nigeria, the information system is not advanced nor is there a high rate of literacy. This factor coupled with the economic cost of reaching everyone makes it overly ambitious to propose a full public enlightenment. For this reason, the primary focus for

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[97] J.J. Fishman, "Enforcement of Securities Law Violations in the United Kingdom" (1991) 9 Int'l Tax and Bus. Law. 131 at 192.

[98] R.L. Simmon, "Penal Liability for Insider Trading in Canada, *Commission Des Valeurs Mobilières du Québec v. Blaikie*" (1988) 14 *C.B.L.J.* 477 at 493-494.

now should be on the investors themselves, to make them understand why it is necessary to prevent people, not just corporate managers, from fraudulently using information obtained by virtue of a position of trust which the person occupies. If the enlightenment starts from these people, perhaps they would be able to carry the message, each person in his own little way, to the populace, and who knows, it may succeed in convincing people that there is need to have a general regulatory framework for the regulation of insider trading. More importantly, it may convince them that the danger to society of such a practice justifies the cost of erecting the regulatory framework.

CONCLUSION.

The subject of this thesis is the insider trading regulations in Nigeria. The thesis has aimed to show not only the inconsistencies in the regulations but their actual irrelevance. This has been done by a systematic consideration of the issues pertaining to the regulations, and it has been shown from stage to stage that the regulations do not fit into the Nigerian financial market and are inconsistent with the economic development objectives of the country.

The first two chapters established the historical and theoretical bases for the conclusions in the thesis. Chapter one traced the historical development of insider trading regulations. Apart from the basic objection to insider trading regulations, the pattern of development in Nigeria does not fit the general approach in the advanced market. In advanced countries, insider trading regulations came about after long periods of debate and deliberation, and there is often a gradual and sometimes consistent approach to the issue. The regulations are often made in response to massive fraudulent dealings which the existing laws seemed incapable of preventing. Insider trading regulations in the U.S. were in response to the fraudulent dealings of businessmen in the period leading to the depression of the late 1920s. The *Securities Act* of 1933 and the *Securities Exchange Act* of the following year were a result of painstaking congressional hearings, where evidence was taken from persons engaged in different areas of financial activity. Those to whom the regulations seemed directed, the CEOs, had an opportunity to express an opinion on the issue, even though in the end the regulations were made despite their objections. The regulations could be said to have built upon the disclosure approach adopted in the earlier "blue sky" laws which had been enacted by all but one state at that time. In Canada, the fraud involved in the Windfall Oil and Mines Limited case was one of the factors that encouraged inquiry into the necessity for insider trading regulations. The Royal Committee on Banking and Finance was mandated to look into the issue. Additionally, the Kimber Committee was set up in Ontario to study the effect of trading on confidential information on the securities market and suggest ways of tackling the problem. Again some studies had been done to ascertain the frequency of the practice. Even with these, studies are carried out on a continuous basis before further regulations are made. In Britain the debate on insider trading regulations took place over thirty years before criminal penalties were enacted for the practice in the 1980 *Companies Act*. There was a gradual approach to the issue by building on the disclosure requirements in earlier Acts. Similar studies were carried out in Australia, Hong Kong and Singapore before insider trading regulations were enacted there. In Nigeria, no such study has been carried out, nor was a special committee set up to study the issue. The matter was indeed discussed by the Law Reform Commission on Company Law, but given the enormous range of issues before the Commission, it could not have effectively discussed the necessity of the regulations. Equally, there was no attempt at a gradual approach to the issue which will make the regulations follow the stage of economic development in the country. The lack of a historical basis for the regulations is the first reason for their rejection.

Chapter two examined what theoretical justification there could be for the regulations. Of the theoretical arguments for and against regulation of insider trading, two are of prime relevance in the Nigerian setting. These are the fairness and economic arguments. The fairness principle is inherently tied to the morals involved in allowing trading on the basis of confidential information. The moral arguments cannot stand up to scrutiny in Nigeria, for what is aimed to be regulated is not considered as immoral in the social context of Nigeria. Of more importance is the economic cost to the nation of the regulations. The regulations have the tendency to stultify beneficial market activity by removing the incentive to produce valuable information. The cost of running corporations could be increased and this will be passed on to the hapless consumers. The regulations may also have the effect of scaring away foreign investors. The large sums of money that would be involved in the enforcement of the regulations can be put to better use in providing much needed essential services. The level of investment awareness in Nigeria does not in any way justify the regulations. Fewer than 10% of Nigerians have any investment interests in companies. It is, therefore, expected that the limited class of investors should bear the cost of protecting their investment interests. This the law ensured by leaving it to individual investors to devise means of ensuring that they trade with enough information to enable them make a good investment decision. It is necessary to reiterate the point made in Chapter two that if the regulations are meant to protect investment interest in the sense that everyone should be as knowledgeable as the other about the trades to be executed, then it is based on an unrealistic premise. Not only is such a market impossible, but no one would be interested in trading in a market where everyone is as knowledgeable as he is about the securities to be traded, as this removes the possibility of making a gain. Apart from the theoretical bankruptcy of insider trading regulations in general, it has not been possible to find justification for the regulations in Nigeria, based even on the discredited arguments that are used to support the regulations in advanced markets. It is perceived that the regulations show an unthinking attempt to give an impression of sophistication in securities regulations, without the realisation that those countries from which the regulations were copied have financial markets that are several decades ahead of what obtains in Nigeria. What is worse is that the regulations cannot even claim to be a reaction to pressure from other markets that perceive that Nigeria is being used to effect fraudulent trading in their country. Certain countries, such as the Cayman Islands and the Isle of Man, are examples of countries that have bowed to pressures from U.S. and the U.K. to make insider trading regulations. The promulgation of the irrelevant insider trading regulations merely because Britain finally made express legislation against the practice is a sad commentary on the development of the Nigerian legal system, and represents another example of the enduring vestiges of colonialism. It ought to have been realised that Britain did not take a leap in this direction and held out for a long time against juridical opinion both local and foreign.

It was concluded in chapter two that what the law should address is the prevention of fraudulent abuse of information obtained by or from a person in a position of trust. It was then shown in the next three chapters, appraising the content of the regulations themselves, that this aim is not advanced by the provisions of the regulations. In most instances the law adopts a shotgun approach to the issue, by imposing liability based on the definition of the person acting rather than focusing specifically on the nature of the act. The law does not punish the use of confidential information per se, but its use by certain persons who happen to occupy certain positions in relation to the company. The approach of the regulations in focusing on deals in an impersonal market serves to provide unmerited benefits to persons who trade in those markets with so called insiders. This is acutely apparent in the provision for a private civil suit on the part of the other party to the transaction. There is a possibility of imposing crippling liability on insiders, for they are made liable to all persons who suffer loss as a result of the trade. The absence of a strict privity requirement, even for the plaintiff, and the possibility that insiders may be accountable for the trading of tippees and sub-tippees, is clearly unjust. If the purpose of the regulations had been to prevent the fraudulent abuse of information, there would have been no need to adopt a definitional approach to the question of persons covered. The functional approach would have been better. It would also have been realised that the purpose of liability would be to deter the trader from engaging in fraudulent conduct and not to provide unmerited benefits to the other trading party, whose position *vis-à-vis* the insider is merely fortuitous. The lack of a theoretical basis for the regulations accounts for the inconsistencies in approach. Even within its present framework, the regulations suffer from an array of interpretational difficulties that put traders in an uncertain position when entering into transactions. It is difficult for certain persons to decide if they fall within the prohibited categories. For directors and officers of the company, this may be easy, but for persons who are in a business or professional relationship with the company, it would not be an easy inquiry. As far as investment advisers are concerned, the law puts them in a somewhat uncomfortable position because of the conflict which is bound to arise in the discharge of their duties.

An investment adviser has the duty to act in the best interest of the client and this connotes making the most profitable deals on his behalf. Now such an adviser who comes in possession of price sensitive information would be in breach of the regulation if he trades on it on behalf of the client. He would be in breach of his duties to the client if he fails to so trade for, in such circumstances, he has not made the best deal possible for the client. Where a person determines that he falls within the prohibited category, he faces the more difficult task of determining when he is permitted to trade, because there is no absolute prohibition of trading on the designated persons. The issue of the materiality of the information which he possesses and whether there has been adequate publicity of the information is one which the insider has to determine before he can trade. As pointed out, the answer to the two querries are ones of fact for the Judge to decide and until the matter is litigated, a trading insider cannot be too sure that he has not infringed the provisions of the Act. The only way he can avoid the threat of a law suit in the future is to disclose, publicly, all information which he may perceive to be price sensitive. This is not an attractive option for the insider, since the range of information upon which he trades are so numerous that requiring public disclosure (in terms of using a print or electronic medium with a wide audience) would greatly increase the cost of such transactions by the insider, who is unlikely to make any profits at the end of the day. In such a situation, the practical result of the regulations would be to preclude insiders from trading, a result that is unjustifiable on any ground.

Were a need for the regulations to be accepted for a moment, the futility of enforcement provides a ground for advising the rejection of the regulations in Nigeria.

In advanced countries with sophisticated monitoring devices, it has proved next to impossible to detect trading on confidential information in the impersonal markets. The use of international nominees and multi-layered transactions are now quite common. The internationalisation of the securities market and the development of automatic computerised trading are developments which the investigatory machinery in Nigeria cannot dream of tackling. In Nigeria, there can only be a laughable hope that the regulations will be enforced. Aside from the investigatory problems associated with insider trading regulations generally, political and social factors peculiar to Nigeria will undoubtedly ensure that the regulations remain law only in the sense of being in the statute books. The burden of proof inherent in the regulations, arising perhaps from inelegant drafting, would ensure that few cases, if ever, would succeed. Moreover, as insider trading is a crime in Nigeria, the probability of a conviction is slim. Judges are generally reluctant to convict for acts which are not considered inherently criminal. This fact is of relevance in Nigeria, given the attitude of the ordinary person to the behaviour which the regulations aim to control. The promulgation of laws, without an intention or even probability of enforcement is surely hypocritical. The most damaging effect is the economic implications which the regulations will have. Since the laws have been made, there must be an attempt, no matter how cosmetic, to give an impression of enforcement. Officers would have to be employed and paid, even though it is clear to everyone that nothing would come out of their employment.

Having shown the likely ineffectiveness of the regulation in preventing the conduct at which it is said to be directed, the last chapter shows that the regulations are actually unnecessary as there were adequate existing remedies that would take care of the prevention of fraudulent abuse of information acquired by or from a person in a position of trust. The attitude of the common law has been to develop remedies to take care of conduct which is perceived to be injurious to society, even if no cause of action existed for such a conduct at the time it occurred. The fiduciary duties of directors and officers of corporations took care of instances of abuse in a corporation in face-to-face transactions. The range of this duty has been expanded by the *CAMA*, and it would be possible to imply such a cause of action even in favour of a person who is not a shareholder of the company. The objection that the provision would not cover trades in an impersonal market is answered by at least two points. It was shown that there is no basis to justify an action in favour of the person trading in an impersonal market. Secondly, it is not to be assumed that the lack of a private action in favour of the other party means that the fiduciary duties cannot be enforced against the director or officer in such circumstances. The company would still be able to sue them and it was shown that under the expanded scope of the powers of the Corporate Affairs Commission, it is possible to bring a suit against a company which fails to check such fraudulent trading by its officers, on the ground that the affairs of the company is being conducted in a manner against the public interest. The question of tipping may be tackled appropriately by the constructive trusteeship concept at common law, and as the limit of this concept are not circumscribed, it is possible to extend its application to cover cases as they arise. Aside from these, the contractual remedies recognised at common law for trading parties would in most cases provide relief for the aggrieved party. It was shown that the courts have recently been expanding the range of remedies available to parties to a transaction, especially where the behaviour of one of the parties is tainted with moral culpability. More than this, the Nigerian SEC had been given rule making power to take care of insider trading cases that may arise. This power is an insurance against the event of the courts not rising to the duty of preventing fraudulent conduct. As was argued, it is only when the courts are slow to recognise changing attitudes in the society that the legislature is justified in giving the common law a push by making express legislation. This rule making power might have been given because delays in the legislative process could leave room for damaging abuse while the legislature is in the process of making the law. The rule making power can be quickly utilised when the need arises. The parliamentary remedy for fraudulent trading was to require timely disclosure of corporate information. If the confidentiality of the information can be quickly removed the opportunity to trade on it would also be lost. The *CAMA* thoroughly disregarded this alternative to massive regulations. It is the expansion of the scope of disclosure and publicity that would ensure more investor protection in the Nigerian securities market.

In view of its lack of historical and theoretical bases, the interpretational problems and the overall redundancy of the insider trading regulations in *CAMA* only one conclusion can be drawn: expunge the regulations.

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APPENDIX

Insider Trading Regulations in *CAMA*.

614(1) In this chapter of this decree-

"company" means any company whether or not a company within the meaning of this decree;

"public officer" has the meaning assigned to it under section 277 of the Constitution of the Federal Republic of Nigeria 1979 as amended;

"related company" in relation to a company, means any body corporate which is that company's subsidiary or holding company or a subsidiary of that company's holding company.

(2) For the purpose of this chapter of this part of this decree-

(a) an individual is an insider of a company, if he is or at any time in the preceding six months has been knowingly connected with the company; or[1]

(b) an individual is connected with a company if, but only if-

(i) he is a director of that company or a related company; or

(ii) he occupies a position as an officer (other than a director) or employee of that company or a related company or a position involving a professional or business relationship between himself (or his employer or a company of which he is director) and the first company or a related company which in either case may reasonably be expected to give him access to information which, in relation to securities of either company, is unpublished price sensitive information, and which, it would be reasonable to expect a

[1] Apparently, this should be 'and'.

person in his position not to disclose except for the proper performance of his function;

(c) any reference to "unpublished price sensitive information" to any securities of a company is a reference to information which-

(i) relates to specific matters relating of concern (directly or indirectly) to that company, that is to say, is not of a general nature relating or of concern to that company; and

(ii) is not generally known to those persons who are accustomed or would be likely to deal in those securities but which would, if it were generally known to them be likely materially to affect the price of those securities.

615.-(1) This section shall be subject to section 617 of this decree.

(2) An individual who is an insider of a company shall not buy or sell, or otherwise deal in the securities of the company, which are offered to the public for sale or subscription if he has information which-

(a) he holds by virtue of being connected with the company;

(b) it would be reasonable to expect a person so connected, and in the position by virtue of which he is so connected, not to disclose except for the proper performance of his functions attaching to that position; and

(c) he knows is unpublished price sensitive information in relation to those securities.

(3) An individual who is an insider of a company shall not buy or sell or otherwise deal in the securities, of any other company, which are offered to the public for sale or subscription if he has information which-

(a) he holds by virtue of being connected with the first mentioned company;

(b) it would be reasonable to expect a person so connected, and in the position by virtue of which he is so connected, not to disclose except for the proper performance of the functions of that position;

(c) he knows is unpublished price sensitive information in relation to those securities of that other company; and

(d) relates to any transaction (actual or contemplated) involving both the first company and that other company, or involving one of them and securities of the other, or to the fact that any such transaction is no longer contemplated.

(4) Subsection 5 of this section shall apply where-

(a) an individual has information which he knowingly obtained (directly or indirectly) from another individual who-

(i) is connected with a particular company, or was at any time within the 6 months preceding the obtaining of the information so connected; and

(ii) the former individual knows or has reasonable cause to hold the information by virtue of being so connected; and

(b) the former individual knows or has reasonable cause to believe that, because of the latter's connection and position, it would be reasonable to expect him not to disclose the information except for the proper performance of the functions attaching to that position.

(5) The former individual mentioned in subsection (4) of this section-

(a) shall not himself deal in securities of that company if he knows that the information is unpublished price sensitive information in relation to those securities; and

(b) shall not himself deal in securities of any other company if he knows that the information is unpublished price sensitive information in relation to those securities and it relates to any transaction (actual or contemplated) involving the first company and the other company, or involving one of them and the securities of the other, or to the fact that any such transaction is no longer contemplated.

(6) Where an individual is contemplating, or has contemplated, making (whether with or without another person) a take-over offer for a company in a particular capacity, that individual shall not deal in securities of that company in another capacity if he knows that information that the offer is contemplated, or no longer contemplated, is unpublished price sensitive information in relation to those securities.

(7) Where an individual has knowingly obtained (directly or indirectly) from an individual to whom subsection (5)[2] of this section applies, information that the offer referred to in that subsection is being contemplated or is no longer contemplated, the former individual shall not himself deal in securities of that company if he knows that the information is unpublished price sensitive information in relation to those securities.

(8) An individual who is for the time being prohibited by any provision of this section from dealing on a recognised stock exchange in any securities shall not counsel or procure any other person to deal in those securities knowing or having reasonable cause to believe that that other person would deal in them.

(9) An individual who is for the time being prohibited as above mentioned from

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[2]. This ought to be subsection (6).

dealing in any securities by reason of his having any information, shall not communicate that information to any other person if he knows or has reasonable cause to believe that that other person will make use of the information for the purpose of dealing, or of counselling or procuring any other person to deal in those securities.

616-(1) This section applies to any information which-

(a) is held by a public officer or former public officer by virtue of his position or former position as a public officer, or is knowingly obtained by an individual (directly or indirectly) from a public officer or former public officer who he knows or has reasonable cause to believe held the information by virtue of any such position;

(b) it would be reasonable to expect an individual in the position of the public officer or former public officer not to disclose except for the proper performance of his functions attaching to that position; and

(c) the individual holding it knows is unpublished price sensitive information in relation to the securities of a particular company (referred to as 'relevant securities').

(2) This section applies to a public officer holding information to which this section applies and to any individual who knowingly obtained any such information (directly or indirectly) from a public officer or former public officer who that individual knows or has reasonable cause to believe held the information by virtue of this position or former position as a public officer.

(3) Subject to section 617 of this decree, an individual to whom this section applies shall not-

(a) deal in any relevant securities;

(b) counsel or procure any other person to deal in any such securities, knowing or having reasonable cause to believe that that other person, shall deal in them; and

(c) communicate to other person the information held or (as the case may be) obtained by as mentioned in subsection (2) of this section if he knows or has reasonable cause to believe that he or some other person shall make use of the information for the purpose of dealing, or of counselling or procuring any other person to deal, on a recognised stock exchange in any such securities.

(4) If it appears to the Minister that the members, officers or employees of or persons otherwise connected with any body appearing to him to exercise public functions may have access to unpublished price sensitive information relating to securities, he may by order declare that those persons are to be public officers for the purpose of this section.

(5) The power to make an order under subsection (4) of this section shall be exercisable by statutory instrument.

617-(1) Sections 615 and 616 of this decree shall not prohibit an individual by reason of his having any information from-

(a) doing any particular thing otherwise than with a view to the making of a profit or the avoidance of a loss (whether for himself or another person) by the use of that information;

(b) entering into a transaction in the course of the exercise in good faith of his functions as liquidator, receiver or trustee in bankruptcy;

(c) doing any particular thing if the information-

(i) was obtained by him in the course of a business of a stockbroker in which he was engaged or employed; and

(ii) was of a description which it would be reasonable to expect him to obtain in the ordinary course of that business, and he does that thing in good faith in the ordinary course of that business; or

(d) doing any particular thing in relation to any particular securities, if the information was of a description which it would be reasonable to expect him to obtain in the ordinary course of that business, and he does that thing in good faith in the course of that business.

(2) An individual shall not, by reason only of his having information relating to any particular transaction, prohibited by-

(a) section 615(2), (4)(b), (5) or (6) of this decree from dealing on a recognised stock exchange in any securities; or

(b) section 615(7) or (8) of this decree from doing any other thing in relation to provisions mentioned in paragraph (a) of this subsection; or

(c) section 616 of this decree from doing anything, if he does that thing in order to facilitate the completion or carrying out of the transaction.

618-(1) Where a trustee or personal representative is a body corporate, an individual, acting on behalf of that trustee or personal representative who, apart from paragraph (a) of section 617(1) of this decree would be prohibited by any of section 615 or 617 of this decree from dealing, or counselling or procuring any other person from dealing, in any securities, deals in those securities or counsels or procures any other person from dealing in them, shall be presumed to have acted with propriety and accordingly exempted from the provisions of sections 615 and 617 of this decree:

Provided he acted on the advice of a person who-

(a) appears to him to be an appropriate person from whom to seek such service; and

(b) did not appear to him to be prohibited by virtue of section 615 or 616 of this decree from dealing in those securities.

(2) In this section, the expression "with propriety" means otherwise than with a view to the making of a profit or the avoidance of a loss (whether for himself or another person) by the use of the information in question.

619. No transaction shall be void or voidable by reason only that it was entered into in contravention of section 615 or 616 of this decree.

620. An insider who contravenes any provision of section 615 of this decree or any person who contravenes any provision of section 616 of this decree shall be guilty of an offence and-

(a) liable to compensate any person for any direct loss suffered by that person as a result of the transaction, unless the information was known or with reasonable diligence could have been known to that person at the time of the transaction; and

(b) accountable to the company for the direct benefit or advantage received by the insider as a result of the transaction.

(2) An action to enforce a right created by subsection (1) of this section may be commenced only within 2 years after the date of completion of the transaction that gave

rise to the cause of action.

621. An individual who contravenes the provisions of section 615 or 616 of this decree shall be guilty of an offence and on conviction liable to imprisonment for 2 years or a fine of #5,000 or both such fine and imprisonment.