The University of Namibia

“The effectiveness of Namibian legislation in the regulation of the offence of Insider Trading”.

by

Quinton Silvanus Haoseb

Submitted in partial fulfillment of the requirements for the Degree

Bachelor of Laws

at

The University of Namibia

Supervisor: Ms. K. Nuughweda

Research dissertation presented in fulfillment of part of the requirements for the degree of Bachelor of Laws. The other part of the requirements for this qualification was the completion of a programme of courses.

I hereby declare that I have read and understood the regulations governing the submission of dissertations for the relevant degree, including those relating to length and plagiarism, as contained in the rules of the University, and that this dissertation conforms to those regulations.

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Faculty of Law

Statement on Authenticity

I, the undersigned,

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Do hereby state as follows:

I am registered with the University of Namibia for the degree of Bachelor of Laws under student no. 200744917. The dissertation, which I hereby submit for the degree of Bachelor of Laws at the University of Namibia is my own work and has not been previously submitted by me or any other person for a degree at this or any other tertiary institution. I have not used any other sources than those listed in the bibliography and quoted in the references.

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Supervisor's Certificate

I, _______________________________ hereby certify that the research and the writing of this dissertation was carried out under my supervision.

Supervisor's signature: _____________________________

Date: _____________________________

Acknowledgements

Many people helped me throughout my degree. My dissertation lecturer Professor Horn has laid a fundamental groundwork that continuously supported and guided me as regards the academic framework for my dissertation writing. I am especially indebted to my thesis advisor, Ms. K. Nuughweda, for her guidance in both my professional development and intellectual growth. I am grateful to the past and present lecturers of the Faculty of Law at the University of Namibia for providing me with a wonderful learning environment. Particularly, Mr. K. Kangueehi for cultivating my interest in corporate law, once more Professor Horn for his seemingly encyclopaedic legal insight and last but not least, Ms. Y. Dausab who continues to influence, and bring sunshine and joy to, the study of law. I am grateful to my family for their incredible help throughout my course of study. I thank my grandmother, my aunt and uncle for their support. I want to express my extreme gratitude to them for their continuous and unselfish love. In addition, thanks are due to many other friends and colleagues and everyone that has been there for me throughout this academic experience. Without them, I would not have achieved anything.

Abstract

Securities trading by officers, directors, and other key employees of corporations who have access to private information has generated some of the most sensational scandals in the popular business press.[1] There are considerable fraudulent or otherwise legally reprehensible activities that are commonly found in the area of commercial practices involving dealing in securities.[2] The basic purpose of this paper is to set out and explain the present law and practice governing the commission of the offence of 'insider trading' in Namibia. This thesis discusses whether the Namibian legal system sufficiently provides for the monitoring, detection and prosecution of the offence of insider trading. The paper further discusses whether trading on the basis of non-public material information should be regulated, at all. The study compares the Namibian legal position on insider trading with the position the United States and England, taking a closer look at the key elements of insider trading provisions enacted in those two jurisdictions. The thesis shows the differences between the different systems regarding liability for the offence and finally, after a comparative study between U.S, English and Namibian law, recommendations for Namibian law reform will be made

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[1] Hu, J & Noe, T (1997) *The Insider Trading Debate*. Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter, 34

[2] Ibid.

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Date: ___________________________

Supervisor's Certificate

I, ________________________________ hereby certify that the research and the writing of this dissertation was carried out under my supervision.

Supervisor's signature: _____________________________

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Abstract

Securities trading by officers, directors, and other key employees of corporations who have access to private information has generated some of the most sensational scandals in the popular business press.[1] There are considerable fraudulent or otherwise legally reprehensible activities that are commonly found in the area of commercial practices involving dealing in securities.[2] The basic purpose of this paper is to set out and explain the present law and practice governing the commission of the offence of 'insider trading' in Namibia. This thesis discusses whether the Namibian legal system sufficiently provides for the monitoring, detection and prosecution of the offence of insider trading. The paper further discusses whether trading on the basis of non-public material information should be regulated, at all. The study compares the Namibian legal position on insider trading with the position the United States and England, taking a closer look at the key elements of insider trading provisions enacted in those two jurisdictions. The thesis shows the differences between the different systems regarding liability for the offence and finally, after a comparative study between U.S, English and Namibian law, recommendations for Namibian law reform will be made.

[1] Hu, J & Noe, T (1997) *The Insider Trading Debate*. Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter, 34

[2] Ibid.

CHAPTER 1: INTRODUCTION AND BACKGROUND OF THE RESEARCH

1.1 Statement of the problem

Unlike other illegal activities, insider trading remains, at least among economists and legal scholars, one of the most controversial economic transactions. A substantial body of academic and legal scholarship questions whether insider trading is even harmful, much less worthy of legal action. The views on insider trading range from moral revulsion to positive evaluations of its economic benefits. In turn, many scholars support the current restrictions placed on insider trading while others advocate a laissez-faire government policy.[3]

A number of financial economists and law professors who take the position that insider trading ought to be legal, base their case on the proposition that insider trading makes the stock market more efficient. Presumably, the inside information will come out at some point. Otherwise, the insider would have no incentive to trade on the information. If insider trading was legal, this group argues, insiders would bid the prices of stocks up or down in advance of the information being released. The result is that the price would more fully reflect all information—both public and confidential—about a company at any given time.[4] Those who are opposed to insider trading state that insider trading amounts to theft of a company or corporation's property and must be controlled to reduce and avoid the consequences it may have for companies and financial markets. Prohibiting insider trading is the best means of protection and is important for any company to remain competitive and efficient.[5]

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[3] Hu, J & Noe, T (1997) *The Insider Trading Debate*. Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter, 34

[4] Leland, HE *Insider Trading: Should It Be Prohibited?* (1992) Journal of Political Economy 100, 859-87.

[5] Bainbridge, SM *The Insider Trading Prohibition: A Legal and Economic Enigma* (1986) 38 *University of Florida Law Review* 35. The arguments in favour of and against the regulation of insider trading are discussed further in Chapter 3 of this paper.

Namibian law does not have a definite stance on the offence of insider trading. There is no specific statutory law enacted to deal with the offence, nor are there any reliable juristic writings on the topic. The true legal position of insider trading in Namibia is not properly exposed in legal literature and therefore it is difficult to combat the commission of the offence in terms of Namibian law.

1.2 Research questions

The main research question which this paper seeks to answer is whether the Namibian legal system can be said to have laws in place that *effectively* regulate and combat the offence of insider trading. The following sub-questions are also answered in the paper:

- Who commits the offence of insider trading?
- What constitutes privileged, confidential or 'price-sensitive' information?
- What are the legal consequences for persons who are found guilty of insider trading?
- Should insider trading be legally regulated?

1.3 Purpose of the study

Firstly, a comparative study into the approach of different legal systems gives insight into the contrasting views surrounding insider trading and the different rationales behind those views. From those different views, one can decide which approaches can be imported into the Namibian legal system. Secondly, the purpose of this study is to point out the international trends and standards in connection with the regulation of insider trading. The purpose thereof is to determine if Namibian law is up to date with international standards of commerce. The hypothesis of this study is that the Namibian legal system is ineffective in the regulation of insider trading and that new legislative mechanisms of reform are begging for implementation. In

order to confirm the accuracy of the aforesaid hypothesis, an overview of Namibian law as regards insider trading is made and contrasted against the approach in other jurisdictions, namely England and the United States of America. This serves the ultimate purpose of determining if Namibian law is up to standard from an international perspective, and hence whether reform law is needed.

1.4 Significance of the Study

The law in Namibia on the subject of insider trading is not well developed and our judicial system relies heavily on the insider trading laws of other jurisdictions while presiding over domestic disputes.

Currently it is only the new Companies Act of 2004[6] and the previous Companies Act of 1973[7] that come close to regulating the offence. Even so, the 2004 Act has only one section[8] which relates to the offence of insider trading, and the 1973 Act also applies to insider trading only by virtue of section 440B and section 44C.[9]

There are thus no specific statutory enactments which deal with the offence of trading in Namibia, unlike England which has the *Criminal Justice Act of 1993 (CJA)* that specifically deals with the offence of insider trading.[10]

This paper contributes to the body of existing knowledge in that the findings in this dissertation show the extent to which Namibian law needs reform. This paper exposes the lacunae in our law

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[6] Companies Act 28 of 2004
[7] Companies Act 61 of 1973
[8] Section 241 which is discussed in Chapter 2 of this paper.
[9] These sections are also discussed in Chapter 2of this paper.
[10] Let me mention in passing that South Africa also enacted the Securities Services Act 36 of 2004 and the Insider Trading Act 135 of 1998 which specifically deals with the offence. The latter Act is however said to be flawed in some respects. See the comments of Osode,PC "The New Insider Trading Act: Sound Law Reform or Legislative Overkill?" (2000) 44 *Journal of African Law* 239.

and thereby highlights the areas of our legal framework that need supplementary amendment. This study also determines to what extent Namibian law is contributing to the protection of investors and hence the motivation of investor confidence, and the maintenance of the good reputation of our market. Finally, this paper is significant because it additionally contains suggestions and recommendations for possible law reform and for the harmonisation of divergent scholarly opinions into an appropriate policy framework for regulating insider trading.

1.5 Limitation of the study

Insider trading is a broad concept and cannot be encapsulated completely in this paper alone. The thesis is therefore limited firstly to the provisions, statutory and otherwise, which regulate insider trading in Namibia.[11] Secondly, for the purpose of comparative study, reference will be made to insider trading regulatory provisions in England and the U.S.[12] The study therefore does not discuss all the regulatory provisions of Namibian, English and American law but only those which I selected as significant to the context of the study.

1.6 Research methodology

Desktop reach was the main type of research methodology for this paper. A number of libraries were visited to access relevant books, journals, statutes and other relevant materials like case law and court decisions. The researcher also refers to relevant websites which were consulted for additional information. This diversity in research material was important and convenient because it gave the researcher access to the opinions of various commentators and authors. The dates

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[11] These are predominantly the Companies Act of 2004 and the Companies Act of 1973 and applicable principles of the common law relating to companies.

[12] In the case of England, only the provisions of the Companies Act of 1980 and the Criminal Justice Act of 1993 (CJA) will be discussed. In the case of the United States, only the provisions of the Securities Exchange Act of 1934 and other rules developed by the Securities Exchange Commision will be discussed.

referred to on the websites are the dates on which the websites were last accessed by the researcher. Finally, a comparative research method was be employed, where the researcher made comparative studies between Namibia insider trading laws and those of selected countries that may have more effective regulatory frameworks in place, to learn from their experiences and for purposes of possible application in Namibia.

CHAPTER 2: LITERATURE REVIEW

2.1 Introduction

A lot of desktop research was done, hence the research entailed reading various books and articles for information and insight on the various chapters and the topics discussed in this paper. The books and articles which can be singled out as being the source of the bulk of the information constituting this paper are indicated and elaborated on below. The discussion is made in order of literature relating to Namibian, English and American law on insider trading, respectively.

2.1.1 Namibian Law on insider trading

The only documented source of reference when dealing with insider trading in Namibia is statutory law. In particular, the Companies Act of 2004 and the Companies Act of 1973 relate to the offence.[13] Section 241 of the 2004 Act[14] outlines who qualifies as an insider for the purpose

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[13] Section 440B of the old Companies Act 61 of 1973 is still in force, and this section established The Securities Regulation Panel which, amongst other things, has the power to investigate any discrepancies that may be apparent from an affected commercial transaction.[13] The section states:
(1) There is hereby established a body corporate to be known as the Securities Regulation Panel. (2) Subject to the provisions of subsection (6), the members of the panel shall be appointed by the Minister and shall consist of (a) the chairperson; (b) the Registrar or his or her nominee; (c) the chairperson of the Competition Board established by section 3 of the Maintenance and Promotion of Competition Act 96 of 1979, or his or her nominee; (d) three persons each nominated by the Johannesburg Stock Exchange and the Council of South African Banks; and (e) one person nominated by each of such bodies, associations and institutions, limited to a maximum of fifteen such bodies, associations and institutions which- (i) the Minister in consultation with the panel, has determined as being sufficiently representative of the relevant interests in the regulation of securities; and (ii) have been designated by the Minister by notice in the Gazette. Section 440C deals with the functions of the panel and provides that (1) The functions of the panel shall be to (a) regulate, in such manner as it may deem necessary or appropriate (i) all transactions or schemes which constitute affected transactions; (ii) all proposals which on successful completion or implementation would become affected transactions; and (b) supervise dealings in securities that are contemplated in this Chapter.

[14] *Every director, past director, officer or person who has knowledge of any information concerning a transaction or proposed transaction of the company or of the affairs of the company which, if it becomes publicly known, may be expected materially to affect the price of the shares or debentures of the company and who deals in any way to his or her advantage, directly or indirectly, in those shares or debentures while that information has not been publicly announced on a stock exchange or in a newspaper or through the medium of the radio or television, or through*

of the crime. The section also makes mention of what amounts to price-sensitive or privileged information for the purpose of the crime. Furthermore, the section indicates that insider trading can only be committed by persons dealing in *shares* or *debentures*. I am of the opinion that this is an inadequacy. The offence of insider trading can very much be committed in respect of securities other than shares or debentures. For example, insider trading in the UK can be committed in respect of securities such as futures contracts.

Section 241 also goes on to prescribe a fine of N$8000 and/or imprisonment not exceeding two years if found guilty of the offence. I am of the opinion that this part of the section is too stringent and should be afforded some flexibility. Insider trading usually involves dealings in securities like shares far exceeding the amount of N$8000. The offence can relate to shares worth millions of dollars. It would therefore be disproportionate to punish someone with N$8000, when after illegally dealing in a certain security, such person makes a profit of, say, one million dollars. Section 241 should therefore be amended to include a phrase like 'or any punishment, monetary or otherwise, which the Court deems appropriate in the circumstances'.

Furthermore, section 241 only covers insider trading in respect of companies. The section is therefore flawed as regards the illegal inside dealings in securities of institutions which are not companies. For example loan stocks are a type of security given by the Government or a responsible organ of State. Section 241 only refers to Companies and therefore insider trading in respect of loan stocks is not expressly legally prohibited.[15]

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other electronic media commits an offence and is liable to a fine which does not exceed N$8 000 or to be imprisoned for a period which does not exceed two years or to both the fine and imprisonment.

[15] The detailed discussion of the offence in the Namibian context is made in Chapter 3 of this paper.

The researcher also made use of the writings of Barry[16]. He mainly evaluates the ongoing debate between the regulation and deregulation of insider trading. He highlights the sentiments of some commentators who feel that insider trading is beneficial because it increases market efficiency and others who feel it is prejudicial because it diminishes investor confidence and thereby destroys the reputation of a given market. This piece of literature is helpful in answering the research sub-question, namely whether insider trading should be regulated.

The review of literature on insider trading has also brought to light the fact that statutory provisions that prohibit insider trading often overlap with common law rules that prohibit fraud in general. As such, the review of relevant case law that incorporate these principles of common law will be discussed.

2.1.2 English Law on insider trading

In the U.K insider dealing was made a specific criminal offence by the Companies Act 1980 and was subsequently incorporated in the *Company Securities Insider Dealing Act 1985* which was reenacted in 1993 and is currently contained in Part V of the *Criminal Justice Act of 1993 (CJA)*. The writer Brazier[17] discusses the scope and context of insider regulation in the U.K. He highlights several changes in the evolution of legislation against insider dealing in the U.K and these could be helpful for recommendations on law reform for Namibia. He asserts that insider trading is trading is usually committed by persons who are closely connected to the company such as directors, employees and officers of the company. The writer Rider[18] further adds that persons who have a professional or business relationship with the company also commit the offence. From that foregoing, it is clear that U.K. law focuses on particular categories of persons who are capable of committing the offence. However, in Namibia section 241 provides that

[16] Barry, V. (1983) *Moral Issues in Business* Belmont, CA: Wadsworth Publishing Company
[17] Brazier, G. (1996) *Insider Dealing Law & Regulation* London: Cavendish Publishing Limited.
[18] Rider, BAK. (1983) *Insider Trading* London: Jordan & Sons Limited

every person who has privileged information about a company and trades on the basis of that information commits the offence. It is thus immaterial in terms of section 241 whether such person is a director, employee or officer of the company or has a professional or business relationship to the company as required by U.K. law. Inside information is defined in the Criminal Justice Act 1993 as well as in the law establishing the Financial Services and Markets Act 2000 (FSMA).[19]

2.1.3 American Law on insider trading

The controversial insider trading debate dates back to the 1920s when its effect was first felt in the United States of America after a heavy crash occurred in its Stock Markets in 1929. Currently, the U.S laws on insider trading are not developed by Congress, but are derived from common law principles of fraud.[20]

The governmental body in charge of regulating insider trading is the Securities and Exchange Commission (SEC), which was established by the Securities and Exchange Act of 1934 (referred to subsequently as the 1934 Act).[21] The 1934 Act, its amendments, and additional legislation passed in subsequent decades formulate the legal bounds on insider trading. Among all the code sections, the broad language in Section 10(b)-5 banning any "manipulative or deceptive device" used "in connection with the purchase or sale of any security" is the most often cited legal basis for banning insider trading. The courts have interpreted this section of the law, in cases such as

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[19] The Act also prescribes civil penalties for insider trading in section 118 thereof. This is a significant difference from our Companies Act of 2004 which makes no provision for civil sanctions. The authors Stamp, M & Welsh, C. *(*1996) *International Insider Trading* London: FT Law & Tax discuss the international trend in insider trading regulation and is a valuable source for the comparative study that this paper intends to make and the search question it seeks to answer.

[20] Stamp, M & Welsh ,C. *(*1996) *International Insider Trading* London: FT Law & Tax, 4

[21] Hu, J & Noe, T (1997) *The Insider Trading Debate*. Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter, 34

Speed v Transamerica Corporation[22] as a broad prohibition of insider trading that takes advantage of confidential information.

Sections 10(b) and 17(a) of the 1934 Act are interpreted as more generally prohibiting insider trading on material, nonpublic information about the firm. Section 16(b) requires the returning of short-swing profits by insiders to the corporation, with a short swing defined as “round-trip” transactions (a purchase and a sale or a sale and a purchase) within six months; and Section 16(c) prohibits short sales by insiders.

Besides the above-mentioned sources, many other sources, not the least of which includes journals and internet websites, have been consulted in the gathering of information for the research paper. These sources are cited in the paper in Chapter 3, which deals with a detailed outline of the offence of insider trading.

[22] 99 FSupp. 808, 828-32 [D. Del. 151]

CHAPTER 3: THE OFFENCE OF INSIDER TRADING- A COMPARATIVE EXPOSITION WITH ENGLISH AND AMERICAN LAW.

3.1 General definition of insider trading

Insider trading is a term that most investors have heard and usually associate with illegal conduct.[23] But the term actually includes both legal and illegal conduct. The legal version is when corporate insiders—officers, directors, and employees—buy and sell stock in their own companies.[24] When corporate insiders trade in their own securities, they must report their trades to the relevant body that is entrusted with the task of monitoring such a trade.[25] Trading by corporate insiders such as officers, key employees, directors, and large shareholders may be legal, if this trading is done in a way that does not take advantage of non-public information.[26]

Illegal insider trading refers in general to the purchasing or selling of a security, in breach of a fiduciary duty or other relationship of trust and confidence, while in possession of material, non-public information about the security. In some cases, the information allows the person so buying or selling to profit, and in other cases, to avoid a loss.Insider trading violations may also include "tipping" such information,[27] securities trading by the person "tipped," and securities trading by those who misappropriate such information. Insider trading violations may also include "tipping" such information, securities trading by the person "tipped," and securities trading by those who misappropriate such information.[28]

[23] Stein, S (2001) *New standards for "legal" insider trading*. *Community Banker*. 66
[24] Ibid.
[25] For instance in the U.S. the Securities and Exchange Commission (hereinafter referred to as the SEC) is one such body. In Namibia, the Securities Regulation Panel has mandate over certain transaction concerning securities.
[26] Elder L "Legalize insider trading" http://www.capmag.com 6 June May 2011.
[27] I.e. informing members of the public about material information concerning a security when such information is sanctioned to be confidential.
[28] Barry, V. (1983) *Moral Issues in Business*, 242

In the context of insider dealing, what an 'insider' will try to do is to buy or sell (or suggest that others buy or sell) securities when he is in possession of information which may alter their price; but he will do so before such information has been made public and has therefore had a chance to have any such effect.[29] Such information will usually relate in particular to the company in question. Its value will depend on its precise nature, exactly who is aware of it and what they are then prepared to do.[30] "A very generalised attempt at defining the criminal offence of insider dealing would be along the following lines: a case of insider dealing in securities will usually involve the buying or selling of certain securities relating to a company by a person connected to that company who is, in doing so, in possession of specific information which relates to those securities and is not generally known but which would be likely, if made public, to have a significant effect on the market price of the securities."[31]

"Insider dealings refer to the ability of key employees to profit from knowledge or information that has not yet become public."[32] The mischief which insider dealing law is aimed at preventing, however, is clear. Those close to a company must not be allowed to abuse their position by making use of information in their possession, which concerns securities of that company, to some personal advantage.[33] Although insider trading involves making investment decisions using information that should be confidential, it is not the so using of all information that is not publicly available that will be characterised as insider trading. The general yardstick against which criminal liability for the offence is measured is that the information must be anything that

[29] Brazier, G (1996) *Insider Dealing Law & Regulation*, 76
[30] Brazier, G (1996) *Insider Dealing Law & Regulation*. Ibid.
[31] Brazier, G (1996) *Insider Dealing Law & Regulation*, 81
[32] Barry, V. (1983) *Moral Issues in Business* 242
[33] Barry, V. (1983) *Moral Issues in Business* Ibid.

can reasonably be expected to have a significant effect on a company's share price. The source of the information and the way in which it is acquired also affects the legality of trading on it.

3.2 Regulatory Framework

3.2.1 Namibia: The new Companies Act[34] is the legislation applicable to insider trading and dealings in securities of companies by virtue of section 241. The previous Companies Act[35] also applies to insider trading through section 440B-C which establishes the Securities Regulation Panel. Apart from those provisions of the two Acts there are no further statutory regulations for the dealings in securities of companies. This means that all other matters related to insider trading in Namibia are to be determined by the application of relevant common law principles, and where our courts deem fit, by the application of persuasive foreign legal authorities.

3.2.2 England: In England insider dealing was made a specific criminal offence by the Companies Act 1980 and was subsequently incorporated in the *Company Securities Insider Dealing Act 1985* which was reenacted in 1993 and is currently contained in Part V of the *Criminal Justice Act of 1993 (CJA)*. The Financial Services and Markets Act 2000 (FSMA) in section 118 creates civil penalties for market abuse which run parallel to the criminal offences. These are the dominant statutory enactments as regards the regulation of Insider Trading in English law.

3.2.3 United States: In the U.S the securities regulations do not have a specific insider trading code. In fact, U.S. insider trading prohibitions are based on English and American common law prohibitions against fraud. Hence Stamp & Welsh[36] contend that unlike most European countries,

[34] Companies Act 28 of 2004. Section 241 is discussed in more detail in 3.3.1 of this Chapter
[35] 61 of 1973
[36] Stamp, M & Welsh, C (1996) *International Insider Trading*, 4.

US laws against insider trading do not consist of statutes defining certain prohibited activities. Instead, the US insider trading scheme is very much the product of a common law system, shaped in the large measure by judicial interpretations of several overlapping statutory and regulatory prohibition. The Securities Act[37] was the first piece of legislation in the U.S to regulate dealing in securities. Currently, however, the main regulatory framework for insider trading is the Securities Exchange Act[38]. The Act comprises rules relating to the commission of the offence which have mostly been developed by case law, the bedrock of which is the anti fraud Rule 10b-5 of the Securities and Exchange Commission. The Securities Exchange Act empowers the SEC to take all such steps as it may deem necessary to maintain fairness and honesty within the market, and thereby safeguard the honest image of the market and thereby retain the confidence and trust of investors. The dominant section governing insider trading is section 10(b) of the Securities Exchange Act.[39] Section 10(b) is worded in very general and open ended terms which give the SEC the discretion to give the provision wider amplitude of interpretation. For example, a person may not use any *manipulative or deceptive device or contrivance* when dealing in securities. Exactly what amounts to manipulative and deceptive is undefined and gives the SEC the power to classify the conduct of an accused person itself. “The US Securities and Exchange Commission… has resisted the enactment of a statutory scheme

[37] Securities Act of 1933. Section 17 of the Act generally contained prohibitions of fraud in the sale of securities.
[38] Securities Exchange Act of 1934.
[39] Section 10(b) of the Act provides as follows:
It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange:
(a) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the [Securities and Exchange] Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

defining the offence, believing that the current rather loosely-worded statutes and rules provide the flexibility necessary to deal with changing market practice and problems."[40]

In addition to section 10(b), the SEC has adopted the famous Rule 10b-5, which provides:

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facilities of any national securities exchange:

(1) To employ any device, scheme or artifice to defraud;

(2) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading; or

(3) To engage in any act, practice or course of business which operates or would operate on a fraud or deceit upon any person;

in connection with the purchase or sale of any security

Section 16(b) of the Securities Exchange Act prohibits any profits gained in violation of any prohibitive legal provisions, from any purchases and/or sales within any six month period made by corporate directors, officers, or stockholders owning more than 10% of a firm's shares. This is similar to the position in the U.K. where no offence will be committed if the individual delays his exploitation of the insider information for a period of six months and a day.[41] Under section 16(b)... applies regardless of whether the person who made the profit used or possessed material non-public information in trading. Furthermore, under s 16(b), a 'profit' is earned any time a

[40] Stamp, M & Welsh, C (1996) *International Insider Trading*, 4.
[41] The U.K. position is discussed in detail in below

person buys at one price and sells at a higher price.[42] Insider trading is also regulated in the US by the so-called '**abstain or disclose'** rule. The rule basically states that if a person is knowingly in possession of privileged non-public information, that such person has a duty to disclose the information to the relevant members of the public. If for any reason whatsoever the person in question fails to disclose the information to the public, then such person must simply abstain from trading on the basis of that information.[43]

3.3 Who commits the offence of insider trading?

3.3.1 Namibian position: The primary culprits in considering who qualifies as insiders for the purpose of the offence are the persons who are most closely connected to the company in question. These are usually the directors[44], shareholders and employees of the company. Section 241 of the Act new Companies Act[45] prohibits insider trading by "[*e*]*very director, past director, officer*…" of the company.

The prohibition of insider trading by directors, past and present, through section 241 is supplemented by the common law fiduciary duties which directors owe to their companies. "A fiduciary duty is a legal or ethical relationship of confidence or trust regarding the management of money or property between two or more parties, most commonly a *fiduciary* and a *principal*."[46] In a fiduciary relation, one person in a position of vulnerability justifiably reposes confidence, good faith, reliance and trust in the other whose aid, advice or protection is sought in

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[42] Stamp, M & Welsh, C (1996) *International Insider Trading*, 6. The discussion on Section 16 (b) herein is not exhaustive. This section is a very broad aspect of insider trading law in the US. The discussion on the section is merely a fundamental underlining of the general spirit and purport of the statute.
[43] The rule is affirmed in *Re Cody, Roberts & Co*, 40 SEC 907 (1961)
[44] *Fisheries Development Corporation of SA Ltd v Jorgensen and Another*; Fisheries Development Corporation of SA Ltd v AWJ Investments (Pty) Ltd and Others 1980 (4) SA 156 (W) affirms that executive and non-executive directors are treated equally as far as knowledge of the affairs of the company are concerned.
[45] Companies Act 28 of 2004
[46] Worth, C & Morse (1990) *Company Law* 267

some matter. In such a relation good conscience requires one to act at all times for the sole benefit and interests of another, with loyalty to those interests.[47] The nature of the relationship i.e. fiduciary relationship between directors and a company rendered the directors to act for the best interest of the company.[48] Directors owe a fiduciary duty to the company in that they are required to always act bona fide and for the benefit of the company as a whole and not for any collateral purpose such as for to benefit or to protect themselves.[49]

The fiduciary that is of most relevance to insider trading is the duty to *avoid a conflict of interest.* This duty generally requires that the director or any person who stands in a fiduciary relationship with the company must never create a situation where their personal interests conflict with that of the company's. In the context of insider trading, therefore, if a person who owes to the company a fiduciary duty of avoiding a conflict of interest uses confidential information of the company's securities to either trade on it or to procure someone to trade on it, the such is in breach of this common law fiduciary duty and can therefore be visited with legal consequences.

In ***Atlas Organic Fertilizers (Pty) Ltd v Pikkewyn Ghwano (Pty) Ltd and Others***[50] Van Dijkhorst J said "[c]learly a director acts in breach of his fiduciary duty to the company where he sabotages the company's contractual opportunities for his own advantage, or where he uses *confidential information* to advance the interests of a rival concern or his own business to the prejudice of those of his company."[51] A director has a duty not to compete improperly with the company... thereby placing himself in a position in which his duties or interests conflict.

[47] Worth, C & Morse (1990) *Company Law* Ibid.
[48] Worth, C & Morse (1990) *Company Law* Ibid.
[49] Worth, C & Morse (1990) *Company Law* Ibid.
[50] 1981 (2) SA 173 T 198H 199A Emphasis added.
[51] At 197G – H.

Robinson v Randfontein Estates Gold Mining Co Ltd[52] expounded that the law on the position of trust occupied by a director in relation to his company is clear. It is his duty to act for the benefit of the company and not for his own benefit; and that a director has a duty not to misappropriate corporate opportunities.[53] The general principle as stated by Innes CJ at 177 is that where one man stands to another in a position of confidence involving a duty to protect the interest of that other, he is not allowed to place himself in a position where his interests conflict with his duty. The case of expands the duty to avoid conflict of interest, holding that this duty also encompasses the ancillary duty of avoiding the making of 'secret profits' at the expense of the company. This duty basically dictates that a director of a company is not allowed to make profits where in so doing he would be conflicting with the company's interests. This duty generally prevents the use of confidential information obtained by a person in the course of conducting the company's business for personal exploitation. In relation to fiduciary duties, Gower[54] is of the view that 'these duties, except insofar as they depend on statutory provisions expressly limited to directors, are not so restricted but apply equally to any officials of the company who are authorised to act on its behalf, and in particular to those acting in a managerial capacity.'

There is, in my view, a problematic area in the classification of insiders for the purpose of the offence of insider trading is the classification of third parties as insiders. These are persons who have absolutely no connection to the company in question. Is it insider trading when such persons buy or sell securities based on confidential information regarding a company to which they have no contractual or otherwise professional ties?

[52] 1921 AD 168
[53] Ibid 177 - 180
[54] Gower, P (1969) *Principles of Modern Company Law* 3rd ed 518

Section 241 provides that "[*e*]*very director, past director, officer or person who has knowledge of any information concerning a transaction or proposed transaction of the company or of the affairs of the company*…" is prohibited from trading on privileged information regarding that company. The phrase 'or person who has knowledge' in the section shows that the relationship of the person to the company is irrelevant. Any person in possession of information concerning the company is prohibited from trading on the basis thereof. Therefore, not only directors and officers of the company are deemed as 'insiders' by the Act but also any member of the general public who has knowledge of the company's information, whether they are professionally connected to the company or not.

3.3.2 English Position: Section 68 the Act[55] makes a distinction is between **primary** and **secondary** (**temporary**) insiders. Section 68(1) characterises primary insiders.[56] Rider[57] elaborates this statutory provision as follows: The individual must be knowingly connected with the issuer of the securities, and be in possession of unpublished price sensitive information concerning these securities, information which he appreciates is such, and it would not be contemplated that a person in his position would disclose that information except in pursuance of a legitimate corporate purpose. If he deals in the relevant securities whilst in possession of this information, he commits an offence. It is not necessary for the prosecution to prove that he 'used' the information in arriving at his decision to deal, as this will be regarded as a

[55] Companies Act 1980.

[56] 'Subject to the defences in section 68(8)… an individual who is, or at any time in the preceding six months has been, knowingly connected with a company shall not deal on a recognised stock exchange in securities of that company 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 the functions attaching to that position; and

(c) he knows is unpublished price sensitive information in relation to those securities.

[57] Rider, BAK (1983) *Insider Trading* 15.

presumption, albeit a rebuttable one, deriving from the fact that he dealt whilst in possession of the privileged information.

Section 68(1) refers to an 'individual' and therefore the offence under this section cannot be committed by a corporate body. The individual must be knowingly connected with the company that has issued or made available the relevant securities or have been knowingly connected with that company at any time in the preceding six months. No offence under section 68(1) will be committed of the individual delays his exploitation of the insider information for a period of six months and a day.[58] In terms of section 69(4) the word 'company' means any company whether it falls within the definition of a company as defined in the relevant English company laws. Therefore, as long as the requirements of section 68(1) are met, it is irrelevant whether the issuer with whom the individual is connected is a foreign or domestic company. The prohibition of insider trading in terms of English law applies extraterritorially as well, a difference from the approach in Namibia.

Furthermore, to successfully prosecute someone as a primary insider in England under section 68(1), it is not enough for the prosecution to establish that the defendant was in possession of unpublished price sensitive information. There must be additional proof that such person is or has been 'connected' to the company to which the privileged information about the security relates.[59]

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[58] Rider, BAK (1983) *Insider Trading* 15.

[59] Section 73(1) defines what amounts to 'connected' and states that an individual is connected with a company if, but only if:
(a) he is a director of that company or a related company; or
(b)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 a director) and the first company or a related company which in either case may reasonably be

Rider[60] contends that the phrase 'professional or business relationship' is very wide. There is no need for the relationship to be contractual, although it would seem that it must have a commercial element, albeit merely the expectation of payment and the receipt of professional fees. In principle the relationship should be such that the company could restrain the misuse or unauthorised disclosure of confidential information that comprises the unpublished price-sensitive information in question. Where there is a contract with an express or implied term stipulating for confidentiality there is no problem. In other circumstances, for such information to be protected there must be at least an expectation of confidentiality between the parties, even though there may not be a fiduciary relationship.

It is important to appreciate that an individual will be regarded as being 'connected' with a company, even though his professional or business relationship is with some other company, if those companies are related to each other. The final view is thus that even if a person is in possession of privileged information when dealing in securities, such a person does not qualify as a *primary* insider if they are not in a position within the company that can reasonably be expected to give them to access privileged information. For example, a junior clerk who improperly opens and reads confidential papers concerning the securities can, for the mere fact that he is just a junior clerk, not be deemed to be in a position that can reasonably be expected to give him to access privileged information, although he is in fact in possession of such information. He would then be liable as a secondary insider.[61]

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expected to give him access to information which, in relation securities of either company, is unpublished price sensitive information, and in his position not to disclose except for the proper performance of his functions.

[60] Rider, BAK (1983) *Insider Trading* 17

[61] Rider, BAK (1983) *Insider Trading* Ibid.

3.3.3 American Position: Similar to the English approach, U.S law has classified persons into 'traditional insiders', 'temporary insiders' and 'non-insiders' for the purposes of the offence of insider trading. Traditional insiders mainly consist of persons who are closely connected to the company in question. Generally, these are directors, officers[62] and shareholders. These individuals have a well-established common law fiduciary duty to the corporation and its shareholders not to use corporate information for personal gain. Thus, it has long been acknowledged that such individuals violate their fiduciary duty to shareholders when they trade in the company's equity securities while knowingly in possession of material non-public information. Additionally, because an issuer repurchasing its shares in this market owes a fiduciary duty to its shareholders, it violates US insider trading law when it makes such purchases without disclosing material non-public information.[63]

Temporary insiders consist of a variety of otherwise independent persons who may be viewed as insiders in situations in which they are rendering professional services to a corporation. Such persons may include underwriters, lawyers, accountants, financial advisors and other consultants to a corporation.[64] Such persons may be treated as insiders for the purposes of insider trading laws where (1) a special confidential relationship exists pursuant to which the advisor has access to information which is being provided to him or her solely for corporate purposes and (2) where there is an implicit or explicit expectation that the information will be kept confidential.[65]

Non-insiders are persons who do not fall into any of the two above-mentioned categories,[66] but may nevertheless be characterized as insiders because they are in a position of having

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[62] The word officers includes employees and accounting officers.
[63] Stamp, M & Welsh, C (1996) *International Insider Trading*, 8.
[64] Stamp, M & Welsh, C (1996) *International Insider Trading,* 9.
[65] Stamp, M & Welsh, C (1996) *International Insider Trading,* Ibid.
[66] That is to say, they are not traditional or temporary insiders of the company.

unpublished sensitive information, and may use that information to trade. In ***Re Cody, Roberts & Co***[67] the facts were that a broker had received and traded on privileged information concerning the shares of a company to whom he had no professional ties and therefore owed no fiduciary or similar duties. However, the SEC found that the 'abstain or disclose' rule had a wide application and extended to persons who did not fall into the categories of traditional and temporary insiders. The SEC based this finding on the general proposition that material non-public information whether obtained directly or indirectly, should be used only for the specific corporate purpose wherefore it was divulged, and not for personal reasons, and that it would be unfair to permit an individual to trade with people on the basis of information of which they are unaware.[68] The Supreme Court of the US has however disagreed with the wide extension of the 'abstain or disclose' rule (by the SEC) to persons who do not stand in any fiduciary or similar relationship to a particular company. The Supreme, by contrast, adopted the view that the accused person can only be liable if they traded on material non-public information which they obtained in breach of a fiduciary or a similar duty.

Thus in ***United States v Chiarella***[69] an employee at a printing facility discovered by perusing office documents, albeit in breach of a workplace policy, that some companies were about to undergo takeovers. The employee traded on the basis of that discovery and purchased shares in

[67] 40 SEC 907 (1961)
[68] Ibid at 912. The desire of the SEC to prosecute persons who are not professionally related to companies is clear in a number of other cases. For instance, one can consider the case in the US of one Barry Switzer. Mr. Switzer was a football coach who was prosecuted by the SEC in 1981 after he and his friends purchased shares in Phoenix Resources, an oil company. Switzer was at a track meeting when he overheard a conversation between executives of Phoenix Resources, concerning the liquidation of the business. The information which he overheard gave him reasonable grounds to believe that an escalation in the value of the share price of the company was in order. He purchased the stock at around $42 per share, and later sold it at $59 per share, making a profit of around $98,000 in the process. The charges against him were later dismissed by a federal judge on a "lack of evidence" but the intention of the SEC was clear that a person, although not tied to a company in any professional capacity, may be guilty of insider trading in respect of that company.
[69] 445 US 222 (1980)

the companies, and later sold them for a profit. The court of first instance convicted the employee for violating Rule 10b-5, assigned a jail sentence and retrieved the profits which the employee had made. But the Supreme Court reversed the decision on appeal and held that the employee did not stand in any fiduciary duty with the companies that were targeted for takeovers. Hence the employee had no duty to 'abstain or disclose' any information concerning those companies and could therefore not be held accountable.

The case of ***United States v Chestman***[70] laid down the basic premise of the '**misappropriation theory**' as being that a person violates Rule 10b-5 if he or she misappropriates information from a company in breach of a fiduciary or similar duty. The SEC attempted to use this theory to extend liability to persons who, although not in any fiduciary or similar relationship with a particular company, misappropriates information about that company and communicates it to another person with the result that the latter then trades on the basis thereof. Again, the Supreme Court of the US visited this attempted extension of liability with judicial disapproval. The Supreme Court attacked the extension in ***United States v Bryan***[71], a case where the defendant bought securities of firms which he knew were soon going to be offered certain government contracts that would result in the increase of the price of the securities. The court held that the defendant could not be held to be in violation of Rule 10b-5 because the prohibition of 'fraud... in connection with the purchase or sale of any security' means that the fraudulent act must be perpetrate upon the counterparty to the securities transaction. The misappropriation theory improperly bifurcates these elements, creating liability where the fraud (i.e. the breach of a

[70] 947 F 2d 551, 566

[71] 58 F 3d 933 (4th Cir 1995)

fiduciary or similar duty) is perpetrated against one individual (the employer) while the purchase or sale of the securities involves another individual to whom no such duty is owed.[72]

3.4 What constitutes privileged, confidential or 'price-sensitive' information?

3.4.1 Namibian Position: Section 241 of The Companies of the 2004 Act refers to *any information concerning a transaction or proposed transaction of the company or of the affairs of the company which, if it becomes publicly known, may be expected materially to affect the price of the shares or debentures of the company*. This means that if, according to established guidelines of case law and other legal and market directives, it is found that the information on the basis of which a person has traded can materially affect the share price of a company, then such information is regarded as 'inside information' in terms of section 241. The section however requires that the information must be unpublished at the time when it is traded on. Thus if information is *publicly announced on a stock exchange or in a newspaper or through the medium of the radio or television, or through other electronic media*, the person trading on the basis thereof does not commit the offence of insider trading.

Under the common law with regard to the use or misuse of confidential information Nicholas AJA said in ***Schultz v Butt***[73] that although the equitable cause of action based on breach of confidence which is available in England does not exist in our law, it does not mean that the misuse of confidential information in order to advance one's own business interests and activities at the expense of a competitor's may not constitute a wrongful act in the context of an action for

[72] See the discussion in Stamp, M & Welsh, C (1996) *International Insider Trading,* 12. The final destiny of the misappropriation theory is as yet undecided because the Supreme Court, the Federal Courts and the SEC all have divergent views as to what the proper scope and limitations of the applicability of the theory should be. It is desirable in the American jurisdiction that the Supreme Court will pronounce itself conclusively on the issue and establish the true ambit of the misappropriation theory in the interest of legal certainty.
[73] 1986 (3) SA 667 (A) 679H

unlawful competition. In fact, in the ***Prok Africa***[74] case it was said that 'the dishonest use of confidential information is a species of unlawful interference with the trade of another which our law will not countenance.' The unauthorised use of privileged information in insider trading can therefore be actionable under the common law under the law of unlawful competition. The company can also sue under the law of contract if there was a breach of a confidentiality clause.

3.4.2 English Position: Inside information for the purpose of market abuse is defined in the Financial Services and Markets Act (FSMA).[75] Section 118 of the FSMA provides that in essence "inside information" is precise information that is not generally available and that a reasonable investor would use to help them make investment decisions. It is also information that, if generally available, would be likely to significantly affect the price of an investment. Information from research or analysis is deemed to be generally available, and is not inside information. In order for the court to be satisfied that X has indeed committed the crime of insider trading, one of the important assertions that have to be made and proved is that X traded in securities on the strength of information which is considered to be confidential or price-sensitive.

Section 56(1) of the Criminal Justice Act 1993 states that 'inside information' means information which –

relates to particular securities or to a particular issuer of securities or to particular issuers of securities and not to securities generally or to issuers of securities generally; is specific or precise; has not been made public; and if it were made public would be likely to have a significant effect on the price of any securities.

[74] *Prok Africa (Pty) Ltd and Another v NTH (Pty) Ltd and Others* 1980 (3) SA 687 (W) 696C
[75] Financial Services and Markets Act 2000

3.4.3 American Position: In the United States, as far as insider trading is concerned, information is considered material for if there is a substantial likelihood that the disclosure of the information would be viewed by the reasonable investor as having significantly altered the "total mix" of information available.[76] Although the US Supreme Court has not defined materiality in the insider trading context, the appropriate enquiry would likely be whether there is a substantial likelihood that the reasonable investor would consider the information important in making an investment decision or whether there is a substantial likelihood that the information would result in a significant change in the price of the security.[77] Non-public information is information which is considered non-public until the relevant markets have had an opportunity to fully 'digest' the information. There is some uncertainty as to whether information must have been made available to all corners of the market in order to be regarded as having become 'public'.[78] The SEC regulation FD ("Fair Disclosure") requires that if a company intentionally discloses material non-public information to one person, it must simultaneously disclose that information to the public at large. In the case of an unintentional disclosure of material non-public information to one person, the company must make a public disclosure promptly.[79]

3.5 What are the legal consequences for persons who are found guilty of insider trading?

3.5.1 Namibian Position: The person who is found guilty of insider trading faces several legal sanctions. Section 241 makes provision for *a fine which does not exceed N$8 000* and/or imprisonment *for a period which does not exceed two years*.

[76] *TSC Industries Inc v Northway*, 426 US 438 (1976)
[77] Stamp, M & Welsh, C (1996) *International Insider Trading*, 22
[78] Stamp, M & Welsh, C (1996) *International Insider Trading*, 23
[79] Harris, L. (2003) *Trading & Exchanges*, 586

Where a person trades in the securities of a particular company when he or she acquires knowledge of privileged information through contractual negotiations with the company in question, then such person may also be sued under civil law for damages arising out of breach of contract if the company or any injured party can establish that there was an express or implied term of confidentiality regarding the information relating to the securities of the company. The basis of this remedy is expounded in ***Coolair Ventilator Co (SA) (Pty) Ltd v Liebenberg and Another***[80] that the prevention of trading on privileged information insofar as the English action on breach of confidence is based on an implied contractual term relating to confidentiality of information acquired, finds its counterpart in our law in the action on breach of contract.

3.5.2 English Position: The criminal offence of engaging in insider dealing is punishable by a maximum of seven years imprisonment or an unlimited fine in terms of the FSMA. This allows the adjudicator the discretion to impose a fine that is proportionate to the potential or actual profits generated from the transaction of insider trading. The civil disciplinary regime also allows for a wider range of penalties to be imposed.

The Financial Market Services Board[81] can also apply for an injunction restraining market abuse. This remedy can be resorted to when the Board has reasonable grounds to suspect that someone is in the process of, or is about to, engage in illegal insider trading.

3.5.3 American Position: The SEC and other federal agencies and departments have several means of enforcement of insider trading restrictions. The statutory basis of all such remedies is set forth in the Securities Exchange Act. Pursuant to Section 21A of the Securities Exchange

[80] 1967 (1) SA 686 (W)

[81] The Board established by the Financial Markets and Services Act 2000.

Act, federal courts may impose civil penalties of up to three times the profits made or losses avoided from insider trading.

In addition, for controlling persons, Section 21A of the Exchange Act provides civil penalties of up to the greater of $1,000,000 or three times the profits made or losses avoided from the insider trading activities. Civil penalties are in addition to any disgorgement of profits or criminal penalties that may be imposed on a person violating insider trading laws.

Section 32 of the Securities Exchange Act provides, with certain exceptions, for criminal penalties up to a maximum of $1 million ($2.5 million for corporate entities) and ten years imprisonment for each willful insider trading violation.

In 1984 Congress passed the Insider Trading Sanctions Act of 1984 (ITSA), which provides for up to three times the insiders' illegal profits in civil penalties and a tenfold increase in criminal penalties (from $10,000 to $100,000). In 1988, Congress passed the Insider Trading and Securities Fraud Enforcement Act (ITSFEA), which creates a bounty program for insider trading informants and holds the top management of a firm responsible for its employees' illegal insider trading activities. Moreover, ITSFEA increased the maximum criminal penalties to $1 million and the maximum jail sentence to ten years. Trading partners who suffer losses because of insiders' illegal activities have the right to recover their losses under ITSFEA.[82]

Section 20(d) of the Securities Exchange Act authorizes the SEC to seek injunctive relief if it reasonably believes that a person "is engaged or about to engage in practices constituting" insider trading. This would prohibit an insider from engaging in future violations of securities laws, which is sought in almost every case brought by the SEC. In addition to injunctive relief, the

[82] Hu, J & Noe, T (1997) *The Insider Trading Debate*. Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter, 35

SEC may seek other equitable remedies, such as remedial changes in personnel and organization of a controlling person. The most significant equitable remedy available to the SEC, however, is the disgorgement of profits gained or losses avoided as a result of insider trading. It is important to note that disgorgement is sought in almost every action brought by the SEC, and is in addition to any other criminal or civil remedies. In addition to the remedies discussed above, in certain circumstances the SEC may bar persons found guilty of insider trading from acting as an officer, director, employee or affiliate of a broker-dealer, investment adviser or investment company. Thus, if an employee of a financial services company is found guilty of insider trading, that person will likely be unable to work within that industry in the future.

3.6 Critical analysis of the research findings: A comparison of the three jurisdictions

3.6.1 Insiders: Section 241 of the Companies Act of 2004 in Namibia is interpreted to mean that every director, past and present, and officer of the company, as well as *any person* is prohibited from illegal insider trading. Namibian law therefore draws no distinction between persons who are related to the company and persons who are not related to the company. It provides an umbrella prohibition that any person is disallowed from illegal insider trading. My opinion is that this is not a proper approach. It is my view that there must at least be some relationship between the company and the person accused of insider trading.[83]

This is similar to the approach in England. In English law, section 73(1)(b) of the Companies Act 1980 requires that the accused person must be in a position involving a professional or business relationship between himself (or his employer or a company of which he is a director) and the company or a related company to which the information concerning the securities relates.

[83] The relationship can be fiduciary, contractual or any other professional relationship for example the rendering of services, giving professional advice etc.

Similarly, the Supreme Court of America has predominantly held that there must first be a relationship between a person and the company to which the security relates, before such person can commit insider trading in respect of that company.[84] It is therefore my recommendation that section 241 should at least qualify the persons that can commit insider trading, instead of providing a blanket statement that any person who trades on privileged information commits the offence.

The writer Mack[85] submits that there ought to be some professional relationship between the insider and the public as regards the information in question. In other words, Mack is of the opinion that the insider should only be held criminally liable if he is sanctioned by legal, moral or other acceptable professional standards to disclose the information in question to the public before trading thereupon, and he fails to do so. If someone does not do what he or she ought to do, the causation involved may be the kind that consists in taking away of a supporting feature of an action. But without such commitment, nor even a moral duty to provide, no causation of the lack of desired advantage can be identified. Machan[86] is in favour of this notion that a special relationship must precede the disclosure of the information in question. He states that "[f]or someone to act fairly requires some prior obligation to distribute burdens or benefits among a given number of people in some suitable proportion or in line with certain specified procedures. Only when one ought to treat others alike, which may occur in special circumstances… does fairness count for something morally important. As this applies to insider trading, if I have a prior obligation to share my information with others, that is, a fiduciary duty to clients or associates, then it is not that the information is "from the inside" but that it is *owed to others* that

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[84] See the previously discussed decisions in *United States v Chestman* 947 F 2d 551, 566 and *United States v Bryan*, 58 F 3d 933 (4th Cir 1995)
[85] Mack, E (1980) 'Bad Samaritarianism and the Causation of Harm: 9 *Philosophy and Public Affairs* 1, 21
[86] Machan, TR (1996) 'What is Morally Right With Insider Trading' 10 *Public Affairs Quarterly* 135, 140

makes my dealings morally and possibly legally objectionable. It is only in such cases that fairness is obligatory, as a matter of one's professional relationship to others, one established by the promise made or contract one has entered into prior to the ensuing duty to be fair. It is only then that one causes injury by refusing to do what one has agreed to do, namely, divulge information prior to using it for oneself".

My recommendation is therefore that unless a person is an ordinary insider, there must be some professional relationship between the person trading on information and the company to which the security relates before insider trading can be committed.

3.6.2 Privileged, confidential or 'price-sensitive' information: Section 241 provides that *any information concerning a transaction or proposed transaction of the company or of the affairs of the company which, if it becomes publicly known, may be expected materially to affect the price of the shares or debentures of the company*. As long as the information can be reasonably said to have a material effect on the price of the share or the debenture of the company, then such information is privileged information. My recommendation is that section 241 does not need any amendment. The section is correctly worded as far as the context of privileged and confidential information relating to the security is concerned.

Under the Criminal Justice Act 1993 in England, a person can only be an insider if he knows that the information is inside information and that it has come from an inside source. This approach should not be followed in Namibia. Instead, the approach in the US should be followed, where there is a rebuttable presumption that any person who deals in securities on the basis of privileged information in fact *knew* that such information came from an insider and that it was inside information.

3.6.3 Legal consequences: Section 241 makes provision for *a fine which does not exceed N$8 000* and/or imprisonment *for a period which does not exceed two years*. It is my view that this penalty clause in the Act is inadequate. The Act should be amended to provide for stricter fines and prison sentences. Alternatively, section 241 can be amended to give the Court the power to impose sentences it deems appropriate according to the circumstances of each case. Guidance can be sought from the English approach. The criminal offence of engaging in insider dealing is punishable by a maximum of seven years imprisonment or an unlimited fine in terms of the FSMA in England. This allows the adjudicator the discretion to impose a fine that is proportionate to the potential or actual profits generated from the transaction of insider trading. In America, civil penalties of up to three times the profits made or losses avoided from insider trading may be imposed.[87] The SEC can also resort to disgorgement of profits gained or losses avoided as a result of insider trading, and injunctive relief when there are reasonable grounds to suspect imminent violations of insider trading regulations. It is therefore in the final analysis the my opinion that remedies such as interdicts (injunctive relief) disgorgement of profits etc should also be introduced as part of section 241 of Act 28 of 2004.

3.6.4 Securities: Insider trading usually involves the dealings in securities of companies. The general rule is that unless a security is listed in the relevant Statute as a regulated security, a person cannot commit insider trading in respect of such security even if he trades in such security using inside information. In Namibia, in relation to the securities in respect of which insider trading is committed, section 241 only refers to shares and debentures. Yet, the offence is

[87] Section 21A of the Securities Exchange Act. Section 32 of the Securities Exchange Act also provides, with certain exceptions, for criminal penalties up to a maximum of $1 million ($2.5 million for corporate entities) and ten years imprisonment for each willful insider trading violation. It shows that insider trading is worthy of severe penalties than contained in section 241 of Act 28 of 2004.

committed in respect of other securities as well.[88] Our Act should list additional securities to be regulated because insider trading is committed in respect of those securities too.

Furthermore, the Companies Act of 2004 prohibits trading in securities using unpublished price-sensitive information of relating to a 'company'. This means insider trading in respect of loan stocks[89] is not prohibited. The Act could be amended to remedy this inadequacy. The United States prohibits insider trading in respect of *any security registered on a national securities exchange or any security not so registered*. This means that even if a security is not listed as a regulated security on an American stock exchange, the rules relating to insider trading nevertheless apply in respect of that security.[90] Namibia can also use this approach, as opposed to the position in the UK where only listed securities are subject to insider trading laws and regulations.

[88] In England, Section 54 and Schedule 2 of the Criminal Justice Act 1993 outline which securities are regulated by the Act and these include, shares, debt securities, warrants, depositary receipts, options futures and contracts for differences. Our Act 28 of 2004 does recognize other securities like equity shares but this is not included in the scope of section 241.

[89] Which relate to the Government or an organ of State and not a company. A Loan stock is an instrument creating or acknowledging indebtedness and issued is by the Government or provincial or local government, various State-controlled institutions, and other institutions designated by the Minister of Finance from time to time. If Namibia can list these securities as regulated, the scope of insider trading can beneficially be widened.

[90] Section 10(b) of the Securities Exchange Act

CHAPTER 4: RECOMMENDATIONS AND CONCLUSION

4.1 The Regulation – Deregulation Debate

4.1.1 Introduction

Many arguments are advanced in favour of regulating and not regulating insider trading. Some of the most prominent arguments both in favour of and against the regulation of the offence by law, are discussed below:

Arguments in favour of Insider Trading

- Insider trading makes the stock market more efficient. Presumably, the inside information will come out at some point. Otherwise, the insider would have no incentive to trade on the information. If insider trading was legal, this group argues, insiders would bid the prices of stocks up or down in advance of the information being released. The result is that the price would more fully reflect all information—both public and confidential—about a company at any given time.[91]
- Increased price efficiency can benefit firms by reducing investor uncertainty. Price efficiency established by insider trading, as opposed to direct disclosure, may better protect confidential corporate information.[92]
- "What causes injury or loss to outsiders is not what the insider knew or did, rather it is what they themselves [the outsiders] did not know. It is their own lack of knowledge which exposes them to risk of loss or denies them an opportunity to make a profit."[93]
- 'Strict insider trading regulation may have a negative effect on the work of securities analysts because stringent insider trading laws can make securities analysts reluctant in

[91] Leland, HE (1992) Insider Trading: Should It Be Prohibited*? Journal of Political Economy* 100, 859-87.
[92] Carlton, D & Fischel, D. (1983) "The Regulation of Insider Trading." Stanford Law Review 33:857–95.
[93] Hetherington, JAC (1997) 'Corporate Social Responsibility, Stockholders, and the Law' *Journal of Contemporary Business* 51

doing their analytical research in fear of contravening a prohibition on disclosure of price-sensitive information.[94]

Arguments Against Insider Trading

- The wrong inflicted by insider trading on uninformed investors is so great that, even if permitting trading increased economic efficiency, the ethical questions raised by the exploitation of uninformed investors would still weigh heavy enough to rationalize its prohibition because the gains are due to "unfair" behavior.[95]
- Insider trading amounts to theft of a company or corporation's property and must be controlled to reduce and avoid the consequences it may have for companies and financial markets. Prohibiting insider trading is the best means of protection and is important for any company to remain competitive and efficient.[96]
- It is unfair on investors who do not have access to the information; it may deter investors from participating in the market at all, undermining the basic purpose of markets, which is to allow companies to raise capital; it may destabilise markets by encouraging rumours; it intrinsically involves profiting from a breach of confidence, at the expense (at least partially) of people to whom the insider has a duty (such as their employer, and their employer's shareholders).[97]

My view is that the arguments in favour of and against insider trading are all legally sound. However, I am of the view that insider trading should be regulated in Namibia. Insider trading

[94] Manne, HG (1966) *Insider Trading and the Stock Market* 189; See also Manne, HG (1966)*In Defence of Insider Trading* 44 *Harvard Business Review* 113-122
[95] Schotland, RA (1967) "*Unsafe at Any Price: A Reply to Manne*." Virginia Law Review 53 (November): 1425–78.
[96] Bainbridge, SM (1986) *The Insider Trading Prohibition: A Legal and Economic Enigma* 38 *University of Florida Law Review* 35.
[97] Bainbridge, SM (1986) *The Insider Trading Prohibition: A Legal and Economic Enigma* 38 *University of Florida Law Review* 35 Ibid.

discourages the confidence of investors and thereby destroys the image and good reputation of the market. Namibia is still a developing country. A very significant part of our development depends on foreign investment.

If insider trading is not regulated by law, it can effectively destroy the prospect of our economy prospering through the attraction of foreign investors. It is important to protect the interests of foreign investors by providing an even playing field where insiders are prohibited from misusing confidential information to the detriment of investors. Our law must promote a culture of fairness in securities trade so that investors do not feel undermined by the practice of insider trading. The most efficient manner in which this objective can be achieved is through the regulation of insider trading and the prescription of strict sentences and fines for persons who are found guilty of contravening insider trading laws. It is therefore my opinion that insider trading should indeed be regulated in Namibia.

4.2 Conclusion

Although insider trading clearly is not a recent phenomenon in the business world, legal as well as economic discussions about it still continue.[98] Both legal and economic scholars still debate whether insider trading should be regulated at all. The insider trading position in Namibia is not sufficiently regulated by statute and the common law cannot be effectively relied on to provide for answers in every case of inadequacy. It is my view therefore that the Namibian legal system cannot be said to have laws in place that *effectively* regulate and combat the offence of insider trading.

[98] Hu, J & Noe, T (1997) *The Insider Trading Debate*. Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter, 36

An international observation reveals that insider trading regulation has a world-wide dimension in the age of global financial markets. The European Community also dealt with the problem and forced its member states to implement a mandatory prohibition against insider trading.[99] The insider trading position in Namibia is not sufficiently regulated by statute and the comoon law cannot be relied on to provide answers in every case of inadequacy. It is my opinion therefore that the Namibian legal system cannot be said to have laws in place that *effectively* regulate and combat the offence of insider trading. New approaches which I have critically analyzed and recommended in chapter 3.6.1 hereof should be considered.

The decision of policymakers to regulate insider trading may depend on the structural characteristics of the economy. For any given economy, this issue is an empirical one to be addressed by research. The results of this research could then be effectively combined with the conclusions of theory to produce practical policy guidelines. Designing such policy requires a detailed assessment of the structure of the economy, some sensitivity to cultural attitudes toward the appropriateness of such trading activity, and careful consideration of the enforcement costs associated with regulating trade.[100]

The overall aim of our laws should be to extend the scope of the offence of insider trading. There should especially be a wider definition of insiders. The objective is to secure the confidence of investors and retain it, and to ensure fairness in the market. 'In judging of fairness and honesty, regard is had to boni mores and to the general sense of justice of the community. While fairness and honesty are relevant criteria in deciding whether competition is unfair, they are not the only

[99] European Community Insider Dealing Directive OJEC 18.11.89 No L 334/30;

[100] Hu, J & Noe, T (1997) *The Insider Trading Debate*. Federal Reserve Bank of Atlanta Economic Review, Fourth Quarter, 44

criteria; questions of public policy may be important in a particular case'.[101] There is therefore a need to make companies and the public aware of the problems caused by insider trading; to educate and increase public awareness in this regard.

Instead of placing all reliance on the courts to enforce the laws relating to insider trading, non-judicial bodies such as the Securities Regulation Panel in Namibia should be given wider ambits of discretion and investigative powers like the SEC in the US. Our legislature should also take note of developments on the regulation of the offence in the US and the UK and incorporate them into our legislature as best permitted by Namibia's overall economic structure.

[101] *Schultz v Butt* 1986 (3) SA 667

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