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CORPORATE & COMMERCIAL ALERT

IN THIS **ISSUE**

INFORMATION NEED NOT BE 'FINAL' IN ORDER TO BE 'INSIDE' INFORMATION

It is relatively rare for the high courts in South Africa to pronounce on matters pertaining to insider trading given that such matters are typically addressed and finalised in administrative proceedings before the Directorate of Market Abuse (DMA). It is thus useful to the note the recent as-yet unreported Pretoria High Court judgement of *Zietsman and another v The Directorate of Market Abuse and another* (A679/14) (24 August 2015) which sets out a number of principles regarding the offence of insider trading and the definitions used in the legislation. The case involved an application for the review of a ruling of the DMA.

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Currently the Financial Markets Act, No 19 of 2012 (FMA) deals with insider trading. The *Zietsman* case concerned the previous Securities Services Act, No 36 of 2004 (SSA) the SSA, but the relevant definitions and principles in question are the same in the FMA and the case is therefore still very relevant.

Briefly, the FMA contains a prohibition against dealing in securities listed on a regulated market if one knows that one is in possession of 'inside information' (s78) subject to a few defences which are not of concern for present purposes (see s78(1)(b)). In terms of s77 of the FMA (and the equivalent s72 of the old SSA):

- 'inside information' means *specific or precise* information, which has not been made public and which is obtained or learned as an insider and if it were made public, would be likely to have a material effect on the price or value of any security listed on a regulated market; and
- 'insider' means a person who has inside information through being a director, employee or shareholder of an issuer of securities listed on a regulated market to which the inside information relates, or having access to such information by virtue of employment, office or profession; or where such person knows that the direct or indirect source of the information was a person contemplated as aforesaid.

The question in *Zietsman*, which was decided in the context of a trade by insiders in shares listed on the JSE's AltX, was whether the information which the insiders possessed was 'specific' or 'precise'. They had knowledge of the fact that the IDC was to advance a R99 million loan to the issuer company, but no agreements were signed at that stage – the transaction was only agreed to in principle. It was argued among other things, that the information was thus neither 'specific' nor 'precise' as required by the definition of 'inside information'. Referring to a number of foreign cases and materials, the court held that in order for information to be 'specific' (even if it is not 'precise') *it need not be in final form:* information relating to circumstances or an event in an intermediate phase could still be specific (and even precise) and could therefore qualify as 'inside information', if its effects on the share price or value would likely to be material.

The court also held that a genuine and *bona fide* belief that known information was not 'inside information' will not justify a defence where such belief was not based on reasonable grounds. It is however submitted that this proposition may warrant a debate having regard to the important distinction

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In practice one sometimes encounters the attitude that as long as nothing was signed there is no 'specific' or 'precise' information and therefore the insider trading provisions are not triggered at that stage.

between intention and (gross) negligence. This distinction is often stressed by the courts in the context of offences which have intention as an element.

Some other interesting, and probably uncontroversial, observations that can be gleaned from the judgement are:

- Whether information is 'material' should be assessed with reference to the 'reasonable investor' test.
- Actual deviations in the share price post the disclosure of the information is important evidence as to whether the information was in fact 'material'.
- In the particular circumstances, the identity of the lender (the IDC) could be seen as being 'material' given that, in the court's view, the terms and conditions under which the IDC advances loans tend to be more lenient than normal commercial bank lending, and a reasonable investor would take that into account as a significant factor (as it is very favourable to the issuer company).

In practice one sometimes encounters the attitude that as long as nothing was signed there is no 'specific' or 'precise' information and therefore the insider trading provisions are not triggered at that stage. Such an approach is inherently risky and the *Zietsman* judgement clearly exposes its potential flaws. Until a higher court reconsider and potentially overturn this reasoning, directors and other insiders are advised to exercise caution now more than ever.

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