SECURITIES TRADING AND INVESTOR PROTECTION IN NIGERIA: AN ASSESSMENT OF THE CURRENT REGIME

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Introduction

The most important distinguishing feature of a Public Company is the fact that it can offer its shares or debentures to the public generally for subscription or purchase. A Private Company on the other hand is prohibited from soliciting investment by a public issue of securities.[1] Infact even the transferability of its shares has to be restricted in the articles.[2]

The power to raise capital from public solicitation is what makes public companies comparatively more ambitious enterprises. But it also raises some important problems of investor and public protection against frauds or deception. Thus in order to protect investors and the public, the law imposes strict controls over invitations to the public to subscribe or purchase securities.

The main form of control in this area is the requirements for the disclosure and publicity of company information which would enable investors and the public to intelligently assess the risk of the investment or the merits of the offer. Such disclosure constitutes an important inducement for subscribers because "nobody but a churl would buy a pig in a poke".[3]

Both at common law and in equity, the problem of securing information required for investment decisions had been approached from a negative point. There was no requirement that any particular information about companies offering securities to the public was to be given. This was probably based on the laissez-faire concept of caveat emptor. The law only required that any information volunteered must be accurate. If such information was inaccurate, the common law sanction for deceit and the right of rescission in equity applied.[4]

These remedies were however too complex and totally inadequate for the control of abuses arising from non-disclosure of material information. For example, intervention of equity could be barred by laches or impossibility of restitution in integrum. At common law, where the statement volunteered was one of opinion or forecast or mere eulogistic commendation of the 'res venditio', it was not actionable even if false so long as the maker honestly believed in it.[5]

Whereas these rules may have been salutary in ordinary contracts or contracts for the sale of goods, they became pitfalls for investors. The complexities were even increased by the insistence at common law that a plaintiff could only succeed if he proved an intent to defraud and actual damages resulting from the misstatement relied on.[6] These made recovery for false inducements extremely difficult.

To remedy these defects and protect investors against misleading information and the evils of non disclosure, measures were introduced by legislation to ensure that information given in any invitation to the public to deal in the securities of a company would be both adequate and accurate. The legislative measures therefore went further to compel the disclosure of significant and material matters which hitherto were rarely, if at all, disclosed. Unlike the position at law and equity, the measures were not just designed to provide remedies. Based on the belief that prevention is better than cure, they were to provide a basis for vigilance and caution on the part of those concerned in company trading.[7]

The key item in the system of formal legal control over public issues is the prospectus. It must accompany any invitation to the public to subscribe for or purchase shares or debentures in a company. It is the main vehicle for disclosure before investment.

DISCLOSURE IN PROSPECTUSES

The general aim of a prospectus is to ensure that the company gives the public the essential minimum of information about its position when it is launched into the business world. Another function of the prospectus is to ensure that whenever a company offers its securities to the public, it fairly and fully discloses the relevant facts. This is necessary to enable the investing public to assess the risk of their investment.[8] To achieve these aims, the prospectus and allotment provisions of the *Companies Act, 1990*[9] require that any offer, by or on behalf of a company, of securities to the public for subscription or sale, must be accompanied by a prospectus. Such a prospectus must state the minimum particulars prescribed in schedule fifteen to the Decree.[10]

The benefits of a prospectus cannot be denied only because the company does not intend to make an immediate public offering of its securities. Thus if an issue to the public is not contemplated, the company must nevertheless file a statement in lieu of the prospectus in the form in schedule sixteen.[11] The reason for this requirement is that since the securities of a public company are freely transferable, they may become widely held even though no public offer is made. Hence it is still vital that as much information as possible is available to the public.

The prospectus provisions apply to all invitations to the public, whether by way of a direct offer by prospectus, or by an offer for sale or by placing. It also does not matter whether the invitation is in a notice, circular, advertisement or otherwise[12].

The provisions do not apply where the securities being offered are all in respective uniform with those already listed and dealt in on a recognised stock exchange. Therefore if an application is being made for quotation of the securities, the issue may also be exempted from compliance with the provisions.[13] Another situation where the provisions may not apply is in respect of an invitation made by a company in respect of its shares only to the existing shareholders of the company or its associated companies.[14]

A prospectus is required to give the persons to whom it is addressed a full, accurate and fair picture of the state and prospects of the company. Therefore, it must not contain any ambiguous statement which is not true in every sense in which it might reasonably be understood. Finally it must disclose every material fact and contract and further-comply with sections 548 to 560 and schedule fifteen.[15]

The common law standard for the framing of prospectuses was laid down by Kindersley, V.C., in *NEW BRUNSWICK CO. V. MUGGERIDGE,*[16] as follows:

> "Those who issue a prospectus, holding out to the public the great advantages which will accrue to persons who will take shares in a proposed undertaking, and inviting them to take shares on the faith of the representations therein contained, are bound to state everything with strict and scrupulous accuracy, and not only to abstain from stating as fact that which is not so, but to omit no one fact within their knowledge, the existence of which might in any degree affect the nature, or extent, or quality of the privileges and advantages which the prospectus holds out as inducement to take shares".17

This formulation which has been variously described as a "golden legacy" and as a "counsel of perfection"[18] has long been given statutory force.[19] Neglect of the rules may therefore give the allottee the right to rescind the contract and repudiate the allotment. In some cases he may also sue for damages or compensation from those responsible. Criminal sanctions are also available in respect of any untrue or misleading prospectus against the directors and other persons concerned in the issue.[20]

The actual contents of a statutory prospectus as prescribed in Schedule Fifteen can be briefly described under three main heads. The first is that full details must be given of the actual offer. This includes the number of shares or debentures being offered and the rights attaching to them. Other details under this head are the minimum subscription, the date of the opening of the subscription lists and the precise administrative arrangements for the making of application and allotments.[21]

The second head requires details of all materials contracts entered into within the previous two years and of all property purchased or acquired or proposed to be purchased or acquired to be given. The property to be covered here is that whose purchase or acquisition is to be financed out of the proceeds of the shares offered. Similarly, details of the expenses of flotation must be given under this head. This item usually deals with any discounts or commission arranged by the promoters. Also any interest held by any director or prospective director is to be declared.[22]

The third set of information which is also included in the prospectus is the report or reports of the company's auditor, whose name and address is given under paragraph 12 of schedule Fifteen.

This report is to be accompanied by the trading results of the company or group or any business to be acquired. The results must cover the five previous years. In particular, it must show the profits and dividends paid over that period.[23]

Where the proceeds of the issue of the securities or any part thereof is to be used to purchase any business or such part of it as would make the latter the company's subsidiary, the prospectus must set out a report by accountants as required in paragraphs 17 and 18 of schedule Fifteen. Such a report is to deal with the profits or losses of the business in the proceeding five years and an account of the company's assets and liabilities as at the date of its financial year.[24]

The arrangement of the items for disclosure in Schedule fifteen and the nature of the information required therein show that the particular items specified in the schedule have been haphazardly built over the years in response to particular forms of malpractice. The law did not set out to specify the full range of information which a prospective investor would ideally like.

The result of this is that we have a list of unconnected and complex items of information, often unrelated to each other or to any overall pattern of disclosure. Thus a prospectus which contains only those statutory details is not likely to give a complete or coherent view of the nature of the enterprise or the prospects and risk for investors. In fact a formally perfect statutory prospectus may do no more than confuse the people it is intended to protect.[25]

It is perhaps in recognition of this problem and the need to check the truth of the information disclosed that the new *Companies Act, 1990*[26] has vested the Securities and Exchange Commission with the power to administer inter-alia the provisions dealing with public offers of securities. Accordingly, all securities proposed to be offered for sale to or subscription by the public must be registered with that Commission[27] in accordance with the provisions of the *Securities and Exchange Commission Act, 1988.*[28] The Commission is given explicit statutory power to refuse registration of any securities if either it is not satisfied with the merits of the offer or that the information stated in the prospectus is cast in a misleading fashion or is inaccurate.[29] Furthermore under Section 557 (4) of the *Companies Decree, 1990,*[30] the Commission has a discretion to reject a prospectus submitted for registration unless it is satisfied that it has been properly signed and dated, that the necessary documents have been endorsed on or attached to it, and that it otherwise fully complies with the requirements of the decree.

These provisions put together appear to give the Commission a discretion that the Registrar did not have under the old law. In the *Companies Act, 1968*[31] the task of the Registrar of Companies with whom prospectuses were registered was only to ensure that they were complete and regular on their face. He was under no duty to carry out any investigation or scrutiny to see that the information disclosed was accurate and not expressed in an misleading manner.[32]

The new powers of the Securities and Exchange Commission gives it control over the whole field of Securities regulation in Nigeria in the same manner as its U.S. counterpart. The fact that it is charged with the duty of scrutinizing all facts and documents bearing upon proposed issues of securities before they are released to the public should enable to the reject any prospectus when lodged for registration if it does not set out the prescribed information. Similarly if the information is put in a manner likely to mislead or create a false impression on the mind of an unwary or inexperienced investor, it should be disallowed. Thus the powers of the Commission at present transcend the limited task of merely ensuring that a prospectus lodged with it complies, ex facie, with the provisions of law. The power to stop undesirable offers of which it does not approve has long since being urged for in view of the low level of literacy and financial or investment journalism in the country.

This enhanced jurisdiction of the Securities and Exchange Commission as the apex regulatory body with power to maintain general surveillance over the securities market has met most of the criticisms of our former prospectus provisions.[33] The old criticism was that there were no statutory measures to check the truth of information contained in prospectuses. This it was contended, seemingly destroyed the efficacy of the disclosure philosophy which is based on the assumption that the company information with which investors are to protect themselves is true and complete. Hence, the philosophy would require that someone is charged with the responsibility of ensuring the accuracy of the information before it is acted upon.

The new regime relating to prospectuses is therefore designed to provide this necessary backup to the disclosure philosophy in order to make it both more relevant and effective. This expectation that the disclosure rules here would be made more efficient by the intervention of the Securities and Exchange Commission is supported by its new powers to make regulations for the purpose of giving effect to the provisions.[34] This should enable the Commission, with the approval of the Minister of Finance, to amend the relevant Schedules Fifteen and Sixteen at any time. This would help to keep the schedules up to date.[35] It is suggested that there is the urgent need for the Commission to exercise the above powers to supplement the information required to be given in prospectuses by extending the requirements of Schedule Fifteen. First it is desirable to have more information about the company's capital structure in the prospectus. This should cover the authorised, issued and paid up capital as well as its loan capital, overdrafts and the directors's borrowing powers.

Secondly, the company should give more information about the nature of its business and that of its subsidiaries and holding companies, if any. Lastly, the provisions of Schedule Fifteen should be extended in relation to information to be disclosed where debentures are offered. The prospectus here should give information about such matters as interest, terms of redemption and security offered.

Some people might argue that the role of the Securities and Exchange Commission in the area of stock trading negates the spirit of deregulation and de-bureaucratization of the business environment in Nigeria. Contrary to this view, it is submitted that the new approach heralded in these provisions is clear testimony that the disclosure rules under our company law can no longer be predicated upon the pure laissez-faire concept of non-interventionalism.[36] Disclosure without some measure of administrative surveillance is often meaningless to those it is supposed to protect.

Our disclosure system must shed off the ugly trappings of its free enterprise foundations and protect unsophisticated investors both from the 'Knavery of others and from making a fool of themselves.[37] In the final analysis however, It is still doubtful if the new securities regime can adequately protect this class of investors. For one thing, they are likely to be mislead into thinking that approval by the Commission represents an official endorsement or confirmation of the merits of the package or the projects envisaged in the prospectus. This might lead them to exercise less caution than they would otherwise have done.

Secondly, the underlying assumption behind all disclosure rules, that an investor who is given full accurate information about the affairs of the company can avail himself of it to make an intelligent appraisal of the worth of the securities offered, is false in the case of the illiterate or unsophisticated average investor.

Justice Douglas of the United State Supreme Court[38] correctly summarised this problem with regard to prospectuses when he said:

> "Those needing investment guidance will receive little comfort from the balance sheets, contracts or compilation of other data... they either lack the training or intelligence to assimilate them and find them useful, or are so concerned with a speculative profit as to consider them irrelevant."[39]

In view of the above, the new laws would have to be backed by a more robust financial press. The analysis of the press couched in popular language would be very useful to average investors, particularly if they couple it with professional guidance from analysts and advisers. These facilities in Nigeria today are more readily available when the securities are quoted or traded on the Stock Exchange.

DISCLOSURE BY PUBLIC QUOTED COMPANIES

The Companies legislation itself does not prescribe any special additional disclosure rules for companies quoted on the Stock Exchange. The approach in the *Companies Act, 1990*[40] is to exempt offers of quoted securities and those for which quotation is being sought from compliance with the prospectus provisions.[41]

Section 556(2) of the Act further stipulates that if the Securities to which any invitation relates are exempted on the above grounds, the prospectus to be issued must first of all state that the securities are to be dealt in on a stock exchange or that application has been or is to be made for quotation of the securities . Secondly, the prospectus must state whether or not the Stock Exchange is an approved one. Such a prospectus must also contain the particulars and information required by the Stock Exchange.[42]

The import of this provision is that quoted companies and those seeking quotation are exempted from issuing a prospectus which strictly complies with the requirements of Schedule Fifteen. This does not however free them from the obligations of disclosure. On the contrary, the Standard Stock Exchange requirements are a good deal more demanding and stringent.

In the first place, every company must, before quotation, sign a general undertaking to provide information both for shareholders and for the Quotations Department of the Stock Exchange on a regular basis in accordance with the Rules and Regulations of the Stock Exchange. These 'General Undertakings' form an integral part of the Listing Requirements by which the company applying for quotation covenants to provide all pertinent information about its performance any, must also accompany each application.[48] It is only after the approval of the application by the Council of the Exchange and compliance with the conditions given by the securities and Exchange Commission that the issue can then be put in the form of a prospectus offering the issue to the public. It must set out the lengthy details specified in paragraph 16(a) of the Listing Requirements.[49] The prospectus has to be "advertised in at least two local dailies".[50]

From the foregoing, it is clear that the details which have to be set out in an issue of quoted securities or that for which quotation is being sought go far beyond the information which is required in a prospectus under Schedule Fifteen.[51] It covers matters like details of the capital and its associates, which it was suggested should be added by the Securities and Exchange Commission in an amended Schedule fifteen.[52]

The depth of information demanded by the Stock Exchange authorities shows that the obligation imposed on companies and other fund users to make full and periodic disclosure of matters crucial for securities trading is the major component of investor protection by the mechanism of the exchange. And as an adjunct to the disclosure rules there are certain ethical and legal codes which are observed by operators on the Stock market.

The codes are monitored and enforced by the authorities of the Stock Exchange and the Securities and Exchange Commission, through such sanctions as suspension, Expulsion or desisting of the securities. The new provisions in the *Companies Act, 1990*[53] dealing with insider trading abuses would also strengthen the hands of the authorities in enforcing or promoting "the just and equitable principles of the trade."[54]

Even though the regulations of the Stock Exchange are not strictly law, they are nonetheless effective. The scrutiny of the authorities, backed by the threat of the suspension or withdrawal of quotation, is a highly potent weapon for securing compliance with the rules. This is more so because the scrutiny of the Exchange is a continuing one. The Listing agreement empowers it to keep an eye on the company throughout its life.

In the recent past, the number of quoted companies and those seeking quotation has steadily risen.[55] The increasing cost of funds of the money market is forcing many companies to solicit equity capital from the public. The privatization programme of government has also put more companies on the stock market. These developments have helped to enlarge the jurisdiction of the Stock Exchange.

On its part also the Exchange has relaxed its stringent listing requirements in order to accommodate small and medium size businesses. In April, 1985 it launched a Second-Tier Securities Market on which about ten companies have been admitted to date.[56]

In spite of the present bubble on the capital market however, the

Stock Exchange rules are far from being of general application in the sense in which the Companies Act[57] applies to all registered companies. There are still less than two hundred companies quoted on both tiers of the market[58]. Consequently the surveillance of the Stock Exchange is not far-reaching. But on the whole, the role of the Stock Exchange in disseminating corporate information in a more readily comprehensible form cannot be underestimated. Its annual merit award is largely designed to promote excellence in corporate disclosure and to enhance investor protection and shareholder-management relations.[59]

The public enlightenment campaigns, conferences, advertisements and other publications which are organised or sent out by the Exchange serve to sensitize not only quoted companies but also those who look forward to being quoted someday.

In particular the Exchange has contributed to the increasing diffusion of International accounting standards into Nigeria. The requirements for the presentation of annual accounts of quoted companies have always been in advance of the legal rules under the Companies enactments.[60] The *Companies Act, 1990* has adopted many of these into the statute as earlier discussed. It is still hoped that the Stock Exchange will continue to play a leading role in the evolution of new rules as well as accounting and auditing standards.

Finally, the Daily official List published by the Exchange gives a fair idea of the performance or prospects of quoted companies. It shows at a glance the volume and price of their traded securities, dividends, earnings per share and price earning ratio[61] These are useful guides for investors, particularly as the information is on a daily basis.

DISCLOSURE BY CORPORATE INSIDERS IN THE COURSE OF SECURITIES TRANSACTIONS

The rules discussed so far deal mainly with prospective investors who are invited to subscribe for or purchase securities in a company. The rules as to disclosure by public quoted companies do however also aim at protecting existing investors who wish to dispose of their securities or to acquire more through the mechanism of the Stock Exchange.

It is quite obvious that the disadvantaged position of shareholders vis-a-vis directors or other insiders with respect to information about the company may enable the latter to enter into securities transactions with shareholders on terms which may be unfavourable to members. This may be done either in the course of face-to-face negotiations for the sale of securities as happened in PERCIVAL V. WRIGHT or by the use of nominees, relations or tepees or in the course of an amalgamation, merger or take-over.

Under the old law, a director or other insider could reap and keep, without adverse legal consequences, any profit made from buying or selling the securities of his company from or to an investor without disclosing to him any material and price-sensitive information at his disposal which had not yet reached the public demand.

A classic instance of this was PERCIVAL vs. WRIGHT[63]. In that case the directors had bought shares from members at a low price without intimating them with the fact that at the time of the sale, an outsider had proposed to offer a higher price for the shares. They then sold the shares at the higher price to the outsider and made swift profits. In an action to rescind the original transaction, it was held that the directors could keep their profits because they were under no fiduciary obligation towards the members which could compel them to disclose any information they had in relation to the transaction. The court emphasized that the directors' fiduciary duties were only owed to the company itself and not to the individual members.

This decision was roundly criticised as being contrary to notions of commercial morality and marker egalitarianism[65]. Another objection to it was it allowed the fiction of corporate personality to obstruct, rather than to enhance, the ends of justice.[66] Despite these strong objections, the case remained a nagging irritant in our law until the promulgation of the *Companies Act, 1990.*[67]

The *Companies Act, 1990* has tried to entrench some formidable devices for shareholders protection. In the first place, Section 279(2), barring its inelegant language, appears to overrule the ratio decidendi in the PERCIVAL case by imposing a fiduciary relationship on a director in the course of any transaction involving a dealing with the company's securities. The relationship will still arise whether or not the director is acting as an agent and even if the other party to the securities transaction is not a member of the company.[69]

The aim of the provision, it is submitted, is the need to assure investors that:

> "the market quotations given for their shares represent objective valuation of the investments they hold and.... that they are dealing with directors on the basis of equality and market judgement rather than being at the mercy of directors equipped with price-sensitive information undisclosed to them"[70]

The most important device for investor protection under the new Act[71] however is the regime against insider trading that is created in Chapter Five of Part Seventeen. The elaborate prohibitions against insider trading abuses are designed not only to take care of situations like PERCIVAL[72] but also to deal with all cases where directors or other insiders use their connection to the company or their privileged position or office to unfairly trade in the securities of the company.

The provision prohibits directors or other insiders from trading in the securities of their company, either by themselves or through others to whom they relay inside information.[73] The prohibition arises where they are in possession of material non-public, price-sensitive information by virtue of their office or connection with the company. Under such circumstances, and insider may only trade if he can make such information public, and he infact does so, without betraying a corporate confidence.74

> The Decree stipulates both criminal and civil remedies against insiders who contravene the anti-dealing provisions.[75] Furthermore, other provisions like those which require the maintenance of a register of directors,s holdings and transaction therein,[76] and the provisions which allow for penetration of the screen of nominee shareholdings,[77] are important supplement to the rule against insider trading.[78] Put together, these should compel directors to deal fairly with shareholders or at least on the basis of a reasonable parity of information in the course of any transaction.

Finally, mention must be made of the requirements to disclose necessary information to shareholders when a take-over of the company is proposed. Section 578 and 602 of the *Companies Act 1990*[79] stipulates that the bid document constituting the invitation under a take-over bid must give certain prescribed information. Also the accompanying directors' circular has to conform to the particulars required in the Act. Furthermore, both have to set out any other information which the Securities and Exchange Commission may prescribe in any regulations made by it.[80] Such regulations are also to be made to deal with all proposed amalgamations, reconstructions or mergers.[81]

The importance of requiring that shareholders are given adequate information in the course of any re-organisation of the company lies in the fact that such transactions do involve either the exchange of their holdings in one company for another or even the outright disposal or acquisition of such interests. Hence they need information upon which to assess the merits of the arrangement, its future prospects and the price or consideration being offered.

Cumulatively, all the provisions considered above are meant to ensure that a shareholder who is invited to take a crucial investment decision is not left to 'wade blindfold through a body-trapped and uncharted minefield'[82], or to buy a pig in a poke.

The provisions, it is submitted, are founded upon the realisation that securities represent, in the words of Professor Louis Loss,[83] intricate merchandise in a system of private capital. They are different from most of the 'merchandise' familiar to the average person such as a loaf of bread which an intending customer can touch and smell in comparison to other brands. The implication of this is that unless investors have the information with which to assess the worth of a company's securities, they stand the danger of being cheated in a transaction with insiders.

The strict enforcement of all the provisions by the Securities and Exchange Commission should go a long way in ensuring the availability of the necessary information for securities trading on fair and equal terms. This is important if investors are not to be deterred by the fear that others may have a strategic but unfair advantage over them. Such fears would erode their confidence in and undermine the stock market and the corporate system as a whole.

CONCLUSION

We have tried to put in perspective the main instruments for the protection of investors, both actual and potential, in the course of securities trading. All together three key items have been emphasized. The first is the statutory requirements for disclosure of relevant information. The second is the system of private regulation through the Stock Exchange, which is itself founded largely on disclosure. The third is the new system of administrative supervision by the Securities and Exchange Commission.

On the whole, it is hoped that cumulatively, these protective devices should help to minimize , if not eliminate, the abuses in the system of public offers and Securities trading generally, which have come to symbolize, more than any other aspect of company law, the unacceptable face of capitalism.

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