THE SCOPE OF INSIDER TRADING LIABILITY FOR TIPPEES UNDER THE NIGERIA'S INVESTMENT AND SECURITIES ACT*

Abstract

The prohibition of insider trading is orchestrated by moral, social and economic considerations; but, more importantly, the acknowledgment that prosecuting insider trading is fundamental to the creation of a transparent and equal securities market for all participants. In keeping with this trend, various countries of the world have enacted laws to regulate insider trading. The United States of America obviously is at the forefront of the fight against this practice and she is closely followed by the United Kingdom. Nigeria is not left out of the fight against insider trading via the Investment and Securities Exchange Act. However, the prohibition is not only restricted to insiders who might have traded on corporate securities on the basis of unpublished price securities but also to individuals who trade in a corporate securities based on unpublished price sensitive information received from corporate insiders otherwise known as tippees. This paper therefore critically examines the scope of insider trading liability for tippees under the Investment and Securities Act.

Keywords: Insider trading, Liability, Tippees, Investment and Securities Act, Nigeria

1. Introduction

In today's information – driven society, the world is being increasingly structured around the collection, manipulation and use of information.[1] Information is therefore central to investing successfully in the financial markets. As such, it has been rightly pointed out in the case of *SEC v Materia*[2] that nowhere is this information more valuable or volatile than in the world of finance, where facts worth fortunes while secret may be rendered worthless once revealed. Thus, directors and other insiders in any type of corporation could take advantage of confidential corporate information not available to external or non – managerial investors to trade in their corporate securities to the detriment of the corporation. By reasons of their positions, insiders within a corporation may acquire information that when made public, will affect the value of the corporate securities. And due to the delay between the time such information is available to such an insider and the time that it becomes public, an insider familiar with the ultimate market impact of the information may trade advantageously to realize profits, usually by buying from existing investors and selling to potential investors. However, the prohibition of trading is not only restricted to insiders who might have traded on corporate securities on the basis of unpublished price securities but also to individuals who trade in a corporate securities based on unpublished price sensitive information received from corporate insiders otherwise known as tippees. As such, this paper examines the scope of the insider trading liability of the tippees under Investment and Securities Act.[3]

2. Definition of Terms

Insider

The *Black's Law Dictionary* defined insider as someone who has knowledge of information not available to the general public.[4]Zekos, on his own part, defined insider as any person who has access or has been given access to inside information.[5] The writer is of the view that this definition by Zekos appears unfair because people who are ignorant to the status of the information may be subjected to the prohibition. However, in providing clarity on who an insider is, Section 315 ISA defined an insider as any person who is connected with the company in one or more of the following capacities:

(a) A director of the company or a related company;
(b) An officer of the company or a related company;
(c) An employer of the company or a related company;

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[1]J Boyle, 'Blackmail and Insider Trading' (1992) 80 *California Law Review* 1413.
[2](1984) 745 F2d 197.
[3]ISA, 2007.
[4] Garner, *op cit*, p 915.
[5] G I Zekos, 'Logistics of Information is the Antidote against Insider Trading,' **(**2008) 6 (1) *Hertfordshire Law Journal*,
49.

(d) An employee of the company involved in a professional or business relationship to the company;
(e) Any shareholder of the company who owns five percent or more of any class of securities or any person who is or can be deemed to have any relationship with the company or member;
(f) Members of audit committee of a company, and any person who is listed in paragraph (a), who by virtue of having been connected with any such person or connected with the company in any other way, possesses unpublished price sensitive information in relation to the securities of the company.

Insider Trading

The concept of insider trading was defined by Olawoyin as the purchase or sell of securities of a company by or on behalf of a person whose relationship in the company is such that he has superior and undisclosed information on the securities while the other party to the transaction is uninformed.[6]. Jadesola also defined insider trading as the purchase or sale of securities in breach of fiduciary duty or other relationship of trust and confidence by persons who have access to material information that is not available to those whom they deal or trade generally.[7] Furthermore, *Black's Law Dictionary* defined insider trading as the use of material, non-public information in trading the shares of a company by a corporate insider or other person who owes a fiduciary duty to the company.[8] The writer is of the view that this definition of insider trading and that of Jadesola are restricted to only those who owe a fiduciary duty to the company. In other words, it does not take cognizance of situation where an individual outside a company purchase or sell corporate securities while in possession of unpublished price sensitive information in a manner that did not involve an insider's breach of duty to the corporation. In effect, liability according to *Black's Law Dictionary* and that of Jadesola's definitions of insider trading are predicated on a fiduciary relationship between the trader and the company thereby excluding liabilities of tippees and other non- insiders.

Tippees

Tippees in simple terms is a person who knowingly obtained, directly or indirectly confidential information from an insider.[9] In other words, a tippee to qualify as a tippee must know the person from whom he obtained the information.

3. Prohibition of Insider Trading Under the Investment and Securities Act

The Investment and Securities Act[10] is the principal legislation regulating insider trading in Nigeria.

3.1. Prohibited Acts

Trading when in Possession of Unpublished Price Sensitive Information

Section 111(1) of ISA generally prohibits any person who is an insider of a company from buying, selling or otherwise dealing 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 relation to those securities. Indeed, in every instance, the law limits the prohibition to situations in which the information possessed by the party is unpublished price sensitive information. For the purpose of insider trading liability, the precondition to be considered is that they actually possess information which they know is unpublished price sensitive information. The statutory phrase 'which he knows is unpublished price sensitive information' suggests that possession of unpublished price sensitive information is required for insider trading liability to attach. Furthermore, for insider trading liability to occur, a necessary element is the defendant's knowledge of the nature of the information, more accurately, the knowledge that the possessed information is unpublished price sensitive information.

[6]G A Olawoyin, *Status and Duties of Company Directors* (Ile-Ife, University of Ife Press, 1977) p 144.
[7]L S Jadesola, 'Regulating Insider Dealing: The Nigerian Experience', (2009) 4(1) *International Journal of Law and Contemporary Studies*, 55; D Pilla*et al*, 'Impact of Insider Trading on Investment Decision by Investors', (2014) 2(4) *International Journal of Advance Research in Computer Science and Management Studies*, 249; G F Parker, 'The Regulation of Insider Trading in Japan: Introducing a Private Right of Action' (1995) 73 (3) *Washington University Law Review*, 1399; R. Pennington, *Company Law* (8thedn, London: Butterworths, 2001) 463; R Kumar and R Arya, 'A Study on Prohibition of Insider Trading under Companies Act 2013/**,** (2018) 120 (5)*International Journal of Pure and Applied Mathematics*, 58.
[8]Garner, *op cit*, p 915.
[9] CAMA, s 615
[10]ISA, 2007.

Thus, the basic prohibition common to all insider trading prohibition is that persons, who come within the prohibitions cannot buy or sell securities when in possession of unpublished price sensitive information relating to corporate securities. The section also, 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 case the information cannot be said to be generally known. There must be a public disclosure. Thus, 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 repealed Companies Act of 1968, if the document is one that requires filing, then this would amount to publication under the constructive notice rule.[11] But the constructive notice rule, to a large extent, is no longer part of the Nigerian Company Law, so that a person is not necessarily affected with notice by such deposition.[12] As such, the trader must know that the information is price sensitive and non-public. Actual knowledge is required. However, insiders can trade if the information becomes public.

Counseling or Procuring Dealings in Securities

Section 111(6) ISA prohibits persons who are prohibited under section 111(1) ISA from dealing on an approved securities exchange or capital trade point in any securities from counseling or procuring any other person to deal in the securities concerned knowing or having reasonable cause to believe that the person will deal in those securities. The ISA does not define what the words 'counsel' or 'procure' mean. However in *R v Calhaem*,[13] the word 'counsel' was interpreted to mean 'to advise' or 'solicit' while in *Winsmore v Greenwich*,[14] 'to procure' was interpreted to mean 'persuade with effect'. Consequently, either counseling or procuring can occur without the passing on of unpublished price sensitive information from the insider to the person counseled or procured. As such, not to include counseling or procuring in the ambit of the law would have left a gaping hole in the legislation since an insider might as well secure somebody or recruit somebody to deal without passing to that person price sensitive information.[15] In both counseling or procuring, for there to be an offence, the defendant must know that the information he is possessing or the information he is basing his counseling or procuring, is unpublished price sensitive information. As such, the section prohibits counseling or procuring dealings in corporate securities while in possession of unpublished price sensitive information.

Communicating Price Sensitive Information

Section 112 (3) (c) of ISA prohibits a person from communicating the unpublished price sensitive information to any other person if he 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.[16] Again, the prohibition 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 prohibition on communication applies only if the communication is made with the expectation that the person would deal, if it is made with the expectation that the person would refrain from dealing, there is no liability. The law is silent in the liability of the person to whom the information is communicated if he actually deals in such circumstance; the researcher is of the view that the person would only be liable if he qualifies as a tippee. The law is also silent as regards person who aids and abets insider trading. The writer is of the view that it should also be an offence for a person to aid and abet

[11]The rule was clear that anyone dealing with the company was deemed to have notice of the registered document which were regarded as public documents; *Re Jon Beauforte (London) Ltd* (1953) Ch.131; A AOjo, 'A Legal Excursion into the Consequences and Effects of the Doctrine of Ultra Vires in Nigerian Corporate Governance', (2017) 65 Journal of Law, Policy and Globalization, P 224.

[12]CAMA, s 68; *Royal British Bank v Turquand* where the court states that outsiders dealing with a company are not bound to ensure that all the internal regulations of the company have in fact been complied with as regards the exercise and delegation of authority: but they are entitled to assume that all acts of internal management have been properly carried out in accordance with the maxim 'omnia praesumuntur rite et solemniter esse acta' – 'all things have been done properly and solemnly which ought to have been done'.

[13](1985) QB 808.

[14](1745) Willes 577.

[15] The difference between counseling and procuring as seen from the judicial appreciation of the words is that, in the case of counselling, even if the person counselled did not deal eventually, the counsellor would have committed offence whereas in the case of procuring, the procurer is not capable if the person procured ended up not actually dealing.

[16] This section applies to public officers, former public officers and their tippees.

insider trading activity, so long as they knew that an offence was occurring. This would capture brokers who place trades knowing that their clients are insiders.

3.2. Prohibited Persons

Section 111 and 112 of ISA apply to a discrete group of specified persons. The list is exclusive, if a trader is not on it, he is not subject to the section. As such, the following persons are prohibited from buying, selling or otherwise dealing in the securities of the company which are offered to the public for sale or subscription if they have information which they know is unpublished price sensitive information in relation to those securities.

Insiders

The distinction between legally permitted securities trading by insiders and what is illegal needs to be carefully understood. The presumption that an insider who is involved in the management or affairs of a public company would have access to privileged information is but natural. However, that cannot absolutely preclude insiders from acquiring or alienating any securities. Such a blanket prohibition would not be reasonable and would be in violation of the legal rights of insiders and would defy the logic of freely tradable securities. More importantly, such a prohibition may not even be practically viable as it would be irrational to stop insiders of a company from dealing in their securities. This is exactly where a distinction is required to be drawn between what is prohibited and what is not. Insiders are therefore prohibited from buying or selling or otherwise dealing in the securities of the company while in possession of unpublished price sensitive information. The restriction is on insiders directly or indirectly using the price sensitive information that they hold to the exclusion of the other shareholders in arriving at trading decisions. There is absolutely no restriction on insiders in trading in securities of the company if they do not hold any price sensitive information that the public is not already aware of. Indeed, it is unclear whether or not the ISA will apply where the insider, say a director or employee, buys or sells as an agent of someone else. Thus, an effort was made in the interpretation of section 315 by the drafters in their definition of insider trading to make the ISA applicable when the insider traded for the benefit of any person, but this meaning cannot be found in the substantive sections dealing with insider trading and as such might be of doubtful effect. The ISA also does not define benefit of the other person. However, the writer is of the opinion that by virtue of the definition dealing in securities under section 315 ISA,[17] that the provisions of section 111(1) ISA applies whether the insider traded as principal or agent. Insider as defined under section 315 ISA are only prohibited from dealing in securities which are offered to the public for sale or subscription. [18]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 the writer is of the opinion that there is stronger reason to regulate the dealing of insiders in private company or in private deals in public companies, if, as has been argued, the insider trading regulations were out to correct *Percival's* case.

Furthermore, the prohibition on the insider lasts for as long as he occupies the office and up to six months after relinquishing the office.[19] The writer is of the view that the six months period is arbitrary, however, it may be justified that six months is enough time for the information to become public or lose its ability to affect the price of the securities. Indeed, this is not necessarily so, though 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 objectives of insider trading regulations. As such, the objective is the suppression of the abuse of information acquired by virtue of a position of trust and this objective would be better promoted if the prohibition was made to last as long as the information remains non-nonpublic.

Again, prohibiting an insider of a company from buying or selling or otherwise dealing in the securities of the company seem too narrow. If the insider as a result of his privileged position in the company has unpublished price sensitive information about another company with whom his company deals and thereupon deals in the securities of the other company, it seems he would not be caught. The writer therefore recommends the adoption of a better approach that will make an insider culpable not only where he buys and sells security in his company on the strength

[17]Section 315 ISA defined 'dealing in securities' to mean (whether as principal or agent) making or offering to make with any person, or inducing or attempting to induce any person to enter into or to offer to enter into: (a) any agreement for or with a view to acquiring, disposing or subscribing for, or underwriting of securities; or (b) any agreement the purpose or pretended purpose of securing a profit to any of the parties from the yield of securities or by reference to fluctuations in the price of securities.

[18]ISA s 111(1).

[19]*Ibid*, s 315.

of unpublished price sensitive information but also if he buys or sells securities of another company on the basis of unpublished price sensitive information of the other company which he has as a consequence of being an insider of the first company. The ISA has adopted this approach in relation to tippees of corporate insiders under section 111(3) (a) ISA[20] and it is unclear why the same prohibition does not extend to insiders.

Persons Contemplating Take Over

Section 111 (4) ISA prohibits a person contemplating or has contemplated making (whether with or without another person) a takeover offer[21] for a company in a particular capacity from dealing in securities of that company in another capacity if he knows that the offer is contemplated or is unpublished price sensitive information in relation to those securities. Thus, the individual making the bid is prohibited from dealing in the securities of the target company otherwise than as a takeover bidder. As such, 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 ISA.[22] Furthermore, insiders of the bidder and target companies are also prohibited from tipping confidential information on a tender offer, and any person possessing information on a tender offer from trading in the target's securities if substantial steps towards the commencement of the bid have been made.[23] It is important to point out that section 111 (4) ISA is applicable independently from any violation of fiduciary duties. As such, the prohibition is triggered by possession of confidential information, and therefore completely ignores the issue of breach of fiduciary duties in order to effectively regulate insider trading in relationship to a tender offer.

Public Officers

Section 112(1) (a) of ISA prohibits public officers or former public officers who hold information which is reasonable to expect a person in his position not to disclose except for the proper performance of the functions attaching to that position and the public officers know it is unpublished price sensitive information in relation to securities of a particular company. Section 112 generally prohibits abuse of information obtained in official capacity. Essentially, any public officer or former public officer and by virtue of his position (a) holds any information which he knows is unpublished price sensitive information in relation to securities of a particular company or; (b) he knows or has reasonable cause to believe he held the information by virtue of any such position, is prohibited from dealing in such securities, counselling or procuring other persons to deal in such securities. In addition, such a public officer or former officer is also prohibited from communicating such information to any other person if he knows or has reasonable cause to believe that he or some other persons shall make use of the information for the purpose of dealing, counselling or procuring any other person to deal on a securities exchange or capital trade point in any such securities.[24]

Tippees

The classic tipper-tippee scenario in insider trading violation involves an insider (tipper) discloses price sensitive information to an outsider (tippee), who subsequently trades on the basis of this information. Section 111(2) of ISA prohibits any person from buying, selling or otherwise dealing in the securities of the company which are offered to the public for sale or subscription where: (a) such a person has information which he knowingly obtains (directly or indirectly) from another person who is connected with a particular company, or was at any time within the six

[20] By s 111(3) (a) ISA, tippees of corporate insiders, once they know that the information is inside information in relation to the securities or transaction (actual or contemplated) involving the company or any other company or involving one of them and the securities of the other or that the said transaction is no longer contemplated, can no longer deal in the securities of the company.

[21]By Section 117 ISA, 'takeover' means the acquisition by one company of sufficient shares in another company to give the acquiring company control over that other company.

[22] Under Section 131(1) ISA, where any person acquires shares, whether by a series of transactions over a period of time or not, which (taken together with shares held or acquired by persons acting in concert with him) carry 30 per cent or more (or any lower or higher threshold as maybe prescribed by the Commission from time to time) of the voting rights of a company; or together with persons acting in concert with him, holds not less than 30% but not more than 50% (or a lower or higher threshold as maybe prescribed by the Commission from time to time) of the voting rights and such person or any person acting in concert with him, acquires additional shares which increase his percentage of the voting rights, such person shall make a takeover offer to the holder of any class of equity share capital in which such person or any person acting in concert with him holds shares.

[23]ISA, s 111(4).

[24]ISA, s 112 (1).

month preceding the obtaining of the information so connected; (b) where the former person 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 attached to that position.

4. Conditions for Tippee's Liability

To find liability against a tippee, the following conditions must be met:

(a) The person from whom the unpublished price sensitive information was obtained must be insider or be such an insider within the six months preceding the obtaining of the information;
(b) The tippee must know about or have reasonable cause to know that the insider holds the information by virtue of his capacity as an insider;
(c) The tippee must know or have reasonable cause to believe that because of the insider's connection and position, it would be reasonable to expect him not to disclose the unpublished price sensitive information except for the proper performance of the functions attached to his position. [25]

Knowledge of the Insider Status of the Information

In other words, a tippee to qualify as a tippee must know the person from whom he obtained the information. Also, 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 of his office. Nevertheless, the more pressing inquiry is the meaning of the word 'obtained'. ISA is silent as to its meaning. However, it was held in the case of *R v Fisher*[26]that 'obtain' connotes some positive effort on the part of tippee so that a tippee who is merely told to deal will not be prohibited. But on appeal in *Attorney Generals Reference (No 1 of 1988),*[27] 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. The writer is of the view that this does not solve all the difficulties that might arise. What of the secretary who reads the directors 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 talks of receiving directly or indirectly from an insider. In essence, this is an 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. The writer is of the view that in such a case it appears that liability will depend on his knowledge of the status of the person whom he overheard.

Knowledge of Proper Disclosure

Moreover, 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 of his office.[28] It appears that it is the subjective knowledge of the tippee that is important. Nevertheless, the writer is of the view that the knowledge should not be entirely subjective for if it were, the alleged tippee would be able to escape liability merely by pleading that he did not know that the insider would not be reasonably expected to disclose the information. Again, a tippee remains prohibited so long as the information remains nonpublic. Furthermore, a tipper may be liable for the insider trading of a tippee even when the tipper did not himself trade. Like persons who trade while in possession of unpublished price sensitive information, tippers may be liable for penalties up to three times the profit earned from or loss avoided by the actual trader. [29] Other civil and criminal penalties may apply as well. As such, both the tipper and a trading tippee are both liable for insider trading when without disclosing the information to the public, the tipper breaches a fiduciary duty to the company by spreading the information to the tippee and the tippee knows, or should know, that the breach took place.

The writer is of the view that these conditions of liability of a tippee restricts the scope of the section and the question is what happens in a situation where a person is unaware of the insider connection with a company or trades on the basis of unpublished price sensitive information not obtained from an insider. The ban covers only those who hear from a defined insider and as such, secondary and tertiary tippees may freely trade. In other words, the provision of section 111(2) of ISA does not apply to trades between the initial tippee and the tippee's purchaser/

[25]ISA, s 111(2).
[26] Unreported cited in B Hannigan, *Insider Dealing* (London: Kluwer Law Publisher, 1988) p 72.
[27](1989) AC 971.
[28]ISA, s 111(2).
[29]*Ibid*, s116.

seller of the security who is not an insider and also subsequent trades between the tippee's purchaser/seller and other purchasers/sellers which do not fall under trades between a corporate insider and the initial tippee. The section should be amended to capture trades between tippees and subsequent purchasers/sellers in possession of unpublished price sensitive information which do not fall under trades between a corporate insider and the initial tippee from the corporate insider. [30]

It also does not prohibit a tippee from giving the information to another person. For example, the chairman of United Bank for Africa Plc is on his way to a meeting and makes a phone call. His driver overhears parts of the conversation and picks up information about an upcoming takeover which is likely to boost the price of shares of United Bank for Africa Plc Plc. The driver realizes that this significant news for his son who for a long time has been thinking about buying shares in United Bank for Africa Plc. Therefore, he immediately tells his son, who buys a large number of shares. The son also tells a friend about the information he received from his father. Who has violated the insider trading provision? In essence, who will be liable for insider trading since ISA provided that the tippee must have received the information from an insider that has breached a fiduciary duty?

5. Conclusion and Recommendations

The provisions of section111 (2) ISA therefore leaves unanswered question regarding the liability of a tippee where the tippee is unaware of the insider connection with a company or trades on the basis of unpublished price sensitive information not obtained from an insider. As such, where the unpublished price sensitive information is revealed to a third party through a long chain of tippees-tippers, the person trading might escape liability even when he trades on the basis of unpublished price sensitive information being aware of the inside nature of the information. The writer therefore recommends that liability suffices where the tippee know or ought to know of the unpublished price sensitive information and that the tippee does not need to have received the information from an insider that has breached a fiduciary duty. In other words, even if the unpublished price sensitive information is revealed to a third party through a long chain of tippers-tippees, the person trading might be liable as long as he/she trades on the basis of unpublished price sensitive information being aware of the inside nature of the information. Also, a tippee should not only be prohibited from trading but also from tipping such information. As such, any tippee regardless how remote who knowingly possess unpublished price sensitive information should be prohibited from trading on or tipping such information.

[30]Remote tippees.