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INSIDER TRADING AND THE CULPABILITY OF CORPORATE OFFICERS UNDER THE NIGERIAN LAW

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Abstract

Insider trading is said to occur where an individual or organization buys or sell securities while knowingly in possession of some confidential information which is not generally available and which is likely, if made available to the general public to materially affect the prices of those securities. Thus, there had been widespread concern about the misuses of confidential information by officers of the company in particular, their associates, their families and friends to whom information about the company had been divulged. Moreover the misuse by outsider such as accountants, auditors, bankers and even lawyers, who might have access to restricted information about the company, would affect the value of the shares on the stock market. In other to curb this unfair advantages held by those corporate officers, the writers examined the various laws such as the Companies and Allied matters Act 2004, Investment and Securities Act, Securities and Exchange Commission Act etc. put in place to checkmate these corporate officers. The papers conclude by making useful recommendations, on how to eliminate the high-handedness of those corporate officers in the sale and purchase of shares of a company.

***Keyword**: Insider trading, culpability, corporate officers, company law.*

1. INTRODUCTION

One of the areas where the laws have developed so much is in the field of company law. And in area of company law that has been of much concern over the years to scholars and practitioners alike, and which has been of little notice or consideration by investors, but it advertently affects their stake in the sale and purchase of securities is in the area of insider trading.

Directors and other officers who are the alter ego of any organization or corporation and often in the position are to know price sensitive information about the company. Thus the law relating to insider trading forbids an insider from using material insider information to his advantage. The person who buys or sells on the basis of material non-public information is usually any person who has access to the price-sensitive information about the securities of the company or a person who has received the insider information from them.

Insider trading is also said to affect adversely the confidence of investors in the securities of companies, thus making it a matter of public concern as the practice discourage legitimate investment in corporate shares. Beside the fact that insider trading may harm the company and other parties to the transaction is also considered unethical because insiders are fiduciaries and so owe a duty not to profit from their position without the consent of their corporation. Obviously therefore in dealing with company securities it is incumbent on the directors or corporate officers to avoid any misuse of any price – sensitive information regarding the company securities.

Hitherto, insider trading was provided for under section 614 – 624 of CAMA, 1990. It is however sad to note that these sections were not provided for under the present companies and Allied Matters Act, 2004. Without gainsaying the fact, this omission or oversight is seen by the writers as grievous. However to allay the fears of the outsiders, or shareholders, who suffer from the antics of the Directors, insider trading is now covered by **Section 88 of Investment and Securities Act 2004**.[1] Therefore, an aggrieved party can now take either a civil or criminal action against an offender under **Section 87 and 93 of ISA 2004** respectively. It is also of great importance to note that though insider trading was not specifically provided for under CAMA 2004, the provision of **Section 279, 280 and 282** respectively which deals with the duties of care and skill, go a long way to show that Directors owe fiduciary duty which include the duty against the misuses of insider information to his own advantage and to the disadvantage of others.

The writers critically dealt with the concept of insider trading, who can be termed to be an insider, the information that could be classified as insider information, acts that are prohibited by the statute, insider trading under the various statutes.

[1] Cap 124 L.F.N 2004 (hereinafter referred to as ISA 2011)

A. The concept of insider trading

Insider dealing is said to occur where an individual or organization buys or sells securities while knowingly in possess of some confidential information which is likely, if made available to the general public to materially affect the price of those securities. The import of the above exposition is that if for instance a company's director, who is aware that the company is in a bad financial state, sells his shares with the knowledge that in a few days time, the news will be made public that there will be a cut in dividend payment, insider trading would have resulted.

Insider trading extends 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 his position or former position as a public officer. Thus, in **Cramleigh Precision Engineering Ltd v Bryant**[2] the defendant had acquired valuable technical information as the plaintiff/managing director subsequently formed a company and they sought to use the information gathered from his previous employment for his own advantage and that of his company. The previous employer sought an injunction, which the court decided against the former officer and his company, as to do otherwise would be allowing him to commit a breach of his duty of confidence.

An insider of a company is not to buy or sell securities of the company that are offered for sale or subscription if before sale or purchase had vital confidential information connected with the securities that are yet to be disclosed to the public. For instance **Section 88 (1 – 3) ISA, 2004**[3] provide thus:

> *"Subject to section 90 of this Act, 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 he knows is unpublished price – sensitive information in relationship to those securities – an individual has information which he knowingly obtained/directly or indirectly from another individual who is connected within six month precisely the obtaining of the information so connected, the former individual knows or has reasonable cause to hold the information by virtue of been so connected, and the former individual knows or has reasonable cause to believe of the latter's connection and position, it would be reasonable to expect him not to disclose the information is unpublished price shall not himself deal in securities of any other company, if he knows that the information is unpublished price – sensitive and its relate to any transaction (actual or contemplate) involving the first company and the other company or involving of them and securities of the other, or the fact that any such transaction is no longer contemplated".*

[2] (1965) 1 W.L.R 1293
[3] Ibid

Where a transaction is going on, or being contemplated between one person and other, or between two companies with regard to securities of any of them, an insider is precluded from active or passive participation in such transaction. The objection seek by insider trading springs from the moral and equitable principle that a person put in a position of trust ought not to be allowed to profit from that position. The power committed to the Directors or other corporate officers have to be used in good faith and for proper purposes. In **Allen v Hyatt**[4] where directors induced shareholders to part with their shares on the misrepresentation that the shares needed to effect an amalgamation of the company with another, the directors were held to account to the shareholders for the profit made from the transaction on the ground that the directors were acting as agent for the shareholder.

Today, the prevailing opinion seen to have been similar in that a director renders himself guilty of fraud, if he purchases the holding of a minority shareholder without disclosing to him special circumstances such as assuming sales, merger or other fact or condition enhancing the value of the stock known by the officer or officers, not known by stock holder and not to be ascertained by an inspection of the book.

B. Who is an insider?

An important factor to consider here is that there is restriction to the use of the term to a human person. This connotes that a corporate body cannot be regarded as an insider[5]. The said section lays down the broad parameter for determining an insider.

First, he must be a person, who is at anytime in the preceding six months is knowingly connected with the company.

Secondly, a connection with companies is to be determined by two types of relationships. In the first place a person is deemed to have a connection if he is a director of a company or another company related to the first one. Although a person may accept a directorship of two companies or another company related to the first one, which is not in competition, he may not use any confidential information which he gains in one company for the benefit of the other unless the former company agrees to it.

The second class consist of the officers and employees of the company or a related company within this category, falls all persons who are involved with the company or related company on professional or business basis Directors automatically are insiders. But in the second category, the overriding factors is that by this relationship, the officer or business associate is placed in the unique position in which he may reasonably be expected to have access to the securities of either companies or to unpublished price – sensitive information that ought not to be disclosed in the normal course of business[6]. Persons in these two classes are absolutely prohibited from trading in the securities of the company or its holding or subsidiary company. Under **Section 16 of the America Securities Exchange Act, 1934**, an insider of a company

[4] (1914) 30 T.L.R 44

[5] See section 614 2 CAMA, 1990

[6] Section 614 (2) (b) CAMA, 1990

is defined to include every person who is directly or indirectly the beneficial owner of more than ten percent of any class of any equity shares.

Section 95 (2) (a) (b) (c) of ISA 2004 provides that:

> *An individual is an insider of a company if he is or not anytime in the preceding six months has been knowing connected with a company; an individual is connected with a company, if but only if – he is a director of that company or a related company, 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 group of which he is a director) and the first company or a related company which is either case may personally 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 person in his position not to disclose expect for the proper performance of his functions.*

The above position is also provided in CAMA 1990. Therefore, the expression "insider" under the above section cover any employee, accountant, creditor, solicitor, banker or management consultant of a company (or a related company) if by virtue of their position, they are reasonably likely to have access to unpublished price-sensitive information which they would normally be expected to keep confidential except for the proper performance of their functions. The policy under this head is to encompass persons who because of their association with a company are likely to have access to price-sensitive inside information. Accordingly, a shareholder in that capacity is not an insider, since he has no access to this kind of information or deal in securities of this kind.

Secondly, there is the expression "related company". In other to understand the nature of a related company, it is necessary to see Section 95 of ISA 2004 and section 614 of CAMA, 1990 which defines it as "anybody corporate which is that company or a subsidiary of that company's holding company.

C. Acts that are prohibited by insider trading

Section 88 of ISA 2004 makes provision of prohibition of dealing in securities by insiders. The acts prohibited by this statute are the purchase or sale of any other form of dealings in Securities by an "insider". The Act provides that an "insider" of a company is not to buy or sell securities of that company that are offered for sale or subscription, if before the sale or purchase he had confidential information connected with the securities that was undisclosed to the public. The Act provides thus:

> *"Subject to Section 90 of the Act, an individual who is an insider of a company shall not buy or otherwise deal in the securities of the company which are offered case may personally 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 reachable to expect a person in his position not to disclose except for the proper performance of his functions."*

The above position is also provided in CAMA 1990. Therefore, the expression "insider" under the above section cover any employee, accountant, creditor, solicitor, baker or management consultant of a company (or a related company) if by virtue of their position, they are reasonably likely to have access to unpublished price sensitive information which they would normally be expected to keep confidential except for the proper performance of their functions. The policy under this head is to encompass with a company are likely to have access to price-sensitive inside information.

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> *"Subject to section 90 of this Act, an individual who is an insider of a company shall not buy or otherwise deal in the securities of the company which are offered to the public for sale or subscription if he has information which he knows is unpublished price – sensitive information as relation to these securities. The provision of subsection (3) of this section shall apply where - an individual has information which he knowingly obtains (directly or indirectly) from another individual who is connected with a particular company or was at anytime within the six months preceding the obtaining of the information so connected the former individual knows or has reasonable cause to hold the information by virtue of being so connected, and 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 function attached to that positions......."*

It should be observed that what the Act has tried to do is to prevent trading in secret information relating to securities of companies. Accordingly, it is also required that a situation where a person obtains an unpublished price-sensitive information about the securities of a company which are still secret to members of the public, neither the receiver nor the supplier of the information can deal in the securities of the company.

The prohibition covers all dealings in any securities on the stock exchange by a person already prohibited under the Act. Such a person cannot counsel or procure any other person to deal in the securities. And not only an insider is expected not to deal in any specified securities, he is also debarred from communicating the secret information to any person who might pass it on to some person who might pass it on to some other person that might likely make use of it for the purpose of dealing in the particular security[7].

E. Insider Trading under CAMA 2004

It is sad to note that "insider trading" is not included in CAMA 2004. No reason was adduced for this non-inclusion. However, the section of CAMA 2004, prohibits a director from engaging in any business which conflict with the interest of the company. The Act also prohibits any director from unduly disclosing or making use of the company's information to his advantage or to the disadvantage of an outsider.

[7] Emiola A. Nigerian Company Law, Emiola Publisher, Ogbomosho, Nigeria 2000 P. 241

The question that is begging for an answer is, now that the provision of insider trading is omitted in CAMA, 2004, can a director or any officer of the company be free to deal on insider trading?

The CAMA 2004 provides that a director of a company stands in a fiduciary relationship towards the company, and shall observe the utmost good faith towards the company in any transaction with it or on its behalf.[8] The consequence of this is that, there shall be no conflict of interest in the discharge of his duties as a director. He is also barred by virtue of his office from the use of company property to achieve undue advantage. He shall make no secret profit and shall not misuse corporate information whether as an officer or after resignation. According to **Tom,** the director shall continue to be accountable and can be restrained by an injunction from misusing the information received by virtue of the previous position[9] as strong as the sanction in sections 279 and 280 of CAMA, 2004. We are of the humble view that they do not effectively replace the sanctions in insider trading as stated in sections 621 and 622 of CAMA, 1990. Rather, they reinforce the fiduciary duty of a director and directors are likely to fear more the nebulous provisions of sections 279 and 280 of CAMA, 2004. This seems to be one reform too many, just as scarcity of cases and freedom from directors to act the way they like cannot be a reason for the exclusion.

Section 279 of CAMA, 2004 makes provision for the duty of directors. The section provides thus:

> *A director of a company stands in a fiduciary relationship towards the company and shall observe the utmost good faith towards the company in any transaction with it or on its behalf. A director shall also owe fiduciary relationship with the company in the following circumstances. Where a director is acting as agent of a particular shareholder where even though, he is not an agent of any shareholder, such a shareholder or other person in dealing with the companies securities. A director shall act at all times in what he believes to be the best interest of the company as whole so as to preserve its assets, further its business and promotes the purposes as a faithful, diligent careful and ordinary skillful director would act in the circumstances.........”*

[8] See section 270, 280, 282 CAMA 2004

[9] TOM D.F. Nigerain Business Law (Enugu, Chenglo Ltd, 2006) pp. 205 – 206.

Also section 280 CAMA, 2004 provides thus;

> *"The personal interest of a director shall not conflict with any of his duties as a director under this Act. A director shall not in the course of management of affairs of the company, or in the utilization of the company's property, make any secret profit or achieve unnecessary benefit". A director shall be accountable to the company for any secret profit made by him or any unnecessary benefit derived by him contrary to the provision of subsection 2, of this sector. The duty not to misuse corporate information shall cease by a director or an officer having resigned from the company and it shall still be accountable and can be restrained by an injunction from misusing the information received by virtue of the previous position."*

The concept as applied to directors dealing in their company securities is based on the proposition that a director occupies a position of trust in relation to his company, as such, exercise his power in the best interest of the company.[10]

It is a rule of law that directors' power are conferred on them to be used for the benefit of the shareholders as a whole and not for the benefit of the directors themselves[11] or a section of the shareholders or of employees of the company.[12]

The use of unpublished price sensitive information about the shares of the company by a director is an abuse of director's power. This principle was approved in the case of **Regal (Hastling) Ltd v Gulliver**[13] where the company owned one cinema and the directors decided to acquire two others with a view to selling the whole undertaking as a going concern. For this purpose, they formed a subsidiary company to take the lease of the other cinema but the owner insisted on a personal guarantee from the directors unless the paid up capital of the subsidiary was at least ∈5,000. The company was unable to subscribe in cost for more than 2,000 shares and the directors were not willing to give personnel guarantees. Accordingly, the original plan was changed instead of the company subscribing, for all the shares in the subsidiary, the company took up 2,000 and the remaining 3,000 were taken by the directors and their friends. Later, instead of selling the undertaking, all the shares in both companies were sold, a profit of nearly ∈3 being made on each of the shares in the former subsidiary.

The new controller of the company then caused it to bring an action against the former directors to recover the profit made.

[10] Alaxander v Automatic Telephone Company (1902) 2 ch. 56
[11] Cooks v Deck (1916) 1 AC 554
[12] See sec. 297(4) CAMA 204
[13] (1942)1 All E.R.378

A unanimous House of Lords following the well known cases on trustee particularly **Keech** v **Sandford**[14] held that the directors were liable to account once it was established, and it has been that (I) what the directors did was so related to the affairs of the company that it could properly be said to have been done in the course of their management and utilization of their opportunities and special knowledge of directors (II) What they did resulted in a profit to themselves.

A similar obligation is imposed on a director to account for a profit made by another person dealing in the company's securities, if the director has improperly communicated unpublished price – sensitive information about the company affairs to that person and he used it to his advantage.[15]

F. Insider Trading under Nigeria Law

A mere direct control or regulation of insider trading in Nigeria was introduced by the **Securities Exchange Commission Act, 1990** and the Self Regulatory Device employed by the Nigeria stock exchange.

Section 6(E) of the Securities and Exchange Commission Act provides that;

> *"The commission is charged with the duty of 'protecting' the integrity of the 'securities market' against any abuse arising from the practice of insider trading not withstanding anything to the contrary in the companies Act."*

In order to ensure fair play, Section 1(2) of the Act[16] prohibits an insider from engaging in any stock market business of a character subject to its regulation without full disclosure to and approval of the SEC prior to the particular transaction.

The **Companies Act 1968** did not make provisions against insider trading. The Nigerian Law Reform Commission, noting that insider dealing has been generally condemned as evil and should be discouraged made recommendation for regulating it.

The statutory provisions which are contained in chapter 5 of the CAMA, 1990 are substantially similar to the provision of the **Companies Securities (Insider Dealing) Act, 1985**.

The main features of the Act are criminal sanction[17], civil action[18] for anyone injured by insider trading and widening of the scope of who is an insider.[19] The Act prohibits the following category of insider trading.

[14] (1726) ch 61
[15] See Securities and Exchange Commissioner v Texas Gulf Sulphur Co. (1902) 2 ch
[16] Cap 124 L.F.N 2004
[17] Section 621 CAMA, 1990
[18] Ibid section 620

i. An insider of a company trading in the securities of that company
ii. An insider of one company trading in the securities of another company
iii. An insider (a tippee) trading with information obtained from an insider.
iv. Person contemplating a takeover dealing in securities in a different capacity.

The securities traded in must be those which are offered to the public. Dealing in securities of private companies is excluded because according to section 22 (2) CAMA 1990, a private company is restricted from transferring shares. The information must be one which the insider holds by virtue of his connection with the company. The information must also be such that it would be reasonable to expect a person in his position not to disclose except for the proper performance of his function.

Finally, the insider must know the information to be price-sensitive in relation to the securities, actual or subjective knowledge is required here.

G. Legal Action

The sanction which could be imposed for insider trading activity could be classified as civil, criminal and administrative. In some jurisdiction the regulatory authority is free to choose the appropriate kind of sanction, while in others there are criteria to be followed while making such choice. Generally, administration sanction is favoured in many jurisdiction since it is quicker and result in a more timely imposition of sanction. Such sanctions are provided for in both CAMA, 1990 and ISA, 2004.[20]

H. Civil Sanctions

Apart from the statutory redress in Section 620 CAMA 1990, the aggrieved party to insider trading is entitled to all civil remedies available in law and equity in such circumstances.
In law, damages is itself independent head of claim quite apart from restitutional remedy available in equity.

Some of the remedies provided for by section 620 CAMA, 1990 and those available at common Law and Equity seems to have overlapped. Section 620 (a) for instance provides for payment by an insider who in breach of section 615 and 616 suffered by that person as a result of the transaction, however there is an exception if the information was known or with the exercise of reasonable diligence could have been known to the person at the time of transaction. It seems clear that equity cannot come to his aid in the circumstance.

If, however unjust enrichment or advantage is proved by virtue of the transaction, he would be held to account to the company for the benefit or advantage received or receivable by the insider as a result of the transaction.

[19] Ibid section 614(2)
[20] Section 619 CAMA 1990 and Section 87 ISA 2004 respectively

I. Criminal Penalties

In a majority of jurisdictions, insider trading activity can be punished with imprisonment (e.g. for up to 10 years in the United States of America and South Africa) and high fines (e.g. a fine not less than the profit realized and up to the profit's remedy). However, the prosecution in a panel case generally must prove the element of an offense "beyond reasonable doubt". The CAMA 1990 however stipulated two criminal offences; Section 621 is penalty for the breach of section 615 and section 616 of the statute. The penalty for that offence is two years imprisonment with an option of a fine of ₦10,000 or both.

Section 622 on the other hand imposes stiff penal sanctions on an insider whose willful or reckless conduct contravenes any position of Part XVII of the Act. The penalty of that is imprisonment for five years on conviction or fine of ₦10,000 in the alternative or both. Also under **Section 87 of ISA 2004**, it provides thus:

> *"Any person who contravenes the provision of section 81,82,83 and 85 of this Act commits an offence and is liable on conviction to a fine of not less than ₦500,000 or to imprisonment of a term not exceeding three years or to both such fine and imprisonment."*

Establishing the guilt of an offence under the provision of **Section 622 CAMA 1990** and **Section 87, ISA 2004**, the Act should be deliberate. It must be a conscious and deliberate intention of the person regardless of the effect in others.

J. Administrative Sanctions

In other jurisdiction, the regulation and supervisory authorities often have the power to impose administrative sanctions in cases of insider trading. The sanctions against regulated firms include censure, a revocation of license, limitation on the actions or operations of registered securities. A person involved in insider trading can also be disqualified from being appointed to the management of a company for certain period, ordered to pay the amount of any profit made by insider trading and fined up to a certain amount. In some cases, the supervisory authorities after imposing administrative sanctions can notify the public prosecutor who can initiate a penal sanction against the insider. Many jurisdictions see the sanctions as most effective and efficient way to deter further misconduct on the market though they are not as severe as personal sanction. They can be imposed much faster and proof is by "balance of probability" and not "beyond reasonable doubt".

II. Conclusion

Section 29 of the Securities and Exchange Commission Act, 2004 define insider trading as a situation where a person or group of persons who are in possession of some confidential and price-sensitive information, not generally available to the public, utilized such information to buy or sell securities for the benefit of himself or any person.

Insider trading is objectionable in that it among others, harms the cooperation, reduces the confidence of investors in the securities market and constitutes an unfair additional remuneration to directors and officers of the company. The jurisdiction for the rule against insider trading was hinged on public policy. The practice of insider trading affects adversely the confidence of investors, thus making it a matter of public concern.

Insider trading is a monumental evil which though may not be completely wiped out in the Nigerian corporative system. Hence the need for a comprehensive legislation aimed at protecting investors against the practice.

Thus, statutory regulation in Nigeria is imperative in order to ensure a capital market free from the improper activities of share, speculators and insider traders. It is also imperative in order to engender a high degree of confidence by investors in the capital market and provide adequate protection for these investors. The provision for civil liability in the Act as a sanction against insider trading is quite commendable.

However, the provision for criminal liability in the Act, may not sufficiently deter insider transaction. **Section 87 of ISA 2004**, provides for punishment of three years or a fine of ₦500,000 for violation of section 81, 82, 83, 84 & 85 of ISA 2004. The enforcement of this provision may be difficult and costly. It should be noted that a shareholder who has suffered a loss as a result of the activities of an insider cannot be personally compensated in damages if criminal action is resorted to. The purpose of criminalizing insider trading may be auspicious. However, we are of the humble view that it cannot provide adequate remedy to an injured company or shareholder. An ordinary shareholder is therefore not interested in whether an insider who trade in his shares is thrown into jail or not, all that he is interested in is to be compensated for his loss or to get back the undue profit made by the insider in term of the price of the securities between the time he induced him to buy or sell and the time of sell or purchase by the insider. As a matter of practical significance, criminal sanction for an economic offence is not a significant deterrence as the offender is not made to disgorge his profit and the victim is not compensated.

Finally, there should be more stringent laws that will prohibit or reduce to the barest minimum insider trading. By so doing, investors can put their capital to work and put their fortune at risk because they trust that the market place is honest.

III. Recommendations

Arising from the above, the following recommendations are therefore made:

i. Section 614 – 624 CAMA, 1990 which dealt with insider trading should be reinstated in CAMA, 2004 and reinforced.

ii. Section 88 of the investment & Securities Act 2004, which made provision that an insider must know that the person he received the information from is connected to the company within six months preceding the time the information was obtained, should be amended or possibly expunged. This is because it can be used as a defense

by the insider on the ground that he was not aware of the fact that the person who gave him the information is connected with the company as to acquire insider information.

iii. Efforts should be concentrated in strengthening the enforcement of the civil sanctions provided for in the **Section 95 ISA 2004**. This the government can do by providing the Securities & Exchange Commission with the necessary machinery like fund and qualified personnel to monitor and where appropriate institute civil action against violators of the rule.

iv. Our laws should be amended to give investors a private right of action against insider trader. This, will no doubt raise the confidence of private investors who are individuals affected by the act of the insider trades that they can claim their right individually not through the company alone.

v. The administrative sanctions can also be introduced and made more effective by suspending offenders from capital markets and stagnating promotion of erring officers.

vi. Offenders of insider trading should be prosecuted and when found guilty should be jailed without option of fine for a period of not less than ten years.

If the above recommendations are adhered to, the writers are of the opinion that the activities of insider trading will be reduced to the barest minimum if not fully eradicated. By so doing our market will enjoy the highest level of confidence in the world’s stock exchange market.

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