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THE INSIDER TRADING REGULATORY FRAMEWORK IN UGANDA'S CAPITAL MARKETS: CHALLENGES AND OPPORTUNITIES FOR REFORM

Prosscovia Nambatya*

Abstract

Uganda's Capital Markets Authority Act and the Uganda Securities Exchange Insider Trading Rules prohibit the use of non-public price-sensitive information to trade, by an insider, an associate of an insider or a tippee. But this prohibition—based on the need to ensure orderly, fair and transparent trading in securities of listed entities—falls short in many respects. This article points out the loopholes in Uganda's laws on insider trading by making comparative analyses with other jurisdictions as well as internationally applied standards. Despite the existence of capital markets in Uganda for over 20 years, the Authority and Exchange have not prosecuted any cases of insider trading—a fact that suggests either a factual absence of the vice, or an inadequacy of the legal framework coupled with inefficiency of the Exchange and the Authority's enforcement arms. The latter is the more probable explanation, and reform is necessary.

'The stock market is in many respects a complex arrangement for the marketing of information, and reliable information commands a high premium.'[1]

1. Introduction

Capital markets are an important contributor to the economic development of any country; they play a significant role in capital formation, effective use of domestic

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[1] Schotland, R. (1967) Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market. Virginia Law Review, 53(7), 1430

savings and act as a source of long-term patient capital.[2] Studies show that there is a strong correlation between the level of economic development of any country and the level of development of its capital markets.[3] Despite this, the development of capital markets in Africa only recently received attention as the continent recovered from decades of colonial rule.[4]

Globally, capital markets' have developed since the establishment of the first stock exchange in 1531 Antwerp—present-day Belgium.[5] Lesger[6] notes that in the 16th century 'the centre of European international trade shifted from Antwerp to Amsterdam,' and the Amsterdam Stock Exchange thus emerged.[7] The Amsterdam Bourse is considered to have been the first modern securities exchange.[8] After Amsterdam, the concept of stock exchanges became popular and stock exchanges

[2] Roth, A. (1967) Capital Market Development in Israel and Brazil: Two Examples of the Role of Law in Development. Stanford Law Review 19(6), 1277.

[3] See Singh, A. (1997) Financial Liberalisation, Stock Markets and Economic Development. The Economic Journal, 107(442), 771-782

[4] Chimpango, B. The Development of African Capital Markets: A Legal and Institutional Approach. (Routledge, 2017)

[5] There is no comprehensive literature on the Antwerp Exchange's origins and operations. Although it is regarded as the earliest stock exchange, some authors point to the existence of an equity market in Rome. Malmendier is perhaps the most known proponent of trading of shares in ancient Rome. He argues that the Roman *societas publicanorum* or 'society of publicans' had shareholders (participes) and that shares were often traded between 'participes after the contract had been assigned to a societas publicanorum.' For further information on this debate, see Ulrike Malmendier, '*Roman Shares'* In: William Goetzmann and Geert Rouwenhorst, *The Origins of Value; The Financial Innovations that Created Modern Capital Markets* (Oxford University Press 2005) 38; Geoffrey Poitras and Manuela Geranio, '*Trading of Shares in the Societates Publicanorum,'* (2016) 61 Explorations in Economic History 95.

[6] Lesger C. (2006), 'The Rise of the Amsterdam Market and Information Exchange: Merchants, Commercial Expansion and Change in the Spatial Economy of the Low Countries, c. 1550-1630,' Hampshire; Hants Aldershot.

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[8] Petram Lodewijk, '*The world's first stock exchange: How the Amsterdam market for Dutch East India Company Shares Became a Modern Securities Market 1602-1700* (Eigen Beheer 2011).

started sprouting up in various jurisdictions including Austria, Paris, London and New York.[9]

The situation in Africa was different though, and stock exchanges remained a foreign concept for most states until the end of colonialism. Within the colonial structure—a structure of plunder and looting of the colonies—capital markets did not have a place or come up as a priority.[10] Colonies were simply a source of resources for the West, giving rise to the term 'commercial colonialism'.[11] Even in areas where indirect rule was applied, the existing administrative structures were only allowed to remain if they agreed to enforce colonial ordinances, collect and remit taxes, and provide the cheap labour that was necessary to ensure the survival of commercial colonialism.[12]

South Africa, Morocco and Egypt are the exceptions to the above situation as they had stock exchanges even before their independence.[13] An investigation into

[9] For further reading on the history of the New York and London Stock Exchanges, see Ranald Michie, *The London Stock Exchange; A History* (Oxford University Press 1999); Smith, CF. (1929) '*The Early History of the London Stock Exchange*,' The American Economic Review, 19(2) 206; Banner, S. (1998) *The Origin of the New York Stock Exchange 1791–1860*. The Journal of Legal Studies 27(1) 113.

[10] Two schools of thought have emerged on the study of the impact of colonialism on the development of capital markets. On one side, Professor Gunnal Myrdal, argued that colonial powers were to blame for the lack of growth and viewed colonialism as a deprivation of effective nationhood. These scholars fault colonialists for failing to pursue 'active economic development policies, especially in undertaking comprehensive central planning in the sense of state control of the composition and direction of economic activity outside subsistence agriculture.
See Gunnar Myrdal, *Development and Underdevelopment* (Bank of Egypt 1956) 54; Ambe Njoh, '*The Impact of Colonial Heritage on Development in Sub-Saharan Africa*,' (2000) 52(2) Social Indicators Research 163. The second school of thought, led by PT Bauer argues, rather passionately, that although colonialism humiliated and/or irritated the states, it does not follow that the status of colonialism obstructed any material economic advancement. See PT Bauer, *The Economics of Resentment: Colonialism and Underdevelopment*,' (1969) 4(1) Journal of Contemporary History 59. Although this article does not purport to go into the merits and demerits of each of these arguments, it is imperative to point out that Bauer's assertions ignore the fact that there can never be any economic advancement without a right to use the economic resources for the advancement of that state as enshrined in The United Nations General Assembly Resolution 1803 (XVII) of 14th December 1962 on the "Permanent sovereignty over natural resources"

[11] Lea YP, '*What's Wrong with Colonialism?*' (2013) 41(2) Philosophy & Public Affairs 161.

[12] Ambe Njoh, '*The Impact of Colonial Heritage on Development in Sub-Saharan Africa*,' (2000) 52(2) Social Indicators Research 163

[13] The first stock exchange in South Africa, the Kimberley Royal Stock Exchange was established in 1881 to facilitate the trading of shares in the diamond mining companies. See Pierre Morgenrood, '*Cape Town's Forgotten Stock Exchange*,' (2000) 54(4) Quarterly Bulletin of the National Library of South Africa 144 However, South Africa did not gain independence until 1910.

the reasons why this was so points to the flourishing trade that took place in those countries, before and during colonialism. Lukasiewicz, for example, points out that the origin of the Johannesburg Stock Exchange ('JSE')—Africa's largest stock exchange by both size and market capitalisation—is bound up with with the flourishing gold industry in Witwatersrand at the time.[14] Also, the several conquests of Egypt by the Arabs as early as 640 AD,[15] by the Fatimids in 1171 AD, by the Ayyubids till 1250 AD and by the French led by Napoleon Bonaparte in 1798[16] all increased trade activities that birthed a need for financing; and stock markets were thus seen and used as a viable way to finance the trade companies operating in the region.[17]

In East Africa, the first stock exchange was the Nairobi Stock Exchange, formed in 1954 with its registration under the Societies Act of 1954. Despite the fact that Uganda gained its independence in 1962, its first stock exchange was established in June 1997, shortly after the promulgation of the Capital Markets Act, Cap 84 ('the Act') on 24th May 1996 and with the backing of the Central Bank of Uganda. The Act established the Capital Markets Authority ('CMA') and empowered it to promote and facilitate the 'development of an orderly, fair and efficient capital markets industry in Uganda' and to 'make provision with respect to stock exchanges, stockbrokers and other persons dealing in securities.'[18]

One of the functions of the CMA is to protect the integrity of the securities market 'against any abuses arising from the practice of insider trading.'[19] In line with this mandate, the Act prohibits insider trading under § 84.

[14] Marius Lukasiewicz, '*From Diamonds to Gold: The Making of the Johannesburg Stock Exchange 1880-1890,'* (2017) 43 (4) Journal of Southern African Studies 175

[15] During the caliphate of Umar the great.

[16] Yunus Gilani, '*An Islamic Response to Colonialism in Egypt: The French Occupation [1798-1801] and the Role of Ulamá,'* 20(3) Hamdard Islamicus 55.

[17] For a detailed understanding, see David Lubell, '*Paleoenvironments and Epi-Paleolithic Economies in the Maghreb (20,000-5,000BC)'* in Desmond Clark, '*From Hunters to Farmers: The Causes and Consequences of Food Production in Africa,'* [1984] University of California Press 41; Joan Nogue and Jose Luis Villanova, '*Spanish colonialism in Morocco and the Sociedad Geogra ́fica de Madrid, 1876–1956,*' (2002) 28(1) Journal of Historical Geography 6; Yunus Gilani, '*An Islamic Response to Colonialism in Egypt: The French Occupation [1798-1801] and the Role of Ulamá,*' 20(3) Hamdard Islamicus 55.

[18] See long title of the Capital Markets Authority Act, Cap 84

[19] Section 5(2)(f) of the Act

In 2008, the Uganda Securities Exchange ('the USE') passed the Uganda Securities Exchange Insider Trading Rules, 2008 ('the Rules'). The Exchange states the purposes of the Rules as being to boost investor confidence and to promote market efficiency, fairness and orderliness.[20] However, the Act does not define insider trading and neither do the Rules.[21]

This article examines the laws on insider trading in Uganda, with focus on the operations of the CMA as principal regulator and the USE as the principal stock exchange and self-regulating entity. Specifically, the article will point out the loopholes in the insider trading legal framework by making comparative analyses with other insider trading legal frameworks in Africa, the United Kingdom (UK) and the United States of America (USA) since the latter two are more developed jurisdictions to whom emerging capital markets' regulators look for inspiration. The aim of this article is to make a case for reform considering the best practices in securities regulation.

This discussion will commence by exploring the rationale for the prohibition of insider trading globally as well as the debate on whether or not there should be a prohibition at all. It will then focus on regulatory approaches to regulation, comparing Posner and Stigler's two widely accepted theories of regulation before moving into a comprehensive analysis of the insider trading framework in Uganda, pointing out the loopholes such as the failure to cover sub national and national issuances, the vagueness in the type of information covered by the Act and in the tipper-tippee liability and the lack of adequate defences among others. Comparative analyses and recommendations for reform will also be made.

Throughout the article, the terms 'insider trading' and 'insider dealing' are used interchangeably to mean the same thing.

[20] Rule 1 of the Rules.

[21] A comprehensive discussion of this matter will be made in the subsequent discussions in this article.

2. The Rationale behind the Prohibition of Insider Trading

2.1 The value of information in securities markets

Most of the jurisprudence on insider trading has developed from the United States.[22] Generally, the approach to defining insider trading in statutes is to give examples of what inside trading is and to define what is prohibited.[23]

The approach in Uganda is not any different from most jurisdictions. The Act and Rules do not expressly define insider trading, but give examples of what amounts to insider trading. Insider trading involves the buying and selling of securities relating to a specific company by a person who is connected with that company or by that person's associate, where they are in possession of specific information that; relates to those securities, is not yet publicly available, and may have a significant effect on the market price of those securities if it were to be disclosed to the public.[24] In short, insider trading is trading by a person connected to a company, using non-public price-sensitive information.

The prohibition of insider trading is closely linked to the value of information in the securities market. MacVea notes that this explains why almost every country with a securities market has rules prohibiting insider trading.[25] Information is the bedrock of the securities market, and lack of information disclosure would lead to a failure of the securities market. As Francis Bacon said, 'knowledge is power.' Manne has described the stock market as " a complex arrangement for the marketing of information."[26] Trades are conducted using available information and information facilitates the movement of prices. Hanningan notes that 'information is what the market relies on to determine the price of whatever commodity is the subject of the

[22] Hazen TL. (1982) "Corporate Insider Trading: Reawakening the Common Law." *Washington and Lee Law Review*, 39(3): 845-860.

[23] A review of the regulations governing insider trading in the partner states of the East African community reveals that none defines insider trading but gives examples of instances when one is deemed to be engaged in insider trading.

[24] Gil Brazier, 'Insider Dealing: Law and Regulation,' (Cavendish Publishing, 1996)

[25] MacVea, H. (1995). What's Wrong with Insider Dealing. *Legal Studies,* 15, pp. 390-414.

[26] Manne, H. (1966) Insider Trading and the Stock Market. (New York: The Free Press) 47

market.'[27] This explains why securities regulations have robust prospectus disclosure requirements as well as continuing listing obligations, all requiring specific information to be provided to the market before and after admission to the Official List. This information includes periodic financial statements, changes in board and senior management, substantial transactions such as mergers and acquisitions, and major court proceedings by and against the company among others.[28]

The efficient capital markets hypothesis, a financial economics theory, states that the prices of an asset fully reflect the information that is available on that asset.[29] Therefore, when an insider uses non-public information to deal in securities, both ethical and financial issues arise. Insiders are able to make large profits or avoid huge losses by trading on inside information that has not yet been disclosed to the general market. An example is the insider trading case of Ivan Boesky, an American banker convicted of insider trading in 1986. Using tips he received from insiders regarding potential takeover targets, he was able to make profits in excess of hundreds of millions of US dollars. This shows the financial benefits that accrue to insider traders.

2.2 The two schools of thought on prohibition of insider trading

In recent times, a fierce debate has arisen as to whether insider trading should be prohibited. It is worth exploring both sides of the spectrum. Proponents of regulating insider trading point to the unfairness of the act; the fact that only the insider is privy to the relevant information and yet it affects a publicly listed security. Thus by

[27] Hanningan, B. (1994. Insider Dealing. 1st ed. London: Longman, 2. For evidence to the effect that public information is the major source of short term volatility in returns, see Jones, C., Kaul, G. and Lipson, M., 1993. Information, Trading and Volatility, *Journal of Financial Economics,* 36: 127-154. For further reading on information and its impact on share prices, see Scholes M. 1972. The Market for Securities: Substitution Versus Price Pressure and the Effects of Information on Share Prices, *The Journal of Business* 45(2): 179-211; Mitchell, M. and Mulherin J.H. 1994. The Impact of Public Information on the Stock Market. *The Journal of Finance,* 49(3): 923-950

[28] For continuing listing obligations under Ugandan law, see Part VI of the USE Listing Rules, 2003

[29] Fama, E. 1970. "Efficient Capital Markets: A Review of Theory and Empirical Work". Journal of Finance, 25 (2): 383–417.

distorting the level playing field that regulators seek to establish in the securities markets, insiders who deal based on non-public information are seen to act unfairly.

The prohibition of insider trading is also premised on the protection of property rights. Information is seen as a property for the person who discovers it or possesses it.[30] Cinar[31] therefore notes that in such an instance, an insider who uses the information and profits from it is deemed to have stolen it.[32]

The prohibition of insider trading is also meant to prevent harm and damage to others. This harm arises from price movements which may affect positions on the market. Specifically, where the information used has negative connotations, it may trigger price drops leading to losses for other investors. In markets where insider trading is prevalent, investors lose confidence, leading to investor and capital flight.

In a 1961 case*, In the Matter of Cady, Robberts and Co,*[33] the United States' Securities and Exchange Commission ('the SEC') issued an opinion which articulated two reasons for the prohibition of insider trading:

> …[F]irst, the existence of a relationship giving access, directly or indirectly, to information intended to be available only for a corporate purpose and not for the personal benefit of anyone, and second, the inherent unfairness involved where a party takes advantage of such information knowing it is unavailable to those with whom he is dealing…

In this case, J. Cheever Cowdin, who was a director in Curtiss-Wright (a listed company) became aware of a reduction in the dividend of the company during a Board meeting. Before the information would be made public and during the meeting's recess, he telephoned his brokers from the firm Cady, Roberts & Co and informed them of the drop in the dividend. Robert Gintel, a partner and selling broker in Cady, Roberts & Co, used this information to sell off his shares

[30] Engelen and Liedekerke note that information is an intangible property right and that the "existence of property rights in intangibles such as patents, copy right, trademarks, trade secrets, and information, is well-established" See Bainbridge, S.: 2000, 'Insider Trading', in B. Bouckaert and G. De Geest (eds.), Encyclopedia of Law and Economics, Volume III, The Regulation of Contracts (Edward Elgar), pp. 772-812: Easterbrook, F.: 1981, 'Insider Trading, Secret Agents, Evidentiary Privileges, and the Production of Information', The Supreme Court Review 1981, 309-365; Kitch, E.: 1980, 'The Law and Economics of Rights in Valuable Information', Journal of Legal Studies 9, 683-723.

[31] Cinar, M.E. 1999. "The Issue of Insider Trading in Law and Economics: Lessons for Emerging Financial Markets in the World." Journal of Business Ethics, 19(4): 345-353.

[32] Ibid, p. 347.

[33] 40 SEC 907.

during the trading session. Gintel was therefore found in violation of §§ 17(a) and 10(b) of the 1934 Securities Exchange Act and Rule 10b-5,[34] by the Securities and Exchange Commission. Specifically, the Commission noted that the prohibition of sale not only affected Cowdin and Gintel but also extended to the discretionary accounts maintained by Gintel.

In *SEC v. Texas Gulf Sulphur,*[35] the Court emphasized the importance of prohibiting insider trading. In this case, the defendant company was conducting mining activities in Canada and after discovered minerals in one area, officers of the company proceeded to purchase additional shares in it before the discovery could be made public. Their sudden purchases sparked off rumours within the market which they tried to quell by issuing a misleading press release about the findings of the drilling activities and analysis of mineral samples. The Court found that the defendants withheld material information from the public and that they had acted on insider information to purchase additional shares. The Court particularly noted that, '…the Rule is based in policy on the justifiable expectation of the securities marketplace that all investors trading on impersonal exchanges have relatively equal access to material information.'

Fischel and Carlton[36] summarise the justification by noting that to some critics, '…insider trading creates perverse incentives by allowing corporate managers to profit on bad news as well as good, encourages managers to invest in risky projects, impedes corporate decision-making, and tempts managers to delay public disclosure of valuable information.'[37]

Insider trading hampers the orderly and timely flow of information because an insider will usually withhold the information from the market until their orders have been executed. This is detrimental to the disclosure regime that is important for the operation of securities markets.[38]

[34] Title 17 of the Code of Federal Regulations (Commodities and Securities Exchanges).

[35] 258 F. Supp. 262.

[36] Carlton, D. Fischel, D. (1982), "The Regulation of Insider Trading," Stanford Law Review, 35: 857-896.

[37] Ibid, p. 858.

[38] See McVea, H. (1995). What's Wrong with Insider Dealing. Legal Studies,15(3), 390-414,405

Insider trading not only affects the market, but also the listed company whose shares have been traded. Such a company is likely to lose its reputation. In *Diamond v. Oreamuno*,[39] the court warned that:

> the prestige and good will of a corporation, so vital to its prosperity, may be undermined by the revelation that its chief officers had been making personal profits out of corporate events which they had not disclosed to the community of stockholders.

Nyantung Beny, using data from a cross § of 33 countries found that, '…countries with more prohibitive insider trading laws have more diffuse equity ownership, more accurate stock prices, and more liquid stock markets.'[40] Her findings pointed to the fact that insider trading laws are important for stock market development. Bhattacharya and Daouk[41] also tracked 51 countries for a period of over 20 years and studied the effect of the enactment of insider trading regulations on the cost of equity, reaching a similar conclusion.[42]

On the other hand, there are economists and scholars who do not support the criminalisation and prohibition of insider trading. These include Professor Henry Manne,[43] Daniel Fischel,[44] and Frank H. Easterbrook.[45] These scholars view insider trading as necessary for the market. They argue that it is difficult to discover, with certainty, who the victim of the insider trade is—hence making it a victimless crime.[46] They attack the view that insider trading distorts the level playing field that

[39] 24 N.Y.2d 494.

[40] Nyantungy Benny, L. 2005. Do Insider Trading Laws Matter? Some Preliminary Comparative Evidence. *American Law and Economics Review*, 7(1), pgs 144-183

[41] Bhattacharya, U, and Hazem D. 2002. "The World Price of Insider Trading," Journal of Finance, 57:75-108.

[42] Bhattacharya, Utpal, and Hazem Daouk. 2002. "The World Price of Insider Trading," 57 Journal of Finance 75-108.

[43] Manne, H. (1966), 'Insider Trading and the Stock Market,' New York: The Free Press.

[44] Carlton, DW. Fischel, D.R. (1982) The Regulation of Insider Trading. Stanford Law Review, 35(5), 857-895.

[45] Easterbrook, F.H. (1985), "Insider Trading as an Agency Problem," in *Principals and Agents: The Structure of Business*, John W. Pratt & Richard Zeckhauser eds. (Harvard Business School Press.

[46] For a detailed understanding of the argument that insider trading is a victimless crime, see Cox, J. (1990) An Outsider's Perspective of Insider Trading Regulation in Australia. *Sydney Law Review,* 12, pg 455-481

exists in securities markets. Brazier[47] argues that 'the idea that securities markets should operate on the basis of complete equality between investors and potential investors is generally thought to be too idealistic to be workable in practice.'[48] In a market where investors exercise their own judgement in interpreting information, it would be difficult to state that all investors are on a level playing field.

Werhane further argues that the prohibition of insider trading undermines the efficient and proper functioning of a free securities market. Hence, regulation banning insider trading is seen as affecting the laissez-faire status of the market.[49] That the market should be left to itself, free from regulatory intervention.

In what has been termed as an extreme view, Manne argues that insider trading is in fact economically beneficial, and advocates for the legalisation of insider trading.[50] Together with other economists, he argues that price movements initiated by an insider reflect an accurate position of the security.[51] Therefore, insider trading is seen as benefitting the securities market by ensuring that the market price of affected securities moves in the appropriate direction regardless of whether that movement is upward or downward.[52]

This view has been adopted by scholars of Economics such as Winslow and Anderson who argue that if insider trading was indeed harmful, then firms would have taken measures to prevent its occurrence and that the decision by firms not to intervene therefore shows that it is not harmful.[53] Winslow and Anderson further note the argument that insider trading may help in communicating information to the market more quickly, hence saving the listed entity from the costs of organised disclosure. This would lead to reduction in costs as 'the disclosure will result in

[47] Brazier, G. (1996), 'Insider Dealing: Law and Regulation,' 1st ed. London; Cavendish Publishing.

[48] Brazier, G. (1996). *Insider Dealing*: Law and Regulation. London: Cavendish, 83

[49] Werhane, PH. (1989) The Ethics of Insider Trading. Journal of Business Ethics, 8, pgs 841-845

[50] Manne, H. (1966) Insider Trading and the Stock Market. New York: The Free Press

[51] Ibid, 85

[52] Ibid, 85

[53] Winslow DA, Anderson S. (1992). From Shoeless Joe Jackson to Ivan Boesky: A Sporting Response to Law and Economics Criticism of the Regulation of Insider Trading*. Kentucky Law Journal,* 81(2), 303

lowered expenditures on investigations into the real value of the security and will cause investors to be more certain about the firm.'[54]

Manne also argues, rather strangely, that insider dealing rewards the entrepreneurial skills of employees.[55] This is based on the view that when insiders trade using non-public information, they increase their own renumeration (supposedly through profits) without the burden of doing so falling on their employer. It is therefore seen as an employee benefit. The views of Professor Manne have, however, come under attack by Schotland.[56]

The debate of whether insider trading should be prohibited or allowed is not yet settled. Nevertheless, almost all jurisdictions with stock markets prohibit it in some degree. Uganda is one of those jurisdictions.

3. Insider Dealing in the Ugandan Perspective

3.1 Approaches to regulation

A regulatory authority cannot adequately regulate everything that is considered to be against public policy or morality; and so it has to determine what to regulate and what to permit or remain silent about.

Two theories of regulation have been advanced; the public interest theory and the economic theory. Posner a proponent of the *public interest theory*, holds the view that regulation is supplied in 'response to the demand of the public for the correction of inefficient or inequitable market practices.'[57] Under this theory, the need for regulation is viewed as a tool to protect the public from unfair practices and market abuse and the regulator's role is seen as representing the interests of the public rather than its own interests.[58]

[54] Ibid, 303

[55] Manne, p 131

[56] Schotland, R. 1967. "Unsafe at Any Price: A Reply to Manne, Insider Trading and the Stock Market." Virginia Law Review, 53(7): 1425-1478.

[57] Posner R.A. (1974), 'Theories of Economic Regulation'. The Bell Journal of Economics and Management Science 5(2);335-358, 335.

[58] Ibid.

Hantke-Domas notes that the public interest theory is an old concept that can be traced back to 1787 within the work of Lord Matthew Hale, *The Portibus Maris.*[59] The term 'public interest' was, however, never defined by statute and this required the courts to interpret it on a case-by-case basis.[60] In *R v. Bedforshire,*[61] Campbell CJ, defined public interest as 'that in which a class of the community have a pecuniary interest, or some interest by which their legal rights or liabilities are affected.'

On the other hand, according to George Stigler's economic theory, regulation represents the interests of a specific category of people and not the public at large.[62] He argues that 'regulation is acquired by the industry and is designed and operated primarily for its benefit'.[63] He recognises the political process involved in making regulations and the impact of lobbying by relevant interest groups. Therefore, he views regulation as a means of advancing the private interests of a group. Everyone may have a say in the regulatory process, but the end result represents the views of those that lobbied most.[64] These interest groups usually wield the power to finance and engage in political campaigns. As a result, governments have no option but to hear them out and create favourable regulations for them.[65]

Stigler's theory therefore suggests that regulators are actually subservient to the industry.[66] His theory has also gained support from other economists, especially Peltzman[67] who notes that regulators face both consumer and industry demands and hence will endeavour to deliver an outcome that optimises the political support

[59] Hantke-Domas, M. 2003. "The Public Interest Theory of Regulation: Non-Existence of Misinterpretation?" *European Journal of Law and Economics.* 15: 165-194

[60] Ibid, 166.

[61] (*24 L.J.Q.B. 84*).

[62] Stigler, G. J. 1971. "The Theory of Economic Regulation." *Bell Journal of Economics and Management Science*, 2: 3–21.

[63] Ibid, p. 3.

[64] Downs, A. 1957. *An Economic Theory of Democracy*. New York: Harper & Row

[65] Olson, M., Jr. 1965. *The Logic of Collective Action: Public Goods and the Theory of Groups.* Cambridge, MA: Harvard University Press

[66] Carrigan, C., Coglianese, C. 2016. Capturing Regulatory Reality: Stigler's The Theory of Economic Regulation, *U of Penn, Inst for Law & Econ Research Paper No. 16-15*

[67] See Peltzman, S. 1976. "Toward a More General Theory of Regulation." *Journal of Law and Economics,* 19: 211–40; Peltzman, S. 1993. "George Stigler's Contribution to the Economic Analysis of Regulation." *Journal of Political Economy*, 101: 818–32.

of all lobbying interest groups.[68] Over the years however, Stigler's theory regarding the environment of interest groups has been broadened by scholars such as Becker,[69] McChesney (1987), Levine and Forrence,[70] Laffont and Tirole,[71] and applied to regulatory processes in other sectors. [72] Stigler's theory has, however, become widely accepted within academic circles[73] and the perception that regulatory agencies are an extension of the interests of specific groups is generally acknowledged.

Nevertheless, when it comes to securities markets, there is a general understanding that regulation follows the public interest theory. Croley emphasizes that regulation is geared toward preventing market failures.[74] The prevention of market failure and protection of investor interests remains central to regulation of the securities market in Uganda. Rule 1 provides that the Rules are geared towards boosting investor confidence, protecting the markets from abuse and promoting market efficiency, orderliness and fairness. § 5 of the Act points out investor protection as one of the functions of the Authority. It can therefore be said that the regulation of insider trading in Uganda follows the public interest theory.

A regulatory authority of an emerging market is always faced with the decision of whether to regulate certain vices when the markets are relatively small. This consideration is therefore important for Uganda. The Ugandan capital markets are not only a new concept but they are also relatively small, under developed and the

[68] Peltzman, S. 1976. "Toward a More General Theory of Regulation." *Journal of Law and Economics,* 19: 211

[69] Becker, G. S. 1983. "A Theory of Competition among Pressure Groups for Political Influence." Quarterly Journal of Economics, 98: 371–400.

[70] Levine, M. E., and J. L. Forrence. 1990. "Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis." Journal of Law, Economics, and Organization, 6: 167–98.

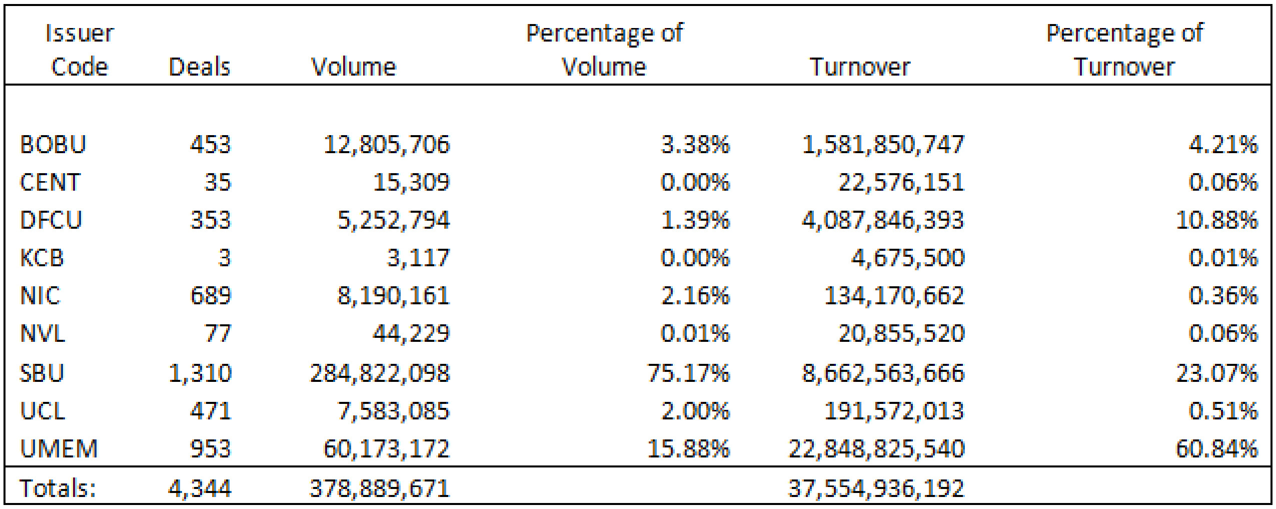
[71] Laffont, J.J., and J. Tirole. 1991. "The Politics of Government Decision-Making: A Theory of Regulatory Capture." Quarterly Journal of Economics, 106: 1089–1127.

[72] See Becker, G. S. 1983. "A Theory of Competition among Pressure Groups for Political Influence." *Quarterly Journal of Economics*, 98: 371–400; McChesney, F. S. 1987. "Rent Extraction and Rent Creation in the Economic Theory of Regulation." *Journal of Legal Studies,* 16: 101–18; Levine, M. E., and J. L. Forrence. 1990. "Regulatory Capture, Public Interest, and the Public Agenda: Toward a Synthesis." *Journal of Law, Economics, and Organization*, 6: 167–98; Laffont, J.-J., and J. Tirole. 1991. "The Politics of Government Decision-Making: A Theory of Regulatory Capture." *Quarterly Journal of Economics*, 106: 1089–1127.

[73] Carrigan, C., Coglianese, C. 2016. Capturing Regulatory Reality: Stigler's The Theory of Economic Regulation, *U of Penn, Inst for Law & Econ Research Paper No. 16-15.*

[74] S. P. Croley, 'Theories of Regulation: Incorporating the Administrative Process' [1998] 98(1) Columbia Law Review 1-168, 70.

trading volumes and turn overs are quite small. There are only 17 listed companies in Uganda, 8 of which are cross listed from Nairobi and hardly trade. In addition, the market only has 6 brokerage firms and few investors, in comparison to Kenya and Tanzania. The table below shows the equity trading statistics for nine companies, which had shares listed in Uganda, between January and August 2018, as obtained from the USE.



Issuer Code	Deals	Volume	Percentage of Volume	Turnover	Percentage of Turnover
BOBU	453	12,805,706	3.38%	1,581,850,747	4.21%
CENT	35	15,309	0.00%	22,576,151	0.06%
DFCU	353	5,252,794	1.39%	4,087,846,393	10.88%
KCB	3	3,117	0.00%	4,675,500	0.01%
NIC	689	8,190,161	2.16%	134,170,662	0.36%
NVL	77	44,229	0.01%	20,855,520	0.06%
SBU	1,310	284,822,098	75.17%	8,662,563,666	23.07%
UCL	471	7,583,085	2.00%	191,572,013	0.51%
UMEM	953	60,173,172	15.88%	22,848,825,540	60.84%
Totals:	4,344	378,889,671		37,554,936,192	

In such a small and underdeveloped market, regulators must critically reflect on their priorities. One may ask whether insider trading should even be an issue deserving attention in Uganda. Although this concern is valid, the reality is that many of the investors into the country's capital markets remain foreign entities. For markets that seek foreign investment, market integrity and investor protection is quite critical. Foreigners making large investments into the markets have to feel protected in order to be attracted to these markets. It is also worth noting that when foreigners come from more developed systems, having similar regulations makes it easier for them to follow and hence make the emerging market attractive. As a result, regulations prohibiting insider trading remains necessary and critical at this nascent stage. The key in addressing the concerns is to strike a balance between investor protection and the promotion of a fair and transparent market on one hand and the promotion of innovation in the market.

3.2 The offence of insider trading in Ugandan law

The prohibition of insider trading in Uganda is covered by two regulatory frameworks; the Capital Markets Authority Act ('the Act) and the rules made by the different licensed stock exchanges. Currently, there are two stock exchanges in Uganda; the Uganda Securities Exchange Ltd ('USE') and ALTX East Africa Ltd. Unlike the USE, ALTX's regulatory framework is not publicly available. ALTX also does not currently have any listed equity securities and only deals in depository receipts. As a result, this discussion will only deal with the regulatory framework of the USE and the CMA.

The CMA Act takes priority over subsidiary legislation made under it, including the regulations created by Exchanges in exercise of the power given to them by the § 24 of the CMA Act and Regulation 14 of the Capital Markets Authority (Establishment of Stock Exchanges) Regulations, SI 84-3. Therefore, in instances where there are inconsistencies between the Act and the Rules or Regulations, the Act takes precedence.

In 2015, a Directive of the East African Community's ('EAC') Council of Ministers regarding Regional Listings in the Securities Market[75] was gazetted. This Directive contains provisions that prohibit insider trading. The application of the East African Community Directives to member states is a controversial matter. On the one hand, Article 123(2) of Uganda's Constitution requires Parliament to make laws governing the ratification of treaties, conventions, agreements and any such arrangements entered into by Uganda. Pursuant to that provision, Parliament passed the Ratification of Treaties Act, 1998 which provides that all such arrangements require ratification by Cabinet or Parliament and should be laid before Parliament as soon as possible after they are engaged in.

On the other hand, The EAC Directives are made under Articles 85(d), 14(3) and 16 of the Treaty for the Establishment of the East African Community ('EAC Treaty') and Articles 31 and 47 of the Protocol on the Establishment of the East African Community Common Market (Common Market Protocol). Partner states are

[75] Directive EAC/EX/CN29/Directive 17 (passed on 29th April 2014), EAC Gazette, Vol. AT 1—No. 7, May 29, 2015, p. 41. Available at: https://cmauganda.co.ug/files/downloads/EAC%20GAZETTE%20NO%20%207%20OF%202015.pdf (Last accessed on May 9, 2019)

required to adapt their national laws to comply with the Treaty and the agreements made under it. Specifically, Article 16 of the Treaty states:

> Subject to the provisions of this Treaty, the regulations, directives and decisions of the Council taken or given in pursuance of the provisions of this Treaty **shall be binding on the Partner States**, on all organs and institutions of the Community other than the Summit, the Court and the Assembly within their jurisdictions, and on those to whom they may under this Treaty be addressed. (Emphasis mine)

Nevertheless, the Protocol gives partner states some leeway in departing from the provisions of the Protocol on the basis of public policy and other limited reasons. In accordance with Article 26 of the Protocol, states are also allowed to take safeguard measures where there are financial disturbances due to movement of capital.

Hence whereas Article 16 of the Treaty makes directives binding, the Constitution takes a different view by noting that directives do not have have automatic and direct domestic legal effect unless they are ratified by Cabinet or Parliament, or are implemented through changes to the relevant domestic legislation.. This establishes a conflict of laws scenario, namely; whether provisions of a treaty can override national law—a question which is answered by examining whether Uganda is a dualist or monist state. That question, however, is beyond the scope of this study.[76] Regardless of the arguments above, it is important to note that the Directive also contains provisions that prohibit insider trading.[77]

3.3 Definition of insider trading

Neither the Act nor the Rules define insider dealing/trading. This approach is not unique to Uganda as many jurisdictions (including Kenya, Tanzania and Rwanda) do not define insider trading, choosing to separately define the term 'insider' and the phrase 'dealing in securities.'

An insider is defined as a person who is or was connected to a company and has unpublished, price-sensitive information. This definition also extends to immediate

[76] The Directives are yet to be adopted in Uganda and are viewed as the benchmark that should be applied by member states in making legislation on matters covered under the Directives. Nevertheless, the applicability of these Directives is a matter that needs to be dealt with by the Attorney General who should advise on their standing in the legal system.

[77] See Rule 3 of the Schedule on the Prescribed Code of Conduct, within the Directive on Regional Listings in the Securities Market.

family members of the insider as well as corporations, partnerships, trusts and other entities that are owned or controlled by the insider.[78]

Under § 1(o) of the Act, dealing in securities is defined as the buying and selling of securities. The definition of 'securities' under § 1(hh) of the Act is broad and covers debentures, stocks and bonds of both corporate entities and government. Rule 4, on the other hand, lists circumstances that amount to insider trading.

Before the 2016 Amendment to the Act, there were concerns about the adequacy of the insider trading framework in achieving its goal of investor protection. Walabyeki notes one of these concerns as being the framework's failure to cover dealing in government bonds.[79] This is premised on the fact that although the definition of securities under § 1(hh)(i) of the Act covers government securities, § 88—which prohibits insider trading—refers to a person who is connected with a body corporate. As Government is not a body corporate, trading in government bonds does not come under the provisions of § 88.

Nevertheless, the 2016 Amendment Act did not address this issue and the definition of an 'insider' still refers to an officer of a corporate entity. A body corporate is defined under § 1 of the Amendment Act as a company incorporated or registered under the laws of Uganda. This means that for purposes of the Act, the insider trading framework only covers dealing in shares and corporate bonds.

On the other hand, the Rules do not refer to bodies corporate and instead define an insider as a person with access to non-published price-sensitive information, as a result of their employment, and other persons that are connected to them. The absence of a reference to bodies corporate may be interpreted as including governments and other sub-nationals.

However, this interpretation would be difficult to sustain. Government shares are not traded on any of the stock exchanges. The Central Bank issues the government securities and lists them with the Exchange, but the actual trading takes place at the Central Bank. Therefore, the Exchange and Authority would not seek to regulate

[78] Rule 2(c), (d) and (e) of the Rules

[79] Walabyeki, J., (2016) 'Insider Trading in Uganda: An Analysis of the Capital Markets Regulatory Framework.' https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2768648 (Accessed on 10th April 2019).

what is regulated by the Central Bank. This was clear to the Exchange and it is presumed that although the Rules do not expressly refer to a body corporate, they would not have sought to bring government securities under the ambit of the prohibition of insider trading.

Recently, the CMA, the Exchange and the BOU have had extensive discussions pertaining to the trading of government securities on the principal stock exchange. These discussions have also covered the possibility of issuance of sub national bonds. If these discussions come to fruition, the regulatory framework as-is would be inadequate to prevent insider trading in these securities.

In Kenya, insider trading extends to dealing in government bonds. In February 2019, the Capital Markets Authority of Kenya penalised an executive of CBA Capital for insider dealing in treasury bonds. According to the Authority, Mr David Maena was found to have used non-public information in bond trades to front-run the market and make dual trades that earned him personal gain.

Walabyeki also notes that the Act does not cover shares of a Ugandan company that is cross listed in another jurisdiction and suggests that the definition of securities be expanded to encompass dealing on any regulated market hence covering cross listed shares as well.[80] This proposal however, fails to consider jurisdictional constraints. The jurisdiction of the CMA is limited to Uganda. It does not extend to other jurisdictions and therefore for cross listed entities, the shares in another jurisdiction would be governed by its own the regulatory authority. Therefore, the definition of securities cannot include shares cross listed outside Uganda as that would create a conflict between the regulators of the different jurisdictions, which is undesirable and unnecessary.

Unlike the Rules, § 88(2) of the Act still prohibits dealing by an insider even after they leave a company, in certain circumstances. A person who was connected with a company 6 months prior to a transaction cannot deal in its securities if they are aware of non-public price-sensitive information about that transaction. The aim is to prevent former employees of the company, in possession of non-public information as well as those who are aware of transactions, from using such

[80] Ibid.

information to trade. The danger with this provision however is that due to the uncertainty surrounding timelines for conclusion of transactions, it may be unfair for an employee to be prohibited from trading in the shares. Transactions do not have consistent timelines, and whereas one transaction may come to the market within a few months, other transactions such as secondary offers, mergers and restructurings may take years to be concluded. An employee who has left the company would not have information as to how the transaction is fairing and stands the risk of being in default even if he/she trades innocently, on the ground only that the transaction happened within six months.

It is not clear if for the offence of insider trading to occur, the offender must not only have been in possession of the information, but also have used it to trade. The Rules, on one hand, state that the person deals as a result of non-public information. In essence therefore, the Exchange would have to prove that the non-public price-sensitive information motivated the insider to trade. Huang classifies such a scenario as the 'strict use' standard.[81] This standard requires that the prosecution prove that the accused person was not only in receipt of the information, but that he actually used the information.[82] Proving usage of information is an uphill task to any regulator and would therefore be a burden on the Exchange.

On the other hand, the Act only requires proof that the person traded while in receipt of non-public price sensitive information. The Authority does not have to prove that the information was actually used. This is known as the 'strict possession standard.'[83] This standard is commonly used by the UK and South Africa. Chitimira critically assesses the South African Securities Services Act and notes that the South African Act presents inside knowledge/information as a prerequisite for liability without requiring that the defendant be shown to have deliberately exploited the said information in concluding the relevant transaction.[84] Although the

[81] Huang, H. 2005. "The Insider Trading "Possession Versus Use" Debate: An International Analysis" Securities Regulation Law Journal, 34(2): 192

[82] Ibid, 132

[83] Huang, 131

[84] Chitimira, H. 2008. 'The Regulation of Insider Trading in South Africa: A Roadmap for Effective, Competitive and Adequate Regulatory Statutory Framework.' LLM Thesis, School of Law at University of Fort Hare. http://hdl.handle.net/10353/230 (Accessed 1st April 2019).

regulators would have to prove that the defendant was aware that this information was inside information, he observes that this removes the overwhelming aforementioned evidentiary difficulties which would otherwise be placed on regulators.[85]

As noted in the case of *Securities Exchange Commission v. Adler,*[86] the danger with the 'strict possession' standard is that it is too wide and can therefore end up prohibiting actions that would not be considered as fraudulent. Huang notes that 'the potential overreaching of the standard would likely frustrate legitimate commercial activities' since intermediaries would never trade when in possession of information even though such information came to their attention after the decision to trade had already been made.[87]

In *United States v. Smith,*[88] the court noted thusly:

> [P]ersons with whom a hypothetical insider trades are not at a "disadvantage" at all provided the insider does not "use" the information to which he is privy. That is to say, if the insider merely possesses and does not use, the two parties are trading on a level playing field; if the insider possesses and does not use, both individuals are making their decision on the basis of incomplete information.

It is difficult however for the other party, not in possession of the information, to confirm that such information was not used and hence mere possession without use may not be easy to prove for the offender.

In recent times, the two original standards, "strict use" and "strict possession" have since been modified into the "modified use" and the "modified possession" standards. The "modified use" standard arose after *Securities and Exchange Commission v. Adler* where court recognised the difficulty in choosing between use and possession. Jurisdictions which adopt the modified use standard do so by adopting a non-use defence hence shifting the focus onto the actual use of the

[85] Ibid
[86] (137 F.3d 1325).
[87] Huang, 136
[88] (9th Cir. 1998).

information and shifting the burden of proof onto the defendant to prove non-use.[89] This modified standard therefore requires for the insider to have actually used the information that they were aware of, in carrying out the trade.

The modified possession standard is more common in the USA and emerged with the passing of Rule 10b5-1[90] by the Securities and Exchange Commission.[91] It has also been adopted by Australia.[92] The only difference between the strict possession standard and the modified possession standard is that the latter takes into consideration some defences, hence resolving the problem of the standard being too wide.[93]

Regardless of which standard is adopted, the difference in the theories applied by the Authority and the Exchange needs to be addressed immediately because applying different standards is bound to cause confusion in the prosecution of insider trading cases. The two parties ought to agree on a single, uniform standard to create clarity.

3.4 Tipper-Tippee liability in insider trading

Tipping involves the provision of non-public price sensitive information to an outsider by the insider or a connected person, with the intention of gaining a personal benefit such as through sharing of profits with the outsider. The prohibition of insider trading also extends to prohibition of tipping. Specifically the Act extends the prohibition to persons who are not insiders themselves but receive inside information from an insider and are aware that such information was obtained by that insider as a result of their connection with an issuer.[94] Such persons are generally known as 'tippees'.

[89] Huang, H. 2005. "The Insider Trading "Possession Versus Use" Debate: An International Analysis" Securities Regulation Law Journal, 34(2):

[90] Codified at Title 17 of the Code of Federal Regulations (Commodities and Securities Exchanges).

[91] Ibid, p. 134.

[92] See § 1043A of the Corporations Act and the 1991 Amendments.

[93] Ibid.

[94] § 88(3) of the Act and Rule 2(d) of the Rules

In 1983, the US Supreme Court made a ground-breaking ruling on tipper liability in the case of *Dirks v. the Securities and Exchange Commission.*[95] Raymond Dirks was an employee in a brokerage firm that offered investment advice on insurance company securities. He received information from a former employee of Equity Funding of America—a listed investment company that sold mutual funds and life insurance—pertaining to an alleged fraud that was taking place whereby the company overstated its assets. The employee's disclosed the information so that Dirks would research about it, investigate it and whistle blow the fraud. Dirks investigated the fraud and informed some of his clients who then sold their shares in the issuer. In the meantime, as he investigated, the share price of the company fell from $26 to $15 and the New York Stock Exchange halted trading in accordance with the limit rules.

The issuer was investigated, and the fraud was unearthed, leading Dirks' censure by the SEC for aiding and abetting. The SEC took the view that once a tippee discovered confidential material information from an insider, they were obliged to disclose it or refrain from trading. This was an attempt to restore the parity-of-information theory which the Supreme Court had rejected in the 1980 case of *Chiarella v. United States.*[96]

The Court noted that a tippee would adopt the duty of the insider not to trade on non-public information, '…only when the insider has breached his fiduciary duty to the shareholders by disclosing the information and the tippee knows or should know that there has been a breach.'[97]

Therefore, it took the view that the tippee ought to have known that there existed a fiduciary duty and that the information was being given in breach of that duty. Nevertheless, there still remained a question of what would constitute a breach by an insider. The Commission hence stated that the test was 'whether the insider personally will benefit, directly or indirectly, from his disclosure' and this introduced the aspect of personal gain. Without personal gain, the tippee would not be liable

[95] [463 U.S. 646].
[96] [445 U.S 222].
[97] Ibid.

and since the tipper, Dirks had only been motivated by the need to expose the fraud that was taking place in the issuer company, there was no derivative liability.

Fiduciary duty not only relates to the duty owed to the shareholders but also extends to the duty owed to the person from whom information is obtained. This was reaffirmed in the 1997 case of *United States v. O'Hagan*[98] where a lawyer obtained non-public information from the clients of the firm and used it to trade. The lawyer, O'Hagan, argued that he had no relationship with the shareholders of the company and hence owed them no duty. The Court disagreed, finding that the fiduciary duty extended to the source of the information and not only the shareholders. He was therefore in breach and liable for insider trading.

Therefore, for a tippee to be liable for insider trading, it must be proved that:

a. The tipper was in possession of non-public information which he provided to the tippee in breach of a fiduciary duty, and;
b. The tipper received or anticipated that he would receive a personal benefit.

Despite the judgement of court in the Dirks case, it remained unclear as to what the legal standard for a personal benefit would be. This uncertainty took centre stage in 2014 case of *United States Vs Newman.*[99] This case was an appeal from the US Court for the Southern District of New York against Todd Newman and Anthony Chiasson who had been convicted of conspiracy to commit insider trading as well as insider trading in violation of the SEC Act and Rules. The two accused were portfolio managers at two different firms who allegedly obtained non-public price sensitive information from analysts at various investment funds and hedge funds who in turn had obtained it from employees of listed companies. Newman and Chiasson used this information to trade and made profits of approximately USD 4M and USD 68 M respectively for their funds.

The Supreme Court reversed the conviction on grounds, among others, that "the Government's evidence of any personal benefit received by the alleged insiders was

[98] [521 U.S. 642].

[99] Case 13-1837, Document 262-1, 12/10/2014. https://www.scotusblog.com/wp-content/uploads/2015/08/15-137-op-below.pdf (Accessed on 10th May 2019).

insufficient to establish the tipper liability from which defendants' purported tippee liability would derive."[100] The Court further emphasized that a "tippee's knowledge of the insider's breach necessarily requires knowledge that the insider disclosed confidential information in exchange for personal benefit."[101] On the issue of personal benefit, the government was tasked with proving that the insiders had in fact obtained a personal benefit.

Government assertions that the insiders were friends or family relatives of the managers were held to be insufficient for purposes of proving a personal benefit. Court took into consideration the fact that personal benefit includes both financial benefits and reputational benefits but noted that this did not mean that the government would allege friendship as proof of a personal benefit. Court therefore held that, "such an inference is impermissible in the absence of proof of a meaningfully close personal relationship that generates an exchange that is objective, consequential, and represents at least a potential gain of a pecuniary or similarly valuable nature."[102]

Tipper-tippee cases are very rare in Africa and the Authority has not prosecuted anyone under tipper-tippee liability so it is difficult to ascertain where the burden of proof would lie in such circumstances and what the ingredients of the offence would be, since neither the Act nor the Rules go further than merely extending liability to tippers and tippees. It is not clear if the ingredients of the offence would include receipt of a personal benefit. However, a critical review of the insider trading framework in Uganda and § 88(3) in particular shows that whether or not the offender made a benefit is immaterial. The silence of the Act on the issue of personal benefit can therefore be interpreted as implying that it need not be proven. This therefore shows that the approach taken by the Authority does not conform to the commonly accepted ingredients of this offence and is a serious departure from tipper liability law.

[100] Page 4 of the judgement.
[101] Page 17 of the judgement.
[102] Page 22 of the judgement

3.5 Information covered by the Framework

In order for there to be insider trading, the accused person must have access to inside information. Inside information is sometimes referred to as 'privileged' although the use of the term is not meant to refer to the nature of the information but the nature of the relationship through which the information is obtained, that is to say that the officer is in a privileged position (as an employee or one connected to the company) compared to other investors.[103]

Until the 2016 Amendment, the Act did not have a definition of information and this created confusion regarding the scope of the information, considering that too wide a scope would render the prohibition unreasonable and too narrow a scope would render it useless. Understanding the challenge posed by this, the Amendment Act explains the meaning of 'information' in relation to securities. Under § 59(11), the Amendment Act defines information to include matters that are insufficiently definite to warrant their being made public, matters of intention, matters relating to negotiations, transactions, arrangements or proposals, information relating to financial performance and any matters relating to the future. § 59 of the Amendment Act further defines the meaning of 'information generally available' as price-sensitive information that has been made known to persons who invest in securities and a reasonable period has passed since that information was made known for it to be assimilated by investors. Together, these two definitions widen the scope of what is considered information and create a 'catch all' scenario that is wider than the disclosable information under the continuing listing obligations provided by the USE Listing Rules.

In addition, the definition of 'information generally available' under the Act not only refers to information being made known to investors but also adds another requirement; that a reasonable period of time must have passed for the 'information to be disseminated among and assimilated by such persons.' Unfortunately, there is no definition of a reasonable period or indication of what the Authority would consider a reasonable timeframe. Different people receive and process information

[103] Rider, B. Kern A. Bazley S. Bryant J. 2016. *Market Abuse and Insider Dealing.* 3rd Ed. West Sussex; Bloomsbury Professional Ltd

differently and hence the addition of the timeframe for processing of the information would place an unreasonable burden on the insider.

In order to understand the complexity of the Authority's definition, it is important to look at the framework of other jurisdictions with regard to information.§ 79 of the South African Financial Markets Act defines publication of information as information being published in accordance with the Rules of the Exchange or information being available for inspection by the public or when the information can be readily acquired by other investors. Under § 118c (8) and (9) of the UK's Financial Services and Markets Act, information is said to be generally available when it has been disclosed in accordance with the rules of the prescribed market; that is to say it is contained in records that are open to public inspection or that can be accessed publicly via the internet or that can be obtained by research or analysis.

This provision is clearer and more reasonable because it does not require the passage of a particular time period from the date on which the information was published and hence, it does not add an unnecessary burden on those who would wish to exercise their property rights in shares or bonds. Moreover, unlike South Africa and the UK, the Ugandan Act makes no attempt to define publication or 'public information'.

Rule 3 on the other hand, provides that 'information is deemed to be price-sensitive information if there is a reasonable likelihood that it would be considered important to an investor in making a decision regarding the purchase or sale of securities. One of the concerns of the reference to 'an investor' is that different investors make investment decisions using different pieces of information and what may be important to one investor may not be important to another. As a result, such a broad definition of price-sensitive information causes uncertainty. This can be remedied by reverting to the test of 'a reasonable investor' and not just 'an investor.' In its definition, the Act does not require that the information be specific or precise. This is a departure from the provisions of some jurisdictions such as South Africa that require the information to be specific or precise.[104] This requirement weeds out

[104] § 77 of the Financial Markets Act of South Africa, Act 19 of 2012 on the definition of inside information

rumours and incoherent, unclear pieces of information. The requirement for the information to be precise is also found in the UK and EU law.[105]

In the South African case of *Zietsman and another v. The Directorate of Market Abuse and another,[106]* the court had to determine whether the information was specific or precise as required by the Financial Markets Act. The information in question related to knowledge that the Industrial Development Corporation ("IDC") had agreed, in principle, to advance a loan facility of R99 million to the issuer, Africa Cellular Towers Ltd (AC Towers). The appellants argued, inter alia, that the information they were in possession of was neither specific nor precise and that 'at the time that they came to know about the loan, there were no details of the loan to show whether AC Towers would be able to pay the loan, and neither were the terms of the loan known.'

The Court determined that the information was specific and precise and the lack of a loan agreement at the time, setting out the terms of the loan, was not a defence. The appellants knew that a loan offer had been made and had in fact been informed of it and had read the valuation report relating to the loan. They knew its details, including the tranches in which it would be disbursed. In addition, the appellants had been warned before not to deal in the shares of the issuer until the information had been made public. The information need not have been in final form (the completion of the transaction with all details included) for it to be seen as specific and precise.

The EU Market Abuse Regime deems information as precise if 'it indicates that circumstances exist or that an event has occurred (or may reasonably be expected to come into existence or occur) and [if it is] specific enough to enable a conclusion to be drawn as to the "possible effect" of those circumstances or that event on the price of the relevant investments.' The European Court of Justice, in the case of *Jean-Bernard Lafonta v. Autorité des marchés financiers[107]* noted that the Directive does not state that 'precise information' only relates to information which makes it

[105] See Article 1 of Directive 2003/6/EC of the European Parliament and of the Council of 28th January 2003.

[106] *[2015] ZAGPPHC 651*

[107] [Case C-628/13].

possible to determine the likely direction of a change in prices of the listed entity. The Court took cognisance of the fact that an investor can as well base his investment decision on information that does not help in determining the direction of price changes.

§ 59 of the Amendment Act requires that the information used must not be generally available. A similar provision in the Kenyan Act was recently examined in two Kenyan insider trading cases involving the shares of Uchumi Supermarkets Limited. Both cases, *Republic v. Terrence Davidson*[108] and *Republic v. Bernard Mwangi Kibaru*[109] stem from the same set of facts. The two cases involved alleged insider dealing by the CEO of KCB Bank (Terrence Davidson) and a senior executive of Uchumi (Bernard Mwangi Kibaru). The CMA argued that the two officials were aware of the dire financial situation of Uchumi, the issuer, and used that information to dispose of their shares shortly before the collapse of the chain of supermarkets. Particularly KCB Bank was a lender to the issuer hence the CEO knew the financial situation of the issuer and knew that KCB Bank had taken the decision to stop financing Uchumi. He used that information to instruct his brokers to buy shares and later sell them shortly before the collapse of Uchumi.

The Court took a different view from the CMA, ruling that the issuer's dire financial situation was not a confidential matter as its own information memorandum showed that the company was making losses. Therefore, such information could not be classified as non-public. This was so despite the fact that at a prior Board meeting attended by the CEO, detailed discussions had been had about the financial state of the company, and these discussions were not public. It also did not matter that the financial situation of the issuer had become worse since the publication of the information memorandum and that the extent of this had not yet become public information. This ruling however forced the CMA of Kenya to amend its regulatory framework on insider dealing and revisit its enforcement mechanisms.

[108] [Nairobi CMCC 1338 of 2008].

[109] [Nairobi CMCC 1337 of 2008].

The two Uchumi insider trading cases above pose a dilemma for regulatory authorities. The cases seem to suggest that it does not matter that the market did not have all the specifics of the information as along as the general information was available. This does not take into account the fact that not all investors trade on obscure information and that specific and concise information may have more impact on the price of the listed security than general information. Having information that the company is performing badly is not the same as knowing, by reference to figures and the failure to obtain further loans, that the company is on the verge of collapse. The court seemed to suggest that the details did not matter if the general concept was known.

These judgements therefore require that regulators return to the drawing Board and look at inside information through the eyes of courts. This may explain why § 59(11)(d) of the Amendment Act defines information in broader terms including 'matters of supposition', matters that are insufficiently definite and even matters relating to intentions. It remains to be seen whether this would be considered as adequate to secure a conviction.

3.6 Remedies in insider trading

§ 89 of Act provides various penalties for a person found liable for insider trading. Individuals are liable to pay a fine not exceeding UGX 10,000,000 (ten million Uganda shillings) or serve a jail term of up to 5 years, or both, while bodies corporate are liable to pay a fine not exceeding UGX 12,000,000 (twelve million Uganda shillings).

The fines are quite small in comparison to the dangers that insider trading poses to the market, which include loss of investor confidence, sharp price movements and unfair gains. However, it is important to remember that the securities market in Uganda is still very small and underdeveloped. There will be a need to revise these figures as the market grows.

Swan and Virgo observe that the failure of a number of high-profile criminal trials exposed weaknesses in the UK insider trading laws, arising from reliance on penal provisions that were difficult to prove.[110] They also warn that criminal trials are cumbersome and time consuming, and obtaining a conviction requires the proof, beyond reasonable doubt, of the *mens rea*[111] constituting the offence.[112] The CMA has not yet prosecuted any insider trading case and therefore it remains to be seen how the case would play out and whether it would be able to register a conviction.

§ 89(2) of the Act requires a person convicted of insider trading to pay compensation to persons engaged in the transaction with them, who suffer loss as a result of the contravention. This would be the seller if the convict was the buyer or the buyer if the convict was the seller. According to § 89(3), the amount of the compensation is equal to the loss sustained by the person. A person who wishes to institute an action for the recovery of loss must do so within three years of the date of the transaction, according to § 89(6). Where harm has been done to the market as a whole, § 89(4) of the Act requires the guilty party to pay the entire amount of the gain received or the loss averted as determined by court.

The Act leaves the door open for further prosecutions under other laws of Uganda[113] This is particularly important for civil law suits that may arise, inter alia, from the issuer company[114] and law suits related to professional misconduct.[115] Under the Rules, the Exchange has power to stop any trade of an insider if it has not yet been settled, commence disciplinary proceedings if the offender is its employee, freeze the securities that are the subject of the insider trading investigation, impose a penalty equal to the gain made and send a report to the Authority.

§ 60(9) of the Amendment Act gives the Authority power to refer the matter to court in a civil suit and where it is successful, the party must pay the amount of the profit to the Authority, a punitive/compensatory penalty as determined by court, interest, and costs of the suit. This amendment is a welcome development as it

[110] Swan, E. and Virgo, J. 2010. *Market Abuse Regulation*. London: Oxford University Press, 6

[111] A 'guilty mind'—the element of an offence that relates to an accused's state of mind in the context of but opposed to their physical commission (or omission) of an offence.

[112] Ibid.

[113] See Section 89(7) of the Act

[114] For breach of contractual obligations of confidentiality or breach of fiduciary duty.

[115] Such as under laws governing lawyers, accountants, engineers, and other professionals.

makes the costs of insider trading high and hence acts as a deterrent to such conduct.

Capital markets remain relatively new on the African continent and this poses a challenge in the institution of criminal or civil suits against suspected offenders. There is very limited expertise within the police, the judiciary and even in private legal practice—which would render pursuit of justice difficult. The International Organisation of Securities Commissions has noted that the handling of capital markets crimes requires unique expertise as well as special divisions in the police and amongst prosecutors.[116] In the absence of such expertise in Uganda, the Authority will struggle to successfully prosecute insider trading cases.

An insider may also face a law suit from the company, under the agency principle, for use of the inside information. Although such cases are extremely rare, the New York Court of Appeals has sustained a shareholder's derivative suit against an insider to recover the profits made by trading on non-public price-sensitive information. In D*iamond v. Oreamuno,*[117] the Board Chair and President of a company sold his shares on the basis of unpublished information that the company's profits had reduced significantly in comparison to a similar period in the previous year.

The US' Securities Exchange Act of 1934 provided in part:

> For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer… within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months…

[116] See Page 17 of the Report of the Emerging Market Committee of the International Organisation of Securities Commissions. March 2003. Insider Trading: How Jurisdictions Regulate it. https://www.iosco.org/library/pubdocs/pdf/IOSCOPD145.pdf Accessed on 12th April 2019

[117] (24 N.Y.2d 494).

Basing on that agency provision, a shareholder successfully instituted a suit against the Board Chair to recover those profits for the corporation. It should be noted that this case turned on the availability of a specific agency provision in the securities law of the USA. Such provision is not available in Uganda's securities regulatory framework. The enactment of such a provision would strengthen the deterrent nature of the prohibition of insider trading in Uganda and allow companies to assert their rights over their information. However, directors owe a fiduciary duty to the company and this duty can be cited in bringing derivative suits against directors who breach their duty to act in good faith. This does not, however, give locus to a company to bring a suit against an insider to recover profits made.

3.7 Defences to insider trading

Unlike the Rules, the Act provides only one defence to the offence of insider trading. § 88(10) provides that 'it is a defence if the person satisfies the court that the other party to the transaction knew or ought reasonably to have known of the information before entering into the transaction.' This section can be interpreted as allowing insider trading as long as both the parties to the transaction are insiders, to the detriment of the rest of the market.

In the UK, more defences are provided by § 53 of the Criminal Justice Act, 1993. Particularly, the Act provides for three defences. First, a defendant can show that they did not expect the trade to result into a profit attributed to the fact that the information was non-public price-sensitive information at the time. This defence is only available to a person who has traded or encouraged another to trade.

Secondly, a defendant can argue that they believed, on reasonable grounds, that the information had already been disclosed widely enough so that no prejudice would be occasioned to those in the transaction that may not have it. This is known as the 'no prejudice defence.'

Lastly, it is a defence for the defendant to show that they would have still traded even if they did not have the information. This is particularly important when a defendant has established a pattern of trading long before coming into possession of that information and maintains that pattern of trading even when in possession of the information. This could also be in situations where the party is experiencing financial difficulty and hence has to dispose of their shares. It is therefore important for the Authority and the Exchange to consider adopting some of these other defences.

3.8 Issuer practices

Since the insiders are connected with issuers, the issuers have a big role to play in combating insider trading. It is therefore important for companies to put in place insider trading policies and manuals to regulate their employees' dealings and connected parties. The Act does not, unfortunately, require issuers or intermediaries to have in place insider trading policies as well as robust compliance monitoring.

In a departure from the Act, Rule 6 of the Insider Trading Rules requires insiders to notify the Chief Executive Officer of the company before engaging in any disposal or purchase of shares of the entity, except where the transaction is exempted within the provisions of the Rules.

Rule 6(ii) further requires the insider to inform the Chief Executive Officer of the issuer company immediately after the transaction has been completed. Rule 6 covers all insiders who include immediate family members as well corporations, partnerships and trusts connected with the insider. This list therefore includes persons whose only relationship with the company stems from their connection with the insider. Therefore, the requirement for such persons to inform the Chief Executive may be misplaced in view of the fact that they are not employees of the issuer company and may not even have any access to the same. This shows the vagueness of the provision.

It may be helpful and more reasonable for the requirement to be placed on the person who has a direct connection with the company, that is to say the employee or director. In such a case, it would be the employee to bear the duty of reporting transactions that are proposed by their associate. In addition, the Authority should require issuers to have robust insider trading policies in place before a listing may be approved.

Brokers and dealers are also central to combating insider trading. It is these persons who conduct trades on behalf of the insiders since there is currently no direct market access at the Exchange. Licensed brokerage firms are therefore required to properly advise their clients who seek to conduct transactions, especially where the client is an insider or connected to an insider. The Authority should ensure that brokers and dealers are aware of the insider trading framework and should require for a client to be duly reminded of the same before a trade is conducted. Where a broker or dealer fails to do so, there should be penal consequences imposed by the Authority.

4. Conclusion

Despite the enactment of the framework prohibiting insider trading in Uganda, the Authority has not yet prosecuted anyone for the offence.[118] Therefore, the adequacy of the framework has not yet been tested. The failure to prosecute any insider could be as a result of the Authority and Exchange's view that there are no instances of insider trading in Uganda. It could also point to weaknesses in the investigative and enforcement arms of the Authority and Exchange, which should be addressed as a matter of priority.

The recent acquittals in the Uchumi insider trading cases have reaffirmed the difficulties that regulators face in prosecuting suspected insider traders in Africa and hence there is an urgent need for regulators to go back to the drawing board and revisit the regulatory framework in view of current developments.

For Uganda particularly, the Authority should address the identified loopholes within the regulatory framework. These loopholes, as discussed, include reliance on provisions that are in contrast to generally accepted evidential standards when it comes to matters concerning securities markets, the failure to bring sub-national bond issuances into the ambit of the framework, the differences in the standards applied by the Exchange and the Authority, as well as the failure to provide adequate defences. The Authority should continue to educate the market on the dangers of insider trading as well as create alliances with the Directorate of Public

[118] 22 years since the Act came into force.

Prosecutions, the Police and the Judiciary in creating knowledge capacity in those arms. This capacity will be valuable in prosecuting insider trading cases and ultimately combating the vice.

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