

A CRITIQUE OF THE INSIDER TRADING PROVISIONS OF THE 2004 SECURITIES SERVICES ACT

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INTRODUCTION

The Securities Services Act¹ has repealed the Insider Trading Act² and, inter alia,³ governs criminal and civil⁴ liability for the type of conduct previously governed by the Insider Trading Act. The Act⁵ imposes liability on ‘insiders’ who, knowing they have ‘inside information’ relating to particular securities, deal in such securities (for their own or someone else’s account), disclose the ‘inside information’ to others, encourage others to deal in such securities or discourage others from dealing in such securities.

Legislation aimed at curbing insider trading and providing compensation for the victims of insider trading has a dubious past in South Africa.⁶ The insider trading provisions of the Act are not identical to the provisions of the Insider Trading Act but are an attempt at improving on the latter. This article seeks to highlight some of the important changes made, and to show that significant flaws remain and that new ones have been spawned. The article deals with the substantive provisions of the Act imposing liability and not the administrative framework for the enforcement thereof, which remains largely in place.⁷

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¹ Act 36 of 2004 (hereafter referred to as ‘the Act’).

² Act 135 of 1998.

³ The Act also replaces the Stock Exchanges Control Act 1 of 1985, the Financial Markets Control Act 55 of 1989, and the Custody and Administration of Securities Act 85 of 1992 and introduces a substantial number of provisions relating to previously unregulated matters.

⁴ The civil proceedings contemplated in the Act are instituted by the Directorate of Market Abuse (s 83(1)(c)). The Directorate of Market Abuse is the new name for the Insider Trading Directorate (s 83(1)(b)) which was established by the Insider Trading Act (s 12) and in terms of the Act (s 83(1)(a) and (b)) continues to exist under the new name. The Directorate of Market Abuse is a committee of the Financial Services Board (see s 12 of the Insider Trading Act). The Financial Services Board is an independent regulatory institution established under s 2 of the Financial Services Board Act 97 of 1990. Its function is to oversee in the public interest the South African financial services industry.

⁵ See Chap VIII of the Act.

⁶ See S M Luiz ‘Insider trading regulation — If at first you don’t succeed . . .’ (1999) 11 *SA Merc LJ* 136; Richard Jooste ‘The regulation of insider trading in South Africa — Another attempt’ (2000) 117 *SALJ* 284.

⁷ An important innovation from an enforcement perspective is provision for the establishment of an Enforcement Committee by the Financial Services Board (see ss 97—106 of the Act), which has various

FLAWED DEFINITIONS

Liability can only be incurred by an ‘insider’ who acts with knowledge of ‘inside information’. The definitions of ‘inside information’⁸ and ‘insider’⁹ are accordingly of vital importance. The definitions, which are interconnected, are, however, as in the Insider Trading Act, ‘cumbersome and counter-intuitive’.¹⁰ They are in fact circular — to know whether information is ‘inside information’ one has to know who an ‘insider’ is; and to know who an ‘insider’ is, one has to know what ‘inside information’ is.¹¹ ‘Inside information’ is information ‘which is obtained or learned as an insider’; and an ‘insider’ is ‘a person who has inside information’. Since the provisions of the Act that impose criminal and civil liability turn on the meaning of ‘inside information’, the Act is ‘fundamentally incoherent’.¹²

‘PERSON’

Whereas previously the offences (and civil wrongs) could only be committed by an ‘individual’ they can now be committed by a ‘person’.¹³ The fact that there is no reference to ‘individual’ in any of the provisions and the fact that it would be very strange to include partnerships and trusts but exclude corporate bodies leaves little doubt that ‘person’ includes a corporate¹⁴ or other legal entity.¹⁵

functions. Previously civil liability for insider trading had to be litigated in the courts, but now the Financial Services Board has the option to request the Enforcement Committee to make an order.

⁸ Section 72 provides that ‘unless the context indicates otherwise —

“inside information” means specific or precise information, which has not been made public and which —

(a) is obtained or learned as an insider; and

(b) if it were made public would be likely to have a material effect on the price or value of any security listed on a regulated market.’

⁹ Section 72 defines ‘insider’ as follows: “insider” means a person who has inside information —

(a) through —

(i) being a director, employee or shareholder of an issuer of securities listed on a regulated market to which the inside information relates; or

(ii) having access to such information by virtue of employment, office or profession;

or

(b) where such person knows that the direct or indirect source of the information was a person contemplated in paragraph (a).’

¹⁰ See Michael S Blackman, Richard D Jooste & Geoff K Everingham *Commentary on the Companies Act* (2001) vol 1 Revision Service 1at 5–394–14.

¹¹ *Ibid.*

¹² *Ibid.*

¹³ See the definition of ‘person’ in s 72.

¹⁴ In this regard s 332(1) of the Criminal Procedure Act 51 of 1977 is relevant, which provides: ‘For the purpose of imposing upon a corporate body criminal liability for any offence, whether under any law or at common law —

(a) any act performed, with or without a particular intent, by or on instructions or with permission, express or implied, given by a director or servant of that corporate body; and

(b) the omission, with or without a particular intent, of any act which ought to have been but was not performed by or on instructions given by a director or servant of that corporate body, in the exercise of his powers or in the performance of his duties as such director or servant or in furthering or endeavouring to further the interests of that corporate body, shall be deemed to have been performed (and with the same intent, if any) by that corporate body or, as the case may be, to have been an omission (and with the same intent, if any) on the part of that corporate body.’

¹⁵ See definition of ‘person’ in s 2 of the Interpretation Act 33 of 1957. An element of uncertainty in this regard is present because of the reference to ‘he or she’ and ‘his or her’ in s 73.

The imposition of liability for insider dealing on corporate bodies contrasts with the King Task Group's view: 'In view of the lack of development in our law of the jurisprudence concerning the efficacy of the Chinese Wall, the Task Group decided that both the criminal offence of insider trading and the civil remedy set out in the proposed legislation should be limited to conduct by an individual.'¹⁶ The problem alluded to by the King Task Group is one that arises where, for example, the corporate advisory department of a company has inside information relating to the shares in another company and the investment department of the company, which does not have the inside information, deals in the shares. Has the company dealt on the strength of the inside information? Unless some Chinese wall defence is available to the company it appears that it may be liable.

Gower explains the reluctance in the United Kingdom to include corporate bodies as follows:

'Corporate bodies were excluded, not because it was thought undesirable to make them criminally liable but because of the difficulties it was thought would be faced by merchant banks when one department of the bank had unpublished price-sensitive information about the securities of a client company and other departments had successfully been kept in ignorance of that information by a "Chinese Wall" or otherwise. One of those other departments might deal in the shares, in which event the bank as a single corporate body would arguably have committed an offence had the Act applied to corporate bodies.'¹⁷

A Chinese wall is essentially an information barrier.¹⁸ It is created by putting together administrative and organizational arrangements and structures which stop information from flowing from one part of a business to another part of the business.¹⁹ A Chinese wall will usually involve some or all of the following organizational arrangements: the physical separation of various departments to insulate them from each other; an ongoing educational programme to emphasize the importance of preserving confidential information; strict and carefully defined procedures for dealing with the situation where it is felt that the Chinese Wall should be crossed and for maintaining proper records when it happens; monitoring of the effectiveness of the Chinese Wall by compliance officers; and disciplinary sanctions when the Chinese Wall is breached.²⁰ As Cranston explains:²¹

'Chinese walls . . . are designed to stem the flow of information between different parts of the bank. Institutionally a Chinese wall can involve physical separation (in some cases the occupation of different buildings); separate files for the functions separated by the Chinese wall with no access for someone on one side of the wall to a file on the other side; consequent restrictions on physical access and controls on

¹⁶ See the *Final Report of the King Task Group into Insider Trading Legislation* (21 October 1997) para 3.1.2. It may be that companies have been brought within the ambit of liability because they are now able to acquire their own shares and the shares in their holding companies (see ss 85 & 89 of the Companies Act 61 of 1973 respectively).

¹⁷ Paul L Davies (ed) *Gower's Principles of Modern Company Law* 6 ed (1997) 458.

¹⁸ See Kenneth Kaoma Mwenda 'Banks and the use of Chinese walls in managing conflict of duties' (2000) 2 *Web Journal of Current Legal Issues* 14.

¹⁹ See Craig Woolley 'Chinese walls — How thick are they' Insurance Seminar — 1 September 2000 available at <http://www.deneysreitz.co.za/publications/seminars.asp?ThisCat=2&ThisItem=163&ThisSubCat=>

²⁰ *Ibid.* Woolley's paper deals with, inter alia, two leading cases in the UK on the erection of a Chinese wall, namely: *Prince Jefri Bolkiah v KPMG* [1999] 1 All ER 517 (which involved an accounting firm) and *Rakusen v Ellis, Monday & Clarke* [1912] 1 Ch 831 (which involved a firm of solicitors).

²¹ Ross Cranston *Principles of Banking Law* (1997) 31–2. See also Mwenda op cit note 18.

computer access and fail-safe systems; and controlled procedures for the movement of personnel between different parts of the bank. In some financial institutions Chinese walls are underpinned by stop lists and no-recommendation policies.’

It is to be noted that Australian law, which also brings corporate entities (and partnerships) within the ambit of liability,²² expressly provides a Chinese wall defence²³ as a necessary accompaniment to the possibility of corporate liability for insider trading.²⁴ Thus a corporate body (or partnership) has a defence where it ‘has in place a Chinese Wall which “could reasonably be expected to ensure that information was not communicated”, provided that the information was not communicated to another person in the organisation or partnership who made a decision and provided that no advice was given in respect of a transaction by the person who was in possession of the information’.²⁵ The USA²⁶ and the European Union Market Abuse Directive²⁷ provide a similar defence.

According to Rider and Ashe,²⁸ the reactions of the English courts and regulatory institutions to the concept of the Chinese wall have been mixed due to ‘lack of faith in the ability to contain the flow of information within the organs of a corporate institution and the concept’s reliance on the integrity of the human factor’.²⁹ They cite Donaldson J in *North and South Trust Co v Berkeley*³⁰ who said:³¹ ‘[H]ow do you train anyone to act properly in such a situation? What course of action can possibly be adopted which does not involve some breach of duty to one principal or the other . . . neither skill nor dishonesty can reconcile the irreconcilable’. It may well be that, even though a Chinese wall policy may be working effectively,³² the reason for the judicial distrust in England is the legal principle that information obtained by one part of an institution must be regarded as information known by the institution as a whole.³³

It is apparent that the South African legislature has not applied its mind to the possibility of Chinese wall defences and this could be seen as a major flaw in the new provisions. In the absence of statutory Chinese wall defences the efficacy of the operation of financial institutions such as merchant banks and stock-broking firms could be detrimentally affected. To construct an effective Chinese wall policy may, however, be difficult. Thus it has been

²² See s 1043A of the Corporations Act 2001.

²³ See ss 1043F and 1043G of the Corporations Act 2001.

²⁴ See Roman Tomasic, Stephen Bottomley & Rob McQueen *Corporations Law in Australia* 2 ed (2002) at 20.9.8.

²⁵ Sections 1043F & 1043G of the Corporations Act 2001. See Tomasic et al *ibid*.

²⁶ See SEC rules 14e-3(b)(i) & (ii) referred to in the Final Report by the King Task Group into Insider Trading Legislation 21 October 1997 at 9.

²⁷ Directive 2003/6/EC of the European Parliament and of the Council of 28 January 2003 on insider dealing and market manipulation (market abuse para 24).

²⁸ Barry Rider & Michael Ashe *Insider Crime: The New Law* (1993) 76-8.

²⁹ At 78.

³⁰ [1971] 1 All ER 980.

³¹ At 98.

³² See Mwenda *op cit* note 18.

³³ See Gil Brazier *Insider Dealing: Law & Regulation* (1996) 232-3.

suggested that 'such policy needs to be as sophisticated as comparable military structures in order to protect the integrity of information'.³⁴

It is to be noted that the person who deals on behalf of the body corporate could also be guilty of an offence in terms of s 73(2)(a).³⁵

INCLUSION OF A PARTNERSHIP AND TRUST

The definition of 'person' in s 72 includes a partnership and a trust. This indicates that the offences (and civil wrongs) can be committed by a partnership or a trust, neither of which has legal personality in terms of the common law.

The inclusion of trusts and partnerships, without further elaboration, is highly questionable. Numerous questions with no clear answers arise: How is a partnership or a trust to be prosecuted? By prosecuting the individual partners or trustees? When does a partnership have the necessary knowledge for the commission of the offences? In determining if the partnership has the required knowledge, is the state of mind of each partner to be attributed to the partnership? Is it possible for the state of mind of an employee or agent of the partnership to be attributed to the partnership? If partner A knows that he is in possession of inside information regarding a company's shares and partner B innocently deals on behalf of the partnership in the company's shares, does the partnership have the required knowledge for commission of the dealing offence? What penalties can be imposed when a partnership is successfully prosecuted? Can the individual partners be imprisoned? If so, on what basis? Can a fine imposed on the partnership be recovered from the individual partners? Does the fact that the partnership is being treated as a separate legal entity mean that a fine imposed on the partnership may be recoverable only from the partnership assets? But a partnership does not own the assets. They are owned jointly in undivided shares by the partners. Is it possible for a partnership to be guilty of the offences other than dealing?³⁶

Does the 'trust' included in the definition of 'person' comprise all types of trusts? Does it include a bewindtrust? When does a trust have the necessary knowledge for the commission of the offence? In determining if the trust has the required knowledge is the state of mind of each trustee to be attributed to the trust? Is it possible for the state of mind of an employee or agent of the trust to be attributed to the trust? What penalties can be imposed when a trust is successfully prosecuted? Can trustees be imprisoned? If so, on what basis? Can a fine imposed on the trust be recovered from the individual trustees? Or, in the case of a bewindtrust, can it be recovered from the beneficiaries?

³⁴ David F C Brewer & Michael J Nash 'The Chinese wall security policy' (1989) available at www.gammasl.co.uk/topics/chinesewall.html.

³⁵ Section 73(2)(a) provides: 'An insider who knows that he or she has inside information and who deals, directly or indirectly, for any other person in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it commits an offence.' Section 332(5) of the Criminal Procedure Act 51 of 1977, which sought to make the directors and servants guilty of the offence unless they proved their innocence was held to be unconstitutional in *S v Coetzee* 1997 (3) SA 527 (CC).

³⁶ This question also arises in relation to companies.

Does the fact that the trust is being treated as a separate legal entity mean that the fine can only be recovered from the trust assets? But the trust does not own the trust assets. They are owned by the trustees in the case of an ordinary trust and the beneficiaries in the case of a bewindtrust.

It is submitted that our jurisprudence does not provide ready answers to these vital issues and legislation is called for to provide clarity.³⁷

The question of Chinese wall defences also arises in relation to trusts and partnerships.³⁸

THE ELEMENT OF 'KNOWLEDGE'

A common element of all the offences (and civil wrongs) is that the person committing the offence must 'know' that he or she has inside information.³⁹

To know that it is inside information, primary insiders⁴⁰ must, presumably, know (i) that it is 'specific or precise information', (ii) that it has not been made public, (iii) that they have obtained or learned of the information 'through' their position, and (iv) that 'if' [the information] were made public' it 'would be likely to have a material effect on the price or value of any securities or financial instruments'.⁴¹ As far as the secondary insider is concerned, he or she — in order to be a secondary insider — must in addition know that the direct or indirect source of the information was a primary insider (only if he or she also knows this is he or she an insider and has inside information).⁴²

An obvious difficulty in establishing whether a person knows that he or she has inside information is that many of the facts to be established will be matters of judgement. For example, whether information is 'specific or precise' is a matter of judgement. Also significant will be the question whether it has been made public. First, s 74(1)⁴³ merely provides for certain

³⁷ Section 332(7) of the Criminal Procedure Act 51 of 1977 provides: 'When a member of an association of persons, other than a corporate body, has, in carrying on the business of affairs of that association or in furthering or in endeavouring to further its interests, committed an offence, whether by the performance of any act or by the failure to perform any act, any person who was, at the time of the commission of the offence, a member of that association, shall be deemed to be guilty of the said offence, unless it is proved that he did not take part in the commission of the offence and that he could not have prevented it: Provided that if the business or affairs of the association are governed or controlled by a committee or other similar governing body, the provisions of this subsection shall not apply to any person who was not at the time of the commission of the offence a member of that committee or other body.' Section 332(7) does not throw any light on the questions posed as it does not deal with the liability of the association of persons and is, in any event, probably unconstitutional on the same basis that s 332(5) of the Criminal Procedure Act was held to be unconstitutional by the Constitutional Court in *S v Coetzee* 1997(3) SA 527 (CC). See note 35 above.

³⁸ See above.

³⁹ See ss 73(1)(a), 73(2)(a), 73(3)(a), and 73(4).

⁴⁰ The definition of 'inside information' covers both primary insiders (para (a)) and secondary insiders or 'tippees' (para (b)).

⁴¹ See definition of 'inside information' in s 72 of the Act.

⁴² *Ibid.*

⁴³ Section 74(1) provides: 'For the purposes of the definition of "inside information", information is regarded as having been made public in circumstances which include, but are not limited to, the following:

- (a) when the information is published in accordance with the rules of the relevant regulated market for the purposes of informing clients and their professional advisers;
- (b) when the information is contained in records which by virtue of any enactment are open to inspection by the public; or
- (c) when the information can be readily acquired by those likely to deal in any listed securities—

'circumstances' in which 'information shall be regarded as having been made public', and expressly states that the circumstances in which information shall be regarded as having been made public are not limited to the specified circumstances. Furthermore, s 74(2) provides that '[i]nside information which would otherwise be regarded as having been made public must still be so regarded even though . . . it can be acquired only by persons exercising diligence or observation, or having expertise . . . or if . . . it is communicated upon payment of a fee . . . or . . . it is only published outside the Republic'. How, then, can an insider 'know' whether such information has or has not been made public? And, of course, experts may disagree as to whether the information was such that if it were made public it would be likely to have a material effect on the price or value of any securities or financial instrument.⁴⁴

The insider must have understood the specificity and materiality of the non-public information in his possession at the time he chose to deal.⁴⁵ In the case of the primary insider, the prosecution will have to show the same subjective appreciation in relation to the source of the information: that the offender knew he had the information as a result of his inside position.⁴⁶ It is clear that only subjective appreciation of these facts will do. Thus, for example, if the accused thinks (no matter how unreasonably) that the information is public, he does not commit the offence.⁴⁷ In the case of secondary insider dealing it does not matter whether the primary insider has consciously communicated the information to the secondary insider.⁴⁸ As long as the secondary insider dealer has obtained the information from an inside source, even indirectly, he would fall within the scope of the Act. The secondary insider dealer must however know that the inside information came from a primary insider.⁴⁹ This requirement is likely to be difficult to meet, especially if the argument is that the information came indirectly from the primary insider to the suspect via a chain of communications. Proving that a 'sub-tippee' or even a 'sub-sub-tippee' knew that the ultimate source of the information was a primary insider could be fraught with problems.⁵⁰

Proof that a person had the requisite knowledge 'is likely to be a major stumbling block . . . especially where there is no documentary evidence to support such claims'.⁵¹ In dealing with the 'knowledge' requirement it has

- (i) to which the information relates; or
- (ii) of an issuer to which the information relates; or

(d) when the information is derived from information which has been made public.'

⁴⁴ Blackman et al op cit note 10 at 5-394-21.

⁴⁵ Blackman et al op cit note 10 at 5-394-23.

⁴⁶ Ibid.

⁴⁷ See E Lomnicka 'The new insider dealing provisions: Criminal Justice Act 1993, Part V' 1994 *Journal of Business Law* 173 at 181-2.

⁴⁸ Blackman et al op cit note 10 at 5-394-23.

⁴⁹ See para (b) of the definition of 'insider' in s 72.

⁵⁰ Blackman et al op cit note 10 at 5-394-24.

⁵¹ Tomasic et al op cit note 24 at 20.9.6.

been stated⁵² that ‘the new Act⁵³ does not require that the defendant be shown to have deliberately exploited the inside information in concluding the illicit transaction, in addition to proof of mere knowledge of the inside information’.⁵⁴

If the view taken here is that no mens rea is required, then it may be questionable in the light of the presumption that the legislature intended mens rea to be an element of liability of a statutory offence.⁵⁵ Thus it was stated by Botha JA in *S v Arenstein*:⁵⁶

‘The general rule is that *actus non facit reum nisi mens sit rea* and that in construing statutory prohibitions or injunctions, the Legislature is presumed, in the absence of clear and convincing indications to the contrary not to have intended innocent violations thereof to be punishable.’

In order for this presumption to be rebutted there must be considerations indicating that the legislature intended the offence to be one of strict liability.⁵⁷ Such considerations are:⁵⁸

‘[T]he language or the context of the prohibition or injunction, the scope and object of the statute, the nature and extent of the penalty, and the ease with which the prohibition or injunction could be evaded if reliance could be placed on the absence of *mens rea*.’

It has been suggested⁵⁹ that proof of deliberate exploitation of the inside information may create serious evidentiary problems for the prosecution. If so, this may be a factor pointing to strict liability. On the other hand, whether the mens rea requirement would make it easier to evade the prohibition is perhaps arguable; if the accused has inside information, knows it is inside information and deals,⁶⁰ has not a prima facie case for mens rea been presented resulting in the evidentiary burden swinging to the accused? If so, the mens rea requirement poses no evidentiary problem for the prosecution. Perhaps there is sufficient lack of certainty in this regard to call for clarification by the legislature.

PROOF OF PROFIT OR LOSS NOT REQUIRED

In order for the ‘dealing’ offence to be committed it is not stated as a requirement that the accused must have made a profit or avoided a loss. On the other hand it is expressly stated that for civil liability to arise the insider must have made a profit or would have made a profit if he or she had sold the

⁵² See P C Osode ‘The new South African Insider Trading Act: Sound law reform or legislative overkill?’ (2002) 45 *Journal of African Law* 239 at 248.

⁵³ Osode is referring to the Insider Trading Act but the ‘knowledge’ requirement is the same in the new provisions.

⁵⁴ Osode points out that ‘deliberate exploitation’ is required in American and German law but no longer in Canada. See Osode op cit note 52 at 248. Osode states that, ‘deliberate exploitation’ was a mandatory requirement in Ontario until its repeal in 1980 in response to calls by regulators and academics who persuasively argued that the repeal was indispensable to the creation of an effective insider trading prohibition.

⁵⁵ See Jonathan M Burchell *Principles of Criminal Law* 3 ed (2005) 500.

⁵⁶ 1964 (1) SA 361 (A) at 365C.

⁵⁷ Burchell op cit note 55.

⁵⁸ *S v Arenstein* supra note 56 at 365D.

⁵⁹ See Osode op cit note 52 at 248.

⁶⁰ Or ‘discloses’ or ‘encourages’ or ‘discourages’ or ‘stops’, as the case may be.

securities at any stage, or avoided a loss.⁶¹ It is not clear whether such a distinction is justified. It is to be noted, however, that if the insider purchases securities on the strength of price-sensitive inside information, it is perhaps assumed that he/she has purchased at a bargain price and that therefore a profit has been made, albeit unrealized. Similarly, if the insider sold securities on the strength of inside information, it is perhaps assumed that he/she sold at a higher price than would have been obtained if the information had been made public and that therefore a loss has been avoided.

The Insider Trading Act contained no reference to the situation where a profit had not been made but would have been made had the defendant sold the securities.⁶²

NO DEFINITION OF 'DEALING'

There is no definition of 'dealing' in the Act.⁶³ It appears that 'dealing' means buying or selling or a transaction akin thereto such as bartering.

It is not clear, nor was it clear in the Insider Trading Act, whether 'dealing' includes 'subscribing' for shares. Clarification is called for as there appears to be no basis for its exclusion.

It is submitted that, where a company acquires its own shares, it is 'dealing', even though it is not able to 'deal' with them thereafter.⁶⁴ Again, clarification by the legislature is needed.⁶⁵

Abstaining from dealing gives rise to no criminal or civil liability. Thus it is not an offence if a person retains securities he or she would otherwise have sold because he or she has acquired inside information that they will increase in value. This exclusion is no doubt based on the severe evidential problems that a prosecution would face in such a case. Gower says⁶⁶ regarding the same position in the United Kingdom: 'In principle, it is difficult to defend this exclusion since the loss of public confidence in the market will be as strong as in a case of dealing, if news of the non-dealing emerges.'

⁶¹ See s 77 of the Act.

⁶² See s 6(1)(b).

⁶³ Nor was there a definition in the Insider Trading Act.

⁶⁴ In terms of s 85(8) of the Companies Act 61 of 1973 the shares must be cancelled.

⁶⁵ Section 55 of the English Criminal Justice Act, 1993 does define 'dealing'. Section 55(1) provides that, '[f]or the purposes of this Part, a person deals in securities if—

(a) he acquires or disposes of the securities (whether as principal or agent); or

(b) he procures, directly or indirectly, an acquisition or disposal of the securities by any other persons'.

Section 55(4) defines 'procures' as follows: 'a person procures an acquisition or disposal of a security if the security is acquired or disposed of by a person who is—

(a) his agent,

(b) his nominee,

(c) a person who is acting at his direction, in relation to the acquisition or disposal'.

Section 55(5) provides that subsec (4) is not exhaustive as to the circumstances in which one person may be regarded as procuring an acquisition or disposal of securities by another. Section 55(2) defines 'acquire' in relation to a security to include—

(a) agreeing to acquire the security; and

(b) entering into a contract which creates the security'.

Section 55(3) provides that 'dispose' in relation to a security includes—

(a) agreeing to dispose of the security; and

(b) bringing to an end a contract which creates a security'.

⁶⁶ Op cit note 17 at 468.

DEFENCES

Where a person is accused of insider dealing on his or her own account (criminal and civil) liability will be avoided if he or she can prove on a balance of probabilities one of the two defences set out in s 73(1)(b).

The first defence is that the accused 'was acting in pursuit of the completion of an affected transaction as defined in s 440A of the Companies Act'.⁶⁷ This defence was provided for in the previous legislation and its rationale is difficult to understand.⁶⁸ As has been stated:⁶⁹

'Is the idea here that in the case of a takeover, the acquisition of shares of the target company by the acquirer is exempt from the prohibition? Typically, in a takeover situation, the inside information is information about a likely takeover. But that, of course, is a matter of history when the acquirer actually acquires the shares of the target. Of course, it is possible that a person may acquire control without making a takeover bid. Control can be acquired by individual purchases, or on the stock exchange. Then, under the takeover Code, a mandatory offer must be made to the remaining shareholders. Does this exception, then, permit the acquirer to make such individual acquisitions or stock exchange purchases without disclosing its intentions, and hence purchase on the basis of inside information? But surely such an acquirer is not an insider, and therefore it is not hit by the prohibition in the first place? More likely, the legislator had the seller in mind. Is the legislator's intention that if X sells a controlling block of shares (the transaction is an affected transaction) he is not guilty of insider trading, even if he has inside information relating to the value of his shares? But why not? Perhaps the idea was simply that since takeovers are regulated under the Act and the Securities Regulation Code on Take-overs and Mergers, they ought not to be further regulated by the Insider Trading Act. But that would not be a very satisfactory explanation.'⁷⁰

The second defence available to the accused is that he or she 'only became an insider after he or she had given the instruction to deal to an authorised user'⁷¹ and the instruction was not changed in any manner after he or she became an insider.⁷² The rationale for this defence is clear. If a person instructs his or her broker to deal in a security and, subsequent to the giving of the instruction, he or she acquires inside information in relation thereto, he or she should not be guilty of an offence as long as the instruction is not changed before the dealing takes place. This is so because the inside information did not prompt him or her to deal — he would have dealt in the same way even in the absence of the inside information.

In the repealed Insider Trading Act there was no defence formulated in this way. However, in the Insider Trading Act it was a defence that the person concerned 'would have acted in the same manner even without the inside information'.⁷³ It is submitted that the old defence would have covered the circumstances dealt with by the new defence but the old one is

⁶⁷ Section 73(1)(b)(i). The defence presupposes lawful conduct on the part of an accused in the pursuit of the completion or the implementation of an affected transaction (*S v Western Areas Ltd & others* 2004 (4) SA 591 (W) at 606).

⁶⁸ See Blackman et al op cit note 10 at 5–394–26.

⁶⁹ Ibid.

⁷⁰ Perhaps the defence was aimed at the acquirer in a compulsory acquisition of securities of a minority in an affected transaction, in terms of s 440K of the Companies Act 61 of 1973. However, s 73(1)(b)(i) is not limiting in this way.

⁷¹ An 'authorised user' is defined in s 1 as meaning 'a person authorised by an exchange in terms of the exchange rules to perform such securities services as the exchange rules may permit'.

⁷² Section 73(1)(b)(ii).

⁷³ Section 4(1)(b) of the Insider Trading Act 135 of 1998.

undoubtedly wider than the new. For example, an individual who had price-sensitive information in relation to certain securities and sold them to meet pressing financial obligations, or who bought them in order to fulfil a pre-existing obligation to transfer them to another person, would have been protected by the old defence. The new defence would not protect the dealer in these circumstances. It may be, however, that in these examples the offence would not be committed in the first place because the requisite *mens rea* would not be present.⁷⁴

If the old defence had been retained it may have gone some way towards alleviating the concern expressed earlier regarding the inclusion of corporate bodies within the ambit of the insider dealing provisions. The example was given of the corporate advisory division of a company having inside information regarding another company's shares and the investment department of the company dealing in those shares in ignorance of that information. As matters stand at present, it would appear that the knowledge of the corporate advisory division could be imputed to the company with the result that, if the other requirements for liability are present, the company could be criminally liable. If the old defence was still available the company would escape liability on the basis that it 'would have acted in the same manner even without the inside information'.

In the United Kingdom⁷⁵ there is a defence which protects an individual who had reasonable grounds for believing that the information in his possession was disclosed widely enough to ensure that none of the counter parties to the transactions would be prejudiced by not having the information. There is no such defence in South Africa nor was there in the repealed Insider Trading Act. But it would seem that if the accused can establish this, it may show that he did not know that he had inside information.

When a person is accused of insider dealing on behalf of another person⁷⁶ both criminal and civil liability will be avoided if he or she can prove on a balance of probabilities one of the four defences set out in s 73(2)(b).

Two of the defences are the defences that are also available to the insider who deals on his or her own behalf and were dealt with above. So the insider is protected where he or she was acting in pursuit of the completion of an affected transaction,⁷⁷ and also where he or she only became an insider after having given the instruction to deal to an authorized user and the instruction was not changed in any manner after the person became an insider.⁷⁸ The comments made above in relation to these two defences are equally apposite here. With regard to the second defence, it was noted that the Insider Trading Act provided a wider defence. It protected an insider 'who would

⁷⁴ See earlier in this regard where it is suggested that it is unclear whether *mens rea* is a requirement for liability and that legislative intervention is perhaps called for.

⁷⁵ See s 53(1) of the Criminal Justice Act 1993.

⁷⁶ See s 73(2)(a).

⁷⁷ Section 73(2)(b)(iii).

⁷⁸ Section 73(2)(b)(iv).

have acted in the same manner even without the inside information'.⁷⁹ For example, the insolvency practitioner who has to liquidate all the assets of an insolvent company could under the old legislation safely deal if he or she also had price-sensitive information about the securities he or she was about to sell. It appears that there is no longer a defence in these circumstances. The old defence effectively avoided, in the case of certain individuals, a conflict between their contractual or fiduciary obligations and the fact that they had personal knowledge of inside information at the time.

A third defence is one that protects the insider who 'was acting on behalf of a public sector body'⁸⁰ in pursuit of monetary policy, policies in respect of exchange rates, the management of public debt or external exchange reserves'.⁸¹ This defence is identical to one available under the repealed Insider Trading Act⁸² with the minor difference that the term 'foreign' and not 'external' was used in the Insider Trading Act. It is doubtful whether anything turns on this difference. The precise ambit of this defence is not clear. In what circumstances would a 'public sector body' deal in securities 'in pursuit of monetary policy, policies in respect of exchange rates, the management of public debt or external exchange reserves'? The breadth and vagueness of this defence is disconcerting as it may enable public officials, without warrant, to escape liability.

A fourth defence is available to an accused who 'is an authorised user and was acting on specific instructions from a client, save where the inside information was disclosed to him or her by that client'.⁸³ There was a similar but not identical defence in the Insider Trading Act. The difference between the two is that, whereas the defence in the Insider Trading Act was available to any 'individual' accused of the offence in question, the new defence is only available to a person who is an 'authorised user'. An 'authorised user' is 'a person authorised by an exchange in terms of the exchange rules to perform such securities services as the exchange rules may permit'.⁸⁴ It appears that the new defence is more limited in its application than the old one. Consider this example. Someone instructs his accountant to buy a certain number of shares in a company at a certain price on his behalf and the accountant has inside information in relation to these shares which he obtained from another source and which has not been disclosed to the client. The accountant instructs a broker ('an authorised user') to buy the shares. It appears that the accountant would be protected under the old defence but

⁷⁹ Section 4(1)(b).

⁸⁰ A 'public sector body' means

(a) all spheres of the government of the Republic or of any other country or territory;

(b) the South African Reserve Bank; or

(c) the central bank of any country or territory outside the Republic, but does not include the Public Investment Commissioners established by section 2 of the Public Investment Commissioners Act, 1984 (Act No. 45 of 1984).

⁸¹ Section 73(2)(b)(ii).

⁸² See s 4(1)(c).

⁸³ Section 73(2)(b)(i).

⁸⁴ Section 1.

not under the new because the accountant is not an ‘authorised user’. It is submitted that the accountant should not be guilty of the offence as he or she would have acted in the same manner even without the inside information. What makes the situation more peculiar is that if the accountant only became an insider after giving the instruction to the broker the accountant would be able to use the defence in s 73(2)(b)(iv) (discussed earlier). Why should it make a difference when the accountant became an insider? There is no logic to such a distinction.

An insider who knows that he or she has inside information and who discloses the inside information to another person is guilty of the ‘disclosure’ offence.⁸⁵ A defence is provided where such insider ‘proves on a balance of probabilities that he or she disclosed the inside information because it was necessary to do so for the purpose of the proper performance of the functions of his or her employment, office or profession *in circumstances unrelated to dealing in any security listed on a regulated market* and that he or she at the same time disclosed that the information was inside information’.⁸⁶ This exception was provided for in the previous legislation⁸⁷ although the italicized wording is new. The new wording has presumably been inserted to prevent reliance on the exception by, for example, investment advisors whose ‘employment, office or profession’ would no doubt relate to ‘dealing in any security listed on a regulated market’. If this is the case the new provision closes a gaping hole that existed in the old legislation.

The previous legislation provided a further defence to a person accused of the ‘disclosure’ offence which has been removed. The accused was not guilty of the offence if he or she ‘believed, on reasonable grounds, that no person would deal in the securities or financial instruments as a result of such disclosure’.⁸⁸ This defence appears to have involved a subjective/objective test — was the accused’s actual belief that ‘no person would deal’ reasonable? It is not clear why this defence was removed. Should such ‘innocence’ be punished? Perhaps the removal of the defence is indicative of a harder line being taken by the legislature — insiders must be deterred from divulging inside information and the only circumstances in which such conduct will be excused will be those provided by the exception retained in s 73(3)(b). The subjectivity of the defence may also have motivated its removal — enquiries into the state of mind of an accused can be problematic and this, together with the vagueness of the defence, may have led to its demise.⁸⁹

There are no defences to the ‘encouraging’ or ‘discouraging’ offences, contrary to the Insider Trading Act where it was a defence if the accused

⁸⁵ Section 73(3)(a).

⁸⁶ Section 73(3)(b). Emphasis added.

⁸⁷ See s 4(2)(b) of the Insider Trading Act 135 of 1998.

⁸⁸ See s 4(2)(a) of the Insider Trading Act 135 of 1998.

⁸⁹ Difficulty in proving the communication of inside information is evident from the Australian Capital Territory decision in *Myers v Claudianos* (1990) 2 ACSR 73 at 79. See Tomasic et al op cit note 24 at 20.9.7. See also *Hooker Investments Pty Ltd v Baring Bros Halkerston & Partners Securities Ltd* (1986) 4 ACLC 243 at 245 where this issue was considered.

'would have acted in the same manner even without the inside information'.⁹⁰ The removal of this defence seems harsh as there could be genuine instances where the insider would have provided the encouragement or discouragement even without the inside information. The removal is an indication of the harder line taken in the new provisions.

The Insider Trading Act, both in respect of criminal and civil liability, expressly preserved any defences that might have been available other than those provided for in the Insider Trading Act itself.⁹¹ Thus the common law defences⁹² were preserved as well as any other statutory defences that might have been applicable. The new provisions do not expressly preserve such defences. As the Insider Trading Act has been repealed it may be argued that these other defences are no longer available. However, a counter to this may be that in terms of our common law other defences are always preserved unless expressly excluded by the statutory provision in question. Whatever the merits of such arguments may be, it is submitted that legislative clarification is called for.

DEALING 'DIRECTLY OR INDIRECTLY THROUGH AN AGENT'

The new provisions expressly render insiders liable (both criminally and civilly) if they deal 'directly or indirectly or *through an agent*'.⁹³ The provisions of the Insider Trading Act⁹⁴ did not expressly refer to dealing through an agent. It only used the words 'directly or indirectly' and it appears that the insertion of the words 'through an agent' indicates that the legislature did not regard dealing through an agent as being clearly implied in the word 'indirectly'. It is not clear what purpose is served by the word 'indirectly', bearing in mind that our courts are reluctant to treat words in a statute as superfluous.⁹⁵

It is of note that s 73(2)(a), which creates the offence of dealing on someone else's account, does not cover dealing through an agent. It is of course possible to deal on someone else's account through an agent and the exclusion of such a possibility is incongruous.

Where a person deals through a company or a close corporation,

⁹⁰ See s 2 read with s 4(1)(b) of the Insider Trading Act. Although s 4 provided that all of the four defences set out were available in respect of the 'encouraging' offence, those set out in s 4(1)(a), s 4(1)(c) and s 4(1)(d) were, by their nature, inapplicable. It was a defence where the accused: 'was acting on specific instructions from a client, save where the inside information was disclosed to him or her by that client' (s 4(1)(a)); 'was acting on behalf of a public sector body in pursuit of monetary policy, policies in respect of exchange rates, the management of public debt or foreign exchange reserves' (s 4(1)(c)); and 'was acting in pursuit of the completion or implementation of an affected transaction as defined in section 440A of the Companies Act, 1973 (Act No. 61 of 1973)' (s 4(1)(d)).

⁹¹ See s 4(3), s 6(1)(c) and s 6(2).

⁹² Eg ignorance of the law (*S v De Blom* 1977 (3) SA 513(A)).

⁹³ Section 73(1)(a). Emphasis added.

⁹⁴ Section 2(1).

⁹⁵ See e.g. *S v Weinberg* 1979 (3) SA 89 (A) at 98. In *Couve v Reddot International (Pty) Ltd* 2004 (6) SA 425 (W) at 432A–B Jajbhay AJ said that the words 'directly or indirectly' have received little judicial consideration and referred to Smalberger JA's statement in *Belfry Marine Ltd v Palm Base Maritime SDN BHD* 1999 (3) SA 1083 (SCA) at 1107E–F: 'By using the words "directly or indirectly" the Legislature clearly intended to extend and not restrict the expression'

presumably the court can, where appropriate, pierce the corporate veil and treat the transaction as a case of dealing on the person's own account.⁹⁶

INSIDE INFORMATION DOES NOT RELATE TO THE SECURITIES

The 'dealing' and 'encouraging' or 'discouraging' offences⁹⁷ (and civil wrongs) all refer to dealing in 'the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it'. This wording, which was also in the old provisions, is inept. The information relates to the business of the company, or to some matter that will increase or decrease the value of the business; it never relates to the securities themselves.⁹⁸ Also, the securities are not 'affected' by the information — they remain as they were. What is affected by the information is the value or price of the securities, not the securities themselves. As the definition says, 'inside information' must be such that 'if it were made public it would be likely to have a material effect on the *price or value* of any security listed on a regulated market'.⁹⁹

Subsections (1) and (2) of s 52 (the offences of dealing and encouraging, respectively) of the English Criminal Justice Act, 1993 refer to 'securities that are price-affected securities in relation to the information'. And s 56(2) provides that 'securities are "price-affected securities" in relation to inside information, and inside information is "price-sensitive information" in relation to securities, if and only if the information would, if made public, be likely to have a significant effect on the price of the securities'.¹⁰⁰ This wording is preferable to that found in the Act.

PERSON ENCOURAGED MAY DEAL

In terms of s 73(4) an individual is guilty of the 'encouraging' offence if he or she, (i) knowing that he or she has inside information, (ii) encourages or causes another person to deal (iii) in the securities to which such information relates or which are likely to be affected by it. The essential actus reus of the offence is the imparting of advice to deal in specified securities as opposed to substantive disclosure of the information which led the individual to give that advice. If the recipient did in fact receive inside information when encouraged, the individual divulging that information may also have committed the disclosure offence under s 73(3)(a).¹⁰¹

⁹⁶ See Blackman et al op cit note 10 at 5-394-28.

⁹⁷ See ss 73(1)(a), 73(2)(a), 73(4).

⁹⁸ Blackman et al op cit note 10 at 5-394-21.

⁹⁹ Ibid.

¹⁰⁰ Blackman et al op cit note 10 at 5-394-22.

¹⁰¹ It is not necessary that the 'encouraging' be successful, nor is it relevant whether the advice was offered gratuitously or for personal gain (the same applies to the 'disclosure' and 'discouraging' offences). No doubt the severity of the penalty imposed will be influenced by whether a benefit was derived or not (any 'commission or consideration' received is, however, claimable from the insider (see ss 77(4)(d), 77(3)(iv)) in the case of 'encouraging' or 'disclosure'). As far as civil liability is concerned, it is clear from a reading of s 77(4) that it is only if the 'tippee' deals that the amounts referred to in s 77(4) become payable. See the

As was the case under the Insider Trading Act, an individual who is encouraged to deal without receiving any inside information is not guilty of the offence of insider dealing if he deals (nor can he/she be civilly liable). The dealing offence requires possession of inside information on the part of the dealer. So if Mr X says to Mr Y: 'I have inside information about Company A. I will not disclose the information but I strongly advise you to buy its shares', and Mr Y deals, he is not guilty of insider dealing.¹⁰² It is unclear why Mr Y should escape liability. Why should liability only arise if the inside information is passed on to Mr Y? This anomaly represents a serious flaw in the legislature's attempt to combat insider trading.

NO DUTY TO DISCLOSE TRANSACTIONS

An unjustified omission from the new provisions (as also from the Insider Trading Act) is a duty on the part of insiders to disclose their transactions involving securities and instruments issued by their companies/institutions. Such a duty would have at least three benefits. First, it would act as a deterrent to insiders considering unlawful trading.¹⁰³ Secondly, it 'could facilitate the enforcement of the trading ban by the public regulator seeing that the insiders' trades are a matter of public record'.¹⁰⁴ Thirdly, such disclosure increases the pool of information on which market analysts can draw in updating their assessments and forecasts of corporate performance thus enhancing the efficiency of the market.¹⁰⁵

A statutory duty with appropriate sanctions for non-compliance is called for. The fact that the JSE's listing requirements impose such a duty does not, it is submitted, suffice.¹⁰⁶

NO DUTY ON COMPANIES TO DISCLOSE INSIDE INFORMATION

A further duty that would assist in enhancing the market's pricing efficiency would be an affirmative duty of prompt disclosure on companies or institutions when they obtain possession of price-sensitive information relating to their publicly traded securities or instruments.¹⁰⁷ Such prompt disclosure would also effectively eliminate the very existence of material non-public information, thus reducing the opportunities for insider

words 'if the other person dealt' in s 77(4)(a). A requirement of the encouraging, disclosing and discouraging offences is knowledge on the part of the offender that he or she has 'inside information' as defined. The offences are committed without the recipient having known that the offender had the benefit of price-sensitive information when he was encouraged or discouraged. The existence of these offences is likely to curb over-zealousness on the part of company representatives when making presentations to meetings of large shareholders or analysts (see Blackman et al op cit note 10 at 5-394-24).

¹⁰² Mr X could, however, be civilly liable (section 77(4)). See below.

¹⁰³ See Osode op cit note 52 at 256.

¹⁰⁴ Ibid.

¹⁰⁵ Ibid.

¹⁰⁶ 108 See section 3 of the Listing Requirements.

¹⁰⁷ Osode op cit note 52 at 257.

trading.¹⁰⁸ As Osode says, such a duty is ‘presently one of the cornerstones of insider trading regulation in a number of well-respected jurisdictions’ and its absence in South Africa ‘exhibits the lopsided, narrow and often misguided emphasis placed in this jurisdiction upon the regulatory goals of deterrence, individual investor protection and market integrity’.¹⁰⁹

EXTRA-TERRITORIAL REACH

The new provisions, both criminal and civil, like the old, have unlimited extra-territorial reach.¹¹⁰ No territorial connection is required between any element of the offences or civil wrongs and South Africa. For example, a foreign insider who knows that she has inside information and who deals outside South Africa in foreign securities listed on a foreign market to which the information relates could be prosecuted for the insider dealing offence in South Africa.

Bearing in mind that the aim of the provisions is the protection of the South African financial marketplace and its users, both local and foreign, the granting of such an open-ended regulatory licence appears unnecessary.¹¹¹ Such broad assertion of jurisdiction is found nowhere else.¹¹² The financial resources necessary to finance such unlimited enforcement of the legislation are enormous and probably unwarranted.¹¹³ A more restricted approach appears to be called for.¹¹⁴

PENALTY

The maximum penalty for committing any of the offences created by the Act is far heavier than that prescribed under the Insider Trading Act. The maximum penalty now is a fine of R50 million or imprisonment of 10 years, or both such fine and imprisonment.¹¹⁵ Previously the figures were R2 million and 10 years.

The increase in the fine and the period of imprisonment appears to be aimed at conveying a signal to traders that insider dealing and the related offences will not be tolerated. However, the increases are largely ‘sym-

¹⁰⁸ *Ibid.*

¹⁰⁹ *Ibid* at 259.

¹¹⁰ The new provisions apply to ‘securities listed on a regulated market’ (ss 77(1)(a), (2)(a), (3)(i) and (4)). A ‘regulated market’ is given the same broad definition it was given in the Insider Act. A ‘regulated market’ means ‘any market, whether domestic or foreign, which is regulated in terms of the laws of the country in which the market conducts business as a market for dealing in securities listed on that market’ (s 72).

¹¹¹ The King Task Group was in favour of prohibiting an insider deal executed in South Africa in respect of a security or financial instrument listed on a regulated foreign market (op cit note 16 para 5.2).

¹¹² Osode op cit note 52 at 262. As Osode points out, even the United States’ open-ended extra-territorial application of its securities laws by the Securities and Exchange Commission (SEC) has limitations (*ibid*). Germany and the UK have provided for restricted extra-territorial reach and Canada, Japan, Hong Kong and New Zealand make no provision at all for their legislation to apply to illicit transactions that have taken place in foreign jurisdictions.

¹¹³ *Ibid.*

¹¹⁴ *Ibid.*

¹¹⁵ See s 115(a).

bolic',¹¹⁶ given the extreme difficulty in securing successful prosecutions for these offences.

JOINT AND SEVERAL LIABILITY

The civil liability provision in the Insider Trading Act governing the situation where a person dealt on someone else's behalf was confusing.¹¹⁷ This confusion is fortunately not present in the new provision dealing with joint and several liability, s 77(5),¹¹⁸ although there are other anomalies. The effect of s 77(5) appears to be that if Mr X, an insider who knows he has inside information, (a) deals on behalf of Mr Y or (b) discloses the inside information to Mr Y or (c) encourages or causes Mr Y to deal in the securities in question, then, if Mr Y is liable as an insider for dealing, Mr Y is jointly and severally liable together with Mr X to pay the amounts for which Mr X is liable. Section 77(5) by referring to the amounts set out in subsections (2)(i), (iii) and (v),¹¹⁹ (3)(i)(ii) and (v),¹²⁰ or (4)(a), (c) and (d)¹²¹ (the amounts for

¹¹⁶ This is how the increase in the penalty in Australia has been described by Tomasic et al op cit note 24 at 20.9.9.

¹¹⁷ See s 6(2)(c) of the Insider Trading Act and Blackman et al op cit note 10 at 5-394-30 to 5-394-31.

¹¹⁸ Section 77(5) provides: 'If the other person referred to in subsections (2), (3) and (4) is liable as an insider in terms of subsection (1), the insider referred to in subsections (2), (3) and (4) is jointly and severally liable together with that other person to pay the amounts set out in subsection (2)(i), (iii) and (v), (3)(i), (iii) and (v), or (4)(a), (c) and (d), as the case may be.'

¹¹⁹ Section 77(2) of the Act provides: 'An insider who knows that he or she has inside information and who —
(a) deals, directly or indirectly, for any other person in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it;
(b) makes a profit for that other person or would have made a profit if the securities had been sold at any stage, or avoids a loss, through such dealing; and
(c) fails to prove any one of the defences set out in section 73(2)(b) on a balance of probabilities, is, subject to subsection (5), liable, at the suit of the board in any court of competent jurisdiction, to pay to the board —

(i) the equivalent of the profit or loss referred to in paragraph (b);
(ii) a penalty, for compensatory and punitive purposes, in a sum determined in the discretion of the court but not exceeding three times the amount referred to in paragraph (i);
(iii) interest;
(iv) the commission or consideration received for such dealing; and
(v) cost of suit on such scale as may be determined by the court.'

¹²⁰ Section 77(3) of the Act provides: 'An insider who knows that he or she has inside information and who —

(a) discloses the inside information to any other person; and
(b) fails to prove on a balance of probabilities the defence set out in section 73(3)(b), is, subject to subsection (5), liable, at the suit of the board in any court of competent jurisdiction, to pay to the board —

(i) if the other person dealt in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it, the equivalent of the profit which the person made or would have made if the securities had been sold at any stage, or the equivalent of the loss avoided, as a result of such dealing;
(ii) a penalty, for compensatory and punitive purposes, in a sum determined in the discretion of the court but not exceeding three times the amount referred to in paragraph (i);
(iii) interest;
(iv) the commission or consideration received for such disclosure; and
(v) cost of suit on such scale as may be determined by the court.'

¹²¹ Section 77(4) of the Act provided: 'An insider who knows that he or she has inside information and who encourages or causes any other person to deal in the securities listed on a regulated market to which the inside information relates or which are likely to be affected by it is, subject to subsection (5), liable, at the suit of the board in any court of competent jurisdiction, to pay to the board —

(a) if the other person dealt in such securities, the equivalent of the profit which the person made or would have made if the securities had been sold at any stage, or the equivalent of the loss avoided, as a result of such dealing;

which the insider, Mr X, is liable) and not the amounts set out in subsection (1) (the amounts for which Mr Y is liable) makes it clear that the joint and several liability of Mr X and Mr Y relates to the amounts for which Mr X is liable and not the amounts for which Mr Y is liable.

Reading s 75 as a whole, the position therefore appears to be as follows. If, for example, Mr X discloses inside information to Mr Y and Mr Y deals and makes a profit of R1 million and Mr X is liable in terms of s 75(3) and Mr Y is liable in terms of s 75(1), the Financial Services Board can claim the R1million twice, once from Mr X and again from Mr Y, with Mr Y jointly and severally liable with Mr X for Mr X's R1m. This double recovery is distinctly odd, especially considering that Mr X and Mr Y are each already liable to pay a penalty not exceeding three times the amount of the profit.¹²² It is also puzzling why Mr Y should be jointly and severally liable for Mr X's payment and not vice versa. Possibly the legislature's intention was to give the FSB a single claim for the R1 million profit with Mr X and Mr Y jointly and severally liable therefor, but that is not what s 77 provides. A possible pointer to such intention is the fact that subsecs (2), (3) and (4) are made 'subject to subsection (5)'.

Apart from the above, a flaw in s 77(5) relates to scenario (c) above, namely, where Mr X encourages or causes Mr Y to deal. Section 77(5) provides that if Mr Y is liable as an insider for dealing then the joint and several liability referred to in the last paragraph arises. The problem is that Mr Y has not received the inside information. He has only been encouraged or caused to deal. Therefore he cannot be liable as an insider for dealing.

A further anomaly is that in scenario (c) there is no joint and several liability for 'costs of suit' whereas there is in scenarios (a) and (b). Also in scenario (c) there is joint and several liability for 'the commission or consideration' received but not in scenarios (a) and (b). There does not appear to be any rational explanation for drawing these distinctions.

NO CIVIL LIABILITY FOR 'DISCOURAGING'

An insider incurs no civil liability¹²³ for discouraging or stopping someone from dealing.

The exclusion of 'discouragement' or 'stopping' from the ambit of civil liability is unacceptable, a view taken by the King Task Group.¹²⁴ 'Discouragement' or 'stopping' can be as harmful as 'encouraging' or 'disclosing' and should therefore have the same consequences.¹²⁵

(b) a penalty, for compensatory and punitive purposes, in a sum determined in the discretion of the court but not exceeding three times the amount referred to in paragraph (a);

(c) interest;

(d) the commission or consideration received for such encouragement; and

(e) cost of suit on such scale as may be determined by the court.'

¹²² See s 77(1)(ii) and s 77(3)(ii).

¹²³ Criminal liability may arise. See s 73(4).

¹²⁴ See King Task Group op cit note 16 at 5–7.

¹²⁵ The position in the Insider Trading Act was confusing. The provisions imposing civil liability (s 6(1) and s 6(2)) made no reference to 'discouraging' or 'stopping'. However, the provision (s 6(3)) imposing a

LIABILITY FOR 'INTEREST'

The new provisions,¹²⁶ like the old,¹²⁷ provide for liability for, inter alia, 'interest'. As under the Insider Trading Act, it is not clear on what capital amount the interest is calculated, nor is it clear what period is to be used in the calculation.

DETERMINATION OF PROFIT OR LOSS

Section 6(4)(b) of the Insider Trading Act provided that in the determination of the profit made or loss avoided by an individual dealing on his or her own account, the court should have regard to, inter alia, 'the consideration for the dealing'. It is not clear what this meant. Section 77(6) of the new provisions provides that what must be taken into account in the determination of profit made or profit that would have been made or loss avoided is, inter alia, 'the consideration for the *dealing* referred to in subsections (2), (3) and (4)'.¹²⁸ But there is no 'consideration' for 'dealing' referred to in subsecs (3) or (4). Subsection (2) refers to consideration for dealing on another person's account, subsec (3) to consideration for 'disclosure' and subsec (4) to consideration for 'encouraging' or 'causing'.

NO CAUSAL LINK REQUIRED?

Section 77(8)(b) requires claimants to prove, in addition to the fact that 'they were affected by the dealings referred to in subsections (1) to (4)',¹²⁹ that,

- (ii) in the case where the inside information was made public within five trading days from the time the insider referred to in subsections (1) and (2), or the other person referred to in subsections (3) and (4) dealt, they dealt in the same securities at the same time or any time after the insider or other person so dealt and before the inside information was made public; or
- (iii) in every other case, they dealt in the same securities at the same time or any time thereafter on the same day, as the insider or other person referred to in subparagraph (ii).'

The period of five days is arbitrary, but an element of arbitrariness is inevitable once one moves away from requiring a direct causal link between the insider dealing and the claimant's loss to the chosen approach of disregarding causation and compensating claimants who dealt around the same time as the insider dealer.

The arbitrary approach, which was also adopted in the Insider Trading Act,¹³⁰ has been borrowed from the US¹³¹ and signifies a move away from the debate about the need to establish privity between insider and outsider.

penalty on a person liable for disclosure of inside information or encouraging someone to deal provided that the penalty was payable 'together with all commission or consideration for disclosing, encouraging, *discouraging* or dealing'. Emphasis added.

¹²⁶ See s 77.

¹²⁷ See s 6(4)(a).

¹²⁸ Section 77(2), (3) and (4) are set out in notes 119, 120 and 121.

¹²⁹ Section 77(8)(b)(i).

¹³⁰ See s 6(6)(a) of the Insider Trading Act. Section 6(6)(a) used a period of a 'week' and not 'five trading days'.

¹³¹ See s 20A of the Securities Exchange Act of 1934, inserted by the Insider Trading and Securities Fraud Enforcement Act of 1988.

The insider, it is said, is effectively deemed to owe a duty of disclosure to contemporaneous traders for any transactions undertaken on the basis of inside information in the relevant financial instruments or securities.¹³² By trading on the inside information the insider is effectively deemed to have breached that duty. This theory presupposes that since the information on which the insider trades is material, these investors would have relied on it and would have altered their conduct accordingly had the information been disclosed.¹³³ The causal link between the insider and the loss sustained is presumed and the loss is deemed to be sufficiently proximate; the need for privity is thus removed.¹³⁴ The danger of draconian liability arising because of a duty owed to all contemporaneous traders is averted by limiting the damages.¹³⁵ The approach is artificial and leads to fortuitous plaintiffs and windfall recoveries which are not, as a general rule, to be encouraged. However, it is thought to be justifiable where the primary purpose is not compensation but to further the socially beneficial goal of deterrence of insider dealing.¹³⁶ The arbitrary approach can thus be defended.

But has the arbitrary approach been adopted? What of the fact that claimants must prove that they have been 'affected' by the dealing?¹³⁷ Does that not require an element of causality — whatever that element may be? And how can one speak of 'compensation'¹³⁸ where there is, and cannot be, any causal connection — or loss? It is unclear what is meant by 'affected by the dealings referred to in subsections (1) to (4)'. It appears that this is meant to be a separate and distinct requirement.¹³⁹ When is a person 'affected' by such dealing? 'Affected' presumably means *harmfully* affected.¹⁴⁰ But, in any event, in the case of dealings in listed shares, nobody is affected (either harmfully or beneficially) by insider dealing. Persons dealing in shares are affected by the fact that the information has not been disclosed, and this holds true regardless of whether or not there is any insider dealing. If the undisclosed information will, when disclosed, cause the price of the shares to rise, all those who sell before disclosure will be detrimentally affected by the fact that the information has not been disclosed; and all those buying will benefit. And where the information when disclosed will cause the price of the shares to fall, all those who sell before disclosure will benefit from the fact that the information has not been disclosed, and all those who purchase will

¹³² See H McVea 'Fashioning a system of civil penalties for insider dealing: Sections 61 & 62 of the Financial Services Act 1986' 1996 *Journal of Business Law* 344 at 352.

¹³³ *Ibid.* See also Philip Anisman *Insider Trading Legislation in Australia: An Outline of the Issues and Alternatives* (1986) 111.

¹³⁴ McVea *op cit* note 132.

¹³⁵ *Ibid.*

¹³⁶ See D M Branson 'Insider dealing — Part III' 1982 *Journal of Business Law* 536 at 538–9; McVea *op cit* note 132 at 353.

¹³⁷ See s 77(8)(b)(i) which provides: 'The balance referred to in subsection (7)(b) must be distributed to all claimants who — (b) prove to the reasonable satisfaction of the claims officer that — (i) they were affected by the dealings referred to in subsections (1) to (4)'.

¹³⁸ See the use of the word 'compensatory' in ss 77(1)(i), 77(2)(ii), 77(3)(ii), 77(4)(b).

¹³⁹ See Blackman *et al op cit* note 10 at 5–394–33.

¹⁴⁰ *Ibid.*

be harmed. The only possible effect of insider dealing on the market will be to cause the price of the company's shares to move in the right direction, ie to make the market more efficient.¹⁴¹

CONSTITUTIONALITY OF PUNITIVE DAMAGES IN DELICTUAL CLAIMS

The new provisions governing civil liability, like the old, provide for a penalty to be payable by the insider.¹⁴² Serious judicial doubts have been expressed concerning, and considerable academic criticism has been levelled against, the award of punitive damages in delictual claims.¹⁴³ In *Fose v Minister of Safety and Security*¹⁴⁴ Ackermann J quoted with approval the following dictum of Lord Devlin in the House of Lords:

'I do not care for the idea that in matters criminal an aggrieved party should be given an option to inflict for his own benefit punishment by a method which denies to the offender the protection of the criminal law.'¹⁴⁵

Ackermann J said in relation to this dictum:

'In my view it becomes even more unacceptable in a country which has become a constitutional state, which has enacted an interim constitution which is the supreme law of the land and in which extensive criminal procedural rights are entrenched.'¹⁴⁶

The Constitutional Court might well adopt Ackermann J's view and find that the punitive damages provisions are unconstitutional.¹⁴⁷

NO REMEDY FOR CREATORS OF INSIDE INFORMATION

Absent from the regulatory framework in both the Insider Trading Act and the new provisions is any remedy available to the corporate or institutional creators of inside information.¹⁴⁸ This exclusion has been succinctly and, it is submitted, correctly criticized in the following terms:

'[T]here are compelling reasons why it is submitted here that such an omission is unpardonable. Firstly, on the basis of sound Anglo-American legal orthodoxy alone, most inside information is valuable commercial intangible property, usually developed by companies at great expense exclusively for the purpose of pursuing strategic commercial interests, greater profits, preserving competitive advantage as well as corporate prosperity in the short and long term. The use of such information by insiders and non-insiders alike is therefore analogous to "theft" or "conversion" pure and simple . . .

Secondly, corporate law scholarship of the "law and economics" genre has over the last two decades developed a fairly well respected "property rights" based economic theory of insider trading and inside information through which lawyers and legal policy-makers have been taught, *inter alia*, that a failure to

¹⁴¹ *Ibid.*

¹⁴² See ss 77(1)(ii), 77(2)(ii), 77(3)(ii) and 77(4)(b).

¹⁴³ See *Innes v Visser* 1936 WLD 44 at 45, *Lynch v Agnew* 1929 TPD 974 at 978; *Esselen v Argus Printing & Publishing Co Ltd & others* 1992 (3) SA 764 (T) at 771; *Fose v Minister of Safety and Security* 1997 (3) SA 786 (CC) at 822–5; R G McKerron *The Law of Delict* 7 ed (1971) at 207n89; J Neethling *Persoonlikheidsreg* (1991) at 60, 61n167 and 168n355; J C Van der Walt *Delict: Principles & Cases* (1979) at 5–7; Jonathan M Burchell *The Law of Defamation in South Africa* (1985) at 290–4 and *idem Principles of Delict* (1993) at 187.

¹⁴⁴ 1997 (3) SA 786 (CC) at 827.

¹⁴⁵ See *Rookes v Barnard* [1964] AC 1129 (HL) at 1230.

¹⁴⁶ *Supra* note 144 at 827.

¹⁴⁷ See Jooste *op cit* note 6.

¹⁴⁸ Canadian and Australian law provide for an action to be brought by issuers to recover losses that the corporate entity suffered. Canada provides for this action under OSA s 134(4) and CBCA s 131(4)(b). The Australian action is provided by s 1043L(2) of the Corporations Act of 2001.

recognise and respect the issuer's proprietary right in the inside information through the conferment of a statutory right of recovery has the potential to discourage and significantly reduce corporate private sector investment in the search for and production of valuable information. Where that potential is realised, modern society will slowly but surely slip into a state of industrial and economic atrophy. It is certainly doubtful whether the South African Parliament could have intended such a result.

Thirdly, while it might be difficult to demonstrate any real loss attributable to insider trading in cases involving individual impersonal or anonymous exchange transactions, and thereby justify the statutory provision of compensatory damages to such individual investors, there is ample empirical financial economic evidence demonstrating fairly persuasively that if insider trading makes casualties of participants in modern financial markets, corporate issuers would top that list.¹⁴⁹

As Osode points out:¹⁵⁰

'Although most of the studies that provide this evidence are American, the conclusions are applicable to every modern industrialised economy, of which South Africa is certainly one. For example, it is corporations that stand to lose substantial sums of money in concluding "change of control" transactions preceded by substantial insider trading activity and tipping. Similarly, it is the issuer corporations that stand to lose their competitive advantage if strategically important information relating to, say, an invention being leaked to a competitor before the company has either finalised the registration of the related patent with the relevant authorities or secured the exclusive right to work the patent from the inventor. Furthermore, of all the actors whose interests are implicated in incidents of insider trading, it is the corporate issuers that can claim that most incidents of insider trading and tipping are directly traceable to some breach of a fiduciary, contractual or other legal obligation owed to them. Why the South African Parliament would disregard these fairly well established and respected understandings of insider trading seems incomprehensible.'

It is noteworthy that in Australia the Corporation Act, 2001 provides for: (i) an action to be brought to recover losses by the corporate body which issued the securities which were the subject of the contravention;¹⁵¹ and (ii) the corporate body recovering the difference between the price at which its securities were bought from, or sold to, the insider and the price at which those securities could have been bought or sold had the inside information been generally available at the time of the transactions.¹⁵² The corporate body may itself bring these actions but they may also be brought as representative actions by the Australian Securities and Investments Commission, where it is considered to be in the public interest to do so. Such representative actions are undertaken in the name, and for the benefit, of the corporate body.¹⁵³

VICARIOUS LIABILITY

As in the Insider Trading Act (s 6(11)), the common-law principles of vicarious liability are preserved. Section 77(11) provides that '[t]he common law principles of vicarious liability apply to the civil liability established by this section'. What exactly is meant by this is far from clear. How can the common-law principles of vicarious liability apply to civil liability established by s 77? Furthermore, it is unclear to what extent employers are exposed to vicarious liability in the insider dealing context. In terms of the general principles governing vicarious liability, the employer can escape such

¹⁴⁹ Osode op cit note 52 at 254–5.

¹⁵⁰ Ibid at 255.

¹⁵¹ Section 1043L(2).

¹⁵² Section 1043L(5).

¹⁵³ Section 1043L(6).

liability if the employee has (1), subjectively viewed, promoted only his own interests and (2), objectively viewed, entirely disengaged himself from his contractual duties.¹⁵⁴ In *Minister of Police v Rabie*¹⁵⁵ Jansen JA said:

‘It seems clear that an act done by a servant solely for his own interests and purposes, although occasioned by his employment, may fall outside the course or scope of his employment, and that in deciding whether an act by the servant does so fall, some reference is to be made to the servant’s intention The test is in this regard subjective. On the other hand, if there is nevertheless a sufficiently close link between the servant’s acts for his own interests and purposes and the business of his master, the master may yet be liable. This is an objective test’

CONCLUSION

The provisions in the Securities Services Act aimed at regulating insider dealing and related conduct are significantly flawed in numerous respects. It is a serious indictment of the legislature that in the context of insider dealing it continues to churn out legislation that clearly has not been carefully considered and without adequately taking into account criticism of its previous attempts. Nevertheless, it must be conceded that it does appear that the legislature’s efforts have had some deterrent effect. In a media release by the Financial Services Board on 4 August 2004 relating to the Insider Trading Act it is stated that the results of a report by an economics consulting firm¹⁵⁶ commissioned by the Financial Services Board support the overall conclusion that ‘the new regime has changed prevailing attitudes to insider trading, resulted in new policies and approaches among listed corporates and their advisors, and — according to most market participants — led to a sharp reduction in the perceived incidence of insider trading’.¹⁵⁷

¹⁵⁴ See, for example, *Minister of Police v Rabie* 1986 (1) SA 117 (A); *ESS Kay Electronics PTE Ltd & another v First National Bank of Southern Africa Ltd* 1998 (4) SA 1102 (WLD).

¹⁵⁵ 1986 (1) SA 117 (A) at 134; Blackman et al op cit note 10 at 5–394–36.

¹⁵⁶ G:enesis.

¹⁵⁷ G:enesis was engaged in order to gauge the impact that the Insider Trading Act had on the South African financial markets.