

SOME LEGAL ASPECTS OF THE NAIROBI
STOCK EXCHANGE

A Dissertation submitted in partial fulfilment
of the Requirement of the LL.B Degree, University of
Nairobi

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NAIROBI

APRIL, 1976.

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CHAPTER ONE

I N T R O D U C T I O N

A Stock Exchange is a complex financial institution. The "essential functions of any Stock Exchange are to provide a market in existing securities and means of communication through which new borrowers and new lenders can be brought together."¹ A Stock Exchange, then, is the actual place where the sales and purchases of securities are made. It is worth to note that the securities must be existing. This is important because ordinarily, except when there is a new issue of shares perhaps, companies do not sell their shares to the public directly.

The Rules of the Nairobi Stock Exchange prohibit the dealing in of shares by persons, other than the members of the Exchange. Thus, any member of the general public wishing to buy or sell shares, he must do so through a recognised Stock broker, who must be a member of the Nairobi Stock Exchange for the time being.

Not all companies have ~~Man~~ shares quoted on the Stock Exchange. Only public companies with limited liability on their shares can be quoted. Also government bonds are also quoted. The requirements for a company to have its securities quoted on the Stock Exchange are: Firstly the company must have a nominal share capital of Sh. 500,000/=. Secondly, it must have been trading at a profit for the last five consecutive years prior to the application for quotation. Only then can the shares be quoted on the Stock Exchange.

"There are several conditions that must be fulfilled before a specialist group of dealers in shares and stocks arise. Before there can be the makings of a regular market, there must obviously be a considerable value of securities the ownership of which is fairly distributed; there must be a sufficient number of wealthy men and women who wish to hold some of their possessions in financial assets rather than in business or real property. The development of the market will also be greatly assisted if the law recognises simple procedures for the transfer of titles; if shares are of convenient and fairly small denominations and if there is a banking system to provide a simple means of payment."²

In this paper, the author will not concern himself with the exciting economic aspects of the Nairobi Stock Exchange. That has been ably treated elsewhere.³ It is hoped to examine the legal status of the Stock Exchange; the legal position of the parties therein and what general laws apply to the transactions on the Stock Exchange generally. The law will be stated as at 30th March, 1976.

A word of caution. Up to date there have been not a single case going to the High Court as regards our subject matter. This means that there are no Kenyan decisions affecting the Nairobi Stock Exchange. Perhaps we shall find out why this is so. However, the Nairobi Stock Exchange was imported from the English Stock Exchanges, and as such it is only fair to assume that the law relating

to the London Stock Exchange in so far as it applies to general transactions on the Exchange, should also apply to the Nairobi Stock Exchange. By law, I mean the English common law and not the statute law. There are various statutes in England that affect the English Stock Exchanges but have no relevance in Kenya.

The Law of Contract Act⁴ of Kenya, applies the English common law principles of contract to Kenya. Section 3 of the Kenya Judicature Act⁵ also applies the English common law, doctrines equity and statutes of general application prevailing in England on 12th August, 1897, to Kenya. It is on this authority that we shall look to the English common law to ascertain the law as it affects the Nairobi Stock Exchange transactions. I should mention here that the English decision made after 1897, though they have no binding authority, they are freely and frequently cited in the courts of this country to cast a guiding light to our judges and magistrates.

CHAPTER TWO:

A BRIEF HISTORY OF THE NAIROBI STOCK EXCHANGE AND
ITS ORGANISATION

There are four major Stock Exchanges in the whole of Africa. These are found in Nairobi, Lagos, Cairo and Johannesburg. Another one, though still in its infancy, has been recently opened in Accra. Two other Stock Exchanges that were short lived were the Bulawayo; and the Kampala, Stock Exchanges. The former collapsed when the Rhodesia-Nyasaland Federation broke up while the latter "died" a natural death due to lack of business.¹

The Nairobi Stock Exchange came into existence in July, 1954. Prior to that date, sales and purchases of shares had been going on for some years although there had been no organized market as such.

In comparison with other major World Stock Exchanges, the Nairobi Stock Exchange is relatively undeveloped. It is a much younger institution when compared to the London Stock Exchange, or even the New York Stock Exchange, both of which have been in existence for well over a hundred years. The Nairobi Stock Exchange does not even have its own regular place of business. This means that it does not have its own permanent building or "floor" where business could be conducted, unlike the London Stock Exchange. Most of the Exchange business is therefore conducted by correspondence, that is, over the telephone and by mail. However, the little business that there is, keeps the

members of the Exchange busy from Monday to Friday every week.

There are five members in Stock Exchange today. These are:-

- (i) J.S. Donovan and Co. Ltd., P.O. Box 4407, Nairobi
- (ii) Francis Drummond and Co. Ltd., P.O. Box 5465, Nairobi
- (iii) Dyer and Blair, P.O. Box 1396, Nairobi
- (iv) Francis Thuo and Partner, P.O. Box 6524, Nairobi
- (v) Chandulal Shah, P.O. Box 14686, Nairobi.

These five brokers meet every morning at ten o'clock for "Call-ups." By "call-ups" is meant the fixing of prices for that particular day. These prices are fixed by the economic forces of supply and demand operating in the securities market. The purpose of these meetings is to ascertain what are the current selling and purchasing prices of all the quoted shares or securities on that day.

The "call-over" system is used in the Nairobi Stock Exchange. The members meet every morning at Queensway House in Nairobi. The Chairman of the Stock Exchange (who currently is Mr. Francis Thuo, of Thuo and Partners), presides over the meetings. In his absence, any member may be called upon to act as the Chairman for the time being. The Chairman reads out the list of all the securities quoted together with the price ruling at the time. As each security is called, brokers who may have buying orders will bid for stocks or shares and those with selling orders will offer them for sale. A transaction is concluded

when a buyer and a seller agree on a price suitable to both. That is how the call-over system works.

This system implies that the shares can only be bought and sold at the fixed times of the call-over. However, in practice, if a broker receives an order late in the day, he approaches those other brokers who may have shown interest at the time the previous call-over, and the business is transacted.

In comparison, the London Stock Exchange is very developed and complicated. There is a great deal of specialization. These are brokers and jobbers. A client gives his instructions or order to a broker who in time consults a jobber inside the Exchange. The London Stock Exchange has its own building and the jobbers work in there permanently. Brokers operate from their various offices scattered in and around London. Jobbers as such do not deal directly with the members of the general public but only do so through the brokers. Most jobbers are specialists and only deal in certain types of securities. Thus when a broker receives an order for certain shares, he gets in touch with the jobber who specializes in those types of securities. This system requires a heavy volume of business which the Nairobi Stock Exchange does not yet have. The number of brokers on the Nairobi Exchange was six at its inception but has now dropped to five. This in itself shows clearly that there is not enough business as yet to warrant the services of the specialist jobber. Thus the call-over system is more suited to the Nairobi Stock Exchange.

A number of reasons may be put forward here to explain this lack of business on the Nairobi Stock Exchange. First, the most popular type of business unit has been the sole trader, among the Africans. Partnerships are also popular. The incorporated company is a foreign concept which has only recently been introduced as a way of trading. Of late, there has been an increase in the number of companies registered, but ~~are the~~ few of them have their nominal capital being over Sh. 500,000/=. And in any case few of them have been trading at a profit, for more than five years to qualify for quotation on the Nairobi Stock Exchange. Many of the companies registered are owned by foreigners, mostly of Asiatic origin, and their companies are usually private family concerns which do not have to sell any shares to the public.

Further, the big multinationals that operate in Kenya rarely attempt to finance their undertakings with local finance, simply because there is not enough. If they have to, they only go into partnership with the government, but they never attempt to have their shares quoted on the Nairobi Stock Exchange.

Given time, perhaps all this will change in due course. The business ignorance which has prevailed heretofore is now being gradually eroded away and the wananchi are slowly realizing the advantages of incorporation. They are beginning to accept the limited liability company as a safe medium of trading and minimising their risks. However it will take time before they realize the functions of the Stock Exchange.

Many people do not have any idea of what the Stock Exchange is, leave alone what it does. This includes some members of the educated elite as well. For them the Stock Exchange is "just a column in the daily press where the prices of shares are shown." Very few people even bother to find out what it is all about. A simple survey conducted by the author on a number of Nairobi University lecturers revealed an amazing degree of ignorance of the activities and functions of the Nairobi Stock Exchange. This is the "elite of elite" of this country and it has no clue as why the Stock Exchange exists.

However, things are changing. The monetary economy is with us. Before the end of this century, I do NOT see WHY we should NOT have a Stock Exchange in Nairobi as complicated and advanced as any other in the industrialized world.

The management of the Nairobi Stock Exchange is vested in a committee of six members who are elected at an annual general meeting.² The chairman of this committee is also the chairman of the Exchange. He is assisted by a secretary who does all the administrative work of the Exchange.³ Application procedure for membership is laid down in the Rules of the Nairobi Stock Exchange.⁴ Application must be made in writing to the secretary in such form as the committee may from time to time prescribe. The committee may require such candidates to attend an interview in person to supply any further information as the committee may

think fit, for the proper consideration of such application. After fourteen days of such application, the committee must consider the application and then vote on it by ballot. No applicant can be admitted to membership except by a resolution passed by a majority of not less than two thirds of those present and voting. The committee is not bound to disclose any reason whatsoever for any decision either to the applicant or to any other person. If an applicant is rejected he may apply again after six calendar months are over, after such rejection.⁵

The rules of the Nairobi Stock Exchange only regulate membership and procedures therein among members and really do not help us much to ascertain what laws are applied in the Exchange. For that, we have to look further a field.

CHAPTER THREE

THE BROKERS POSITION

The Stock Exchange is a market but unlike the traditional markets where producers attend to sell and consumes^r to buy, the Stock Exchange is a two way market in which brokers are just as likely to be sellers as well as buyers, and also the goods dealt in are abstract. A member of the general public who wishes to acquire or dispose of securities on the Nairobi Stock Exchange must do so through the agency of a stock broker. The investor may either be a direct client^f for the stock broker, or he may give instructions to his bank to undertake a transaction on his behalf, in which case the bank will pass on the instruction to its own stock broker.

A broker is an agent whose course of business is to negotiate and make contracts for the sale of securities of which he is not the legal owner. As such, a breach of the principal's instructions (who is the client) will give him a claim in contrast and not in tort.¹

A broker employed on the Nairobi Stock Exchange, in the absence of anything to the contrary is ~~later~~^{taken} to be employed subject to the terms of the rules and regulation thereof,² and the authority given to a broker by his principal cannot as far as third parties are concerned, be limited to private instructions given to the broken. A stock broker employed to do business at a particular place has implied authority to act in accordance with the reasonable usages of the place.³

"When one employes a broker to do business on the Stock Exchange, he should, in the absence of anything to show the contrary, be taken to have employed the broker on the terms of the Stock Exchange." This was stated by the Judicial Committee in the case of Forget v. Baxter⁴ where stock broker, in an action against their principal, sought to recover the balance of their account in respect of sales and purchases for private speculation on his account. It was held, inter alia, that the defendant in giving authority to the plaintiffs to do on the Stock Exchange must be ~~later~~^{taken}, in the absence of evidence to the contrary, to have employed them on the terms of the Stock Exchange, and therefore, to have authorized the sale of his shares on failure to supply them with requisite funds.

In the Nairobi Stock Exchange the conduct of brokers is regulated by the Rules thereof. However the principles of the English common law apply. Section 3 of the Kenya Judicature Act 1967 applies the English common law and doctrines of Equity prevailing in England on 12th August, 1897, to Kenya. This is why, the reader will note that most of the authorities cited herein were decisions before 1897 and as such are binding law in Kenya. Whether they are good law is another matter.

Stock brokers are not allowed to advertise⁵ and an investor is normally introduced to a broker on the basis of the recommendation of a friend. Alternatively he may write to the secretary of the Stock Exchange who will forward the list of brokers to him. The investor, when

he approaches the broker, usually the broker has information relating to the company in which the investor is interested. This information includes summaries of profits and capital employed, the salient points from the latest chairman's statements and share price statistics for the past ten years or so. In the light of this information the client then decides whether to buy shares of that company or not. If he decides to purchase, then he instructs the broker to go ahead and purchase so many shares. The broker is the bound by some common law rules regarding his conduct as follows:-

a) Broker must act as agent

A broker instructed to buy or sell cannot act as a principal in the matter without the prior knowledge of his client. This principle was laid down in the case of Rothschild v. Brookman.⁶ "When a person placed himself under the advice of a dealer in English and foreign funds, and the latter advised purchases and sales of stock, and it afterwards appeared that the purchases and sales were merely nominal transfers and re-transfers of the dealers over stock, the difference being settled in account, it was held that the Court of Equity rightly interfered to compel an account between the parties, and to set aside the transactions that had taken place, on the ground that the dealer stood in a situation of advantage which Equity will not allow to an agent in dealing with his principal." Such a sale will no doubt be set aside by the court at

the instance of the client. Further, a broker must not act for both vendor and purchaser without informing them both that he is so acting.

b) Broker must make no secret profit save Commission

In the English case of Erskine, Oxenford & Co. v. Sachs⁷, it was held that where the brokers having acted in a fiduciary capacity in the sale of shares and having by reason of that sale and repurchase, affected as one transaction, obtained a profit for themselves, they were bound to account for that profit to their clients. This is based on the equitable principle which prevents a fiduciary from making a profit as this clearly will lead to a conflict of the broker's interest and the client's interest.

c) Termination of Authority

One who employs a broker to buy shares for him impliedly authorizes the broker to do all that is necessary to complete the bargain. Generally whenever a client instructs a broker to sell at a certain price, the brokers authority to sell ceases at the end of the current account. However, the terms of the contract must be considered respectively.

d) Exercise of discretion

Where no definite instructions have been given to the stock broker, or where the instructions leave ~~in~~ a discretion, the broker must be guided by the honest exercise

of his own judgment and the interests of his principal. However, a broker has no authority to carry over his clients bargains in the absence of express instructions. A continuing authority to carry over automatically ceases upon the death of the client.

e) Fiduciary relationship

When a member of the general public wishes to purchase shares in a certain company, he usually gives money to a broker to make a purchase on his behalf. Equally, when he wishes to sell any securities, the broker receives the proceeds of such sale on behalf of the client and then passes it on to him, and, of course, ^{Less} his charges. Money placed in the hands of the stock broker for investment may be followed in equity. This is an equitable relief where the stock broker is made to account for any misappropriation or mismanagement of any money entrusted to him. A resulting trust arises thereby and the money may be recovered from the broker. Likewise money coming into his hands for a sale's proceeds may be followed.

In conclusion, therefore, the stock broker is bound by the principles of the law of agency. He is held in a position of trust and the law will not allow him to abuse the trust placed on him. Further, his interest will not be allowed to conflict with that of his client. He is only entitled to his remuneration as provided for in the Rules of the Exchange and no more. ⁸

CHAPTER FOUR

THE PARTIES TO A SALE

The contract of the stock broker is that at the settling day he will either take the shares himself, in which case, he would be bound to accept and register a transfer and to indemnify the seller himself, or he will give the name of one or more transferees who will accept and pay for the shares.

The ordinary principles of the Law of Contract apply to these transactions.¹ There has to be offer and acceptance; parties thereto must have capacity to contract and the contract must not be tainted with illegality. Where two brokers have been employed respectively for the seller and the buyer, and the name of an infant has been sent in for the purpose of a transfer, and that infant defaults in payment, the broker for the buyer will be liable to indemnify the seller. If one broker acts for both parties then he will be similarly liable to indemnify the seller in case of default.²

Shares in a company or other securities are moveable property and are transferable in the manner provided for in the articles of association of a company.³ "The ordinary contract by the seller on a bargain and sale of registered shares of a company is that the seller shall execute a valid transfer of the shares and hand the same over to the transferee, and so do all that is necessary to be registered member in respect of such shares."⁴

A contract for the sale of shares does not import an undertaking by the vendor that the company will register the transfer. The Companies Act of Kenya - chapter 486 - Laws of Kenya, provides that the registration of a transfer will be at the request of the transferor.⁵ It is further provided⁶ that if a company refuses to register a transfer of any shares it shall within sixty days after the date on which the transfer was lodged with the company, send to the transferee notice of the refusal. The effect of this subsection is to give the company a discretion whether to accept or refuse certain persons, membership of the company. This will depend on the provisions of the companies articles - whether the directors are authorized to reject a transferee.

It is provided in the Rules of the Exchange⁷ that the seller shall make or tender delivery within sixty days after the date of the transaction except:-

- 1) Where by agreement with the buyer or
- 2) Where the contract is endorsed "for quick delivery" in which case delivery shall be made or tendered within ten days after the date of the transaction;
or
- 3) When the seller is doubtful as to his ability to give delivery within sixty days and declares so at the time of making the transaction. He must endorse his contract by writing on it "Delayed Delivery" Or "N.T.P." which indicates that the

buyer is not to press for delivery, but taking into account all the relevant factors regarding the completion of the transaction, delivery shall be made within a reasonable time.

Further it is provided that in the event of the seller failing to effect delivery within the prescribed time of sixty days, the buyer, after giving to the seller on or after the sixtieth day, ten days written notice of his intention to do so, may buy the required amount of shares ^{from} ~~for~~ elsewhere and the previous transactions shall thereupon be deemed to have been rescinded but the seller therein shall be liable to the buyer for any increase in the consideration for the second purchase over the price contracted to be paid in respect of the original purchase.⁸ It is further provided that in cases falling within exception (2) above, no written notice shall be required to be given at the expiry of the ten days.

As a result of the contract of sale, the seller becomes entitled to be indemnified by the purchaser against all future liability in respect of the shares sold. Under a contract for the sale of shares in a company, the measure of damages upon a breach by the buyer is the difference between the contract price and the market price at the date of the breach and there is no obligation on the part of the seller to mitigate the damages by getting the best price he can upon that date. If the seller retains the shares after the breach, he cannot recover from the buyer any further loss, if the market price falls, nor is he liable to have ~~the~~ damages reduced if the market price rises.

In the case of Jamal v. Molla Dawood Sons & Co.⁹ the respondents bought from the appellants shares of the British Buma Petroleum Company Limited, to be paid for on or before December 30, 1911. The contract contained a clause providing that in default of payment the seller should have the option to resell the shares. On December 30, 1911, the respondents refused to pay for them. The appellant sold the shares to a third party on February 28, 1912. He then sued the respondents for damages for breach of contract. It was held that if the seller retains the shares after the breach he cannot recover from the buyer any further loss if the market falls, nor is he liable to leave the damages reduced if the market price rises. The appeal was accordingly allowed.

In the absence of any express or implied term in the bargain, the purchaser will be entitled to all benefits incidental to the ownership of the shares as from the time of the sale. In the case of transactions on the Stock Exchange the respective rights of the buyer and the seller are determined by the rules dealing with this subject and the method of quoting prices in the official list. In the Nairobi Stock Exchange, shares are declared ex dividend on the first day on which the transfer registers are closed.¹⁰

CHAPTER FIVE

1) Right to Indemnity

A person who employs a broker to sell shares on the Stock Exchange is bound to indemnify the broker for any liability he may incur in consequence of carrying out his principal's instructions under the Rules of the Stock Exchange. "The stock brokers" per Lord Eshen M.R. in Hunt, Cox & Co v. Chamberlain¹ "dealing in the shares were bound by the rules of the Stock Exchange that is they were personally liable for them if they bought them. The defendant employed the plaintiffs to buy these shares on the Stock Exchange in their own names. The contract between the brokers and their principal was that if the brokers were made to pay for the shares, the principal would repay them."

Hence, where a broker has bought shares in a company for a client and a petition for winding up is presented before the contract has been completed by transfer, and the broker in accordance with the rules of the Stock Exchange has been obliged to pay the price of the shares to the person from whom he bought them, he is entitled to recover from his principal the money he paid,² similarly if the broker has been ordered to indemnify the seller of shares against liability owing to the name of an infant having been passed as transferee, and such infant failing to pay for the same, the broker will be entitled to be indemnified by the principal.³

The rights of the broker in this respect depend on the rule which prevails in the law of agency that the principal is bound to indemnify the agent against the consequences of all acts done by him in pursuance of the authority conferred upon him.

Brokers have a general lien on securities in their hands as between themselves and the client for the balance due from the client. The fact that the securities in the brokers hands are the property of persons other than the client who deposited them does not prevent the brokers lien attaching to them provided that the brokers did not know that they did not belong to the client and was not put upon inquiry as to his clients title by the circumstances of the case.

2) Accounting to Principal

A broker who receives the price of securities sold must account for the price to the owner of the securities or pay it to some agent duly authorized by the principal to receive payment on his behalf.

3) Closing the Account

Where there is an open account between broker and his client the broker is entitled, on the death of the client to close the account at once and sell all the shares in respect of which he has entered into contracts on behalf of the client.

By the usage of the Stock Exchange, a broker who has

entered into a contract for the purchase of stocks is in the event of the insolvency of his principal justified in immediately selling it. Otherwise, an account is closed, generally when a particular transaction is completed; delivery and all.

4) Default

Under the Rules of the Nairobi Stock Exchange a member of the Exchange unable to fulfill his obligation, will be declared a defaulter and become ineligible for re-admission to the Stock Exchange.³ Any member who is declared a bankrupt forthwith ceases to be a member of the Exchange.⁵

On a default, all members having accounts with the defaulter must close their transactions by buying from or selling to him such securities as he may have contracted to take or deliver. The committee has a discretion to re-admit such a defaulter or bankrupt.⁶

When a member is declared a defaulter and his contracts are dealt with by the subcommittee⁷ the proceedings in the liquidation do not bar his creditors from suing him at law for the balance of their claims after deducting the dividends received by them in that liquidation.

CHAPTER SIX

SPECULATION AND GAMING

Many people think that the Stock Exchange is a gambling institution. But it is far from a gambling institution. It is a market, like any other market where buyers and sellers meet and do business. A distinction, however, must be made between investment and speculation. A speculator is a person who buys shares cheaply and sells them dearly within a relatively short time. He seeks his gain exclusively from price differences. He has no intention of keeping the securities.

On the other hand, the investor's objective is to earn an income on his assets and as such he does not indulge in such short term transactions as the speculator. He intends to keep those securities for a long time and to earn an income from them. As such he is likely to go for the "safe" securities like government bonds.

The Betting, Lotteries and Gaming Act ¹ was passed in 1966 to provide for the Control and Licensing of betting and gaming premises; for the imposition and recovery of a tax on betting and gaming; for the authorizing of public lotteries and for purposes incidental to and connected with the matters aforesaid.

Section 2 of the same Act states that "to bet" means to wager or stake any money or valuable thing by or on behalf of any person or expressly or impliedly to under-

take, promise or agree to wager or stake by or on behalf of any person, any money or valuable thing on any horse race or other race, fight, game, sport, lottery or exercise, or any other event or contingency and "bet" and "betting" shall be construed accordingly.

From the wording of section 2 of this Act, it is clear that the provisions of this Act do not apply to the transactions on the Stock Exchange. Waging contracts were not illegal at common law. In the case of Carlill v. Carbolic Smoke Ball Co.² Hawkins J. defined a wagering contract as "one by which two persons professing to hold opposite views touching the issue of a future uncertain event, mutually agree that, dependent upon the determination of that event, one shall win from the other and that other shall pay or hand over to him a sum of money or other stake; neither of the contracting parties having any other interest in that contract the sum or stake he will win or lose, there being no other real consideration for the making of such contract by either of the parties. It is essential to a wagering contract that each party may there under either win or lose, whether he will or lose being dependent on the issue of the event, and therefore remaining uncertain until that event is known. If either of the parties may win but cannot lose, or may lose but cannot win, it is not a wagering contract." In this case, the defendants had promised to pay £100 to anyone who, after using their smokeball caught influenza. It was held not to be a wagering contract since anyone who failed to catch influenza could not lose anything.

Thus, Stock Exchange transactions are not wagers. The parties buying and selling do not necessarily hold opposing views, nor does any party have to win while the other loses on a transaction. In the case of Richards v. Stark.³ The plaintiff paid a sum of money to the defendant upon the terms that it should be invested in shares and at the end of a fixed period should be returned to the plaintiff with a proportion of any profit resulting from a rise in the value of the shares; if there was no profit, the money was to be repaid. It was held that the plaintiff was not to lose. In either event his deposit would always be returned to him.

In the Stock Exchange, however if neither of the parties really means to sell or buy, then the contract may be said to be a speculation. It may not be called a wager since that would be altering completely the definition of the term "wager". However, where the series of transaction for the sale and purchase of shares gave the buyer an option to demand delivery on payment of an extra sum, it was held that they were wagering contracts since only if the option was exercised would they become genuine transactions of sale and purchase.⁴

A genuine purchase of shares followed by a genuine separate sale creates enforceable obligations even though the original purchase never intended to take delivery of the shares and in fact was merely speculating upon their value.⁵ Thus, one may say that the sales and purchases of stocks and shares are not wagering contracts unless

there is an agreement between the parties to the effect that they shall not be actually carried out but shall only end in the payment of differences in the purchase and resale prices. It is the interest of the party benefitting from a transaction to argue that it is not a wager, since this view entitles him to enforce the contract. At common law wagering contracts were only voidable but not void.

The fact that the object of the principal (client) in employing a broker is speculation does not render the contract made by the broker, a gaming contract. If they are real transactions the client may be bound to indemnify the broker against any liability incurred in respect of them.

In Forget v. Ostiny⁶ where this was decided, Lord Herschell, L.C., delivering the judgment of the Judicial Committee of the Privy Council said⁷ "much stress was laid on the fact that the respondent was known to the appellant to be a bank clerk with a small salary and possession of little other means. This was regarded as bringing home to him the knowledge that the respondent had in view not investment but gambling.

The other circumstances mainly relied on were that the respondent never asked for nor received delivery of any of the shares purchased; that the purchase money was raised by a loan procured by the appellant; that the respondent was not in a position to furnish the whole of the purchase money, and, in fact, only, provided the appellant with a small margin. It may well be that the appellant

was aware that in directing a purchase to be made the the respondent did not intend to keep the shares purchased, but to sell them, when as he anticipated would be the case they rose in value; that his object was not investment but speculation. To enter into such transactions with an object is sometimes spoken of as "gambling on the Stock Exchange; but it certainly does not follow that the transaction involve any gaming contract. A contract cannot be properly so described merely because it is entered into in furtherance of a speculation. It is a legitimate commercial transaction to buy a commodity in the expectation that it will rise in value and with the intention of realizing a profit by its resale. Such dealings are of everyday occurrence to commerce. The legal aspect of the case is the same whatever be the nature of the commodity, whether it be a cargo of wheat or the shares of a joint-stock company. Nor again do such purchases and sales become gaming contracts because the person purchasing is not possessed of the money required to pay for his purchases, but obtains the requisite funds in a large measure by means of advances on the security of the stocks or goods, he has purchased. This, also is an everyday commercial transaction."

In the above case, a broker had been employed to make actual contracts of purchase and sale, in each case completed by delivery and payment, on behalf of a principal whose object was not investment but speculation. These were held not to be gaming contracts.

A conspiracy to induce the committee of the Stock Exchange to order a quotation of the shares of a company and so to cheat and defraud those who may purchase shares in the belief that the rules of the conditions precedent to such a quotation have been complied with is illegal.⁸

CHAPTER SEVEN

CONCLUSION

The Nairobi Stock Exchange has been examined briefly. This paper is by no means exhaustive. The Stock Exchange is a very complex institution, and would require many researchers to bring out all its various legal aspects. Materials on the subject are very meagre at present. No one seems at least as far as Nairobi Stock Exchange is concerned, to have studied the legal aspects of it. Thus this was a venture into a novel field. I hope more research will follow up as the Stock Exchange will no doubt become an important institution within our economic system. That is why this paper was titled "Some legal Aspects of the Nairobi Stock Exchange."

None-the-less, it was ascertained that the Stock Exchange is not a corporation but a market. A voluntary association of brokers who sell and buy securities on behalf of their clients. The type of securities offered range from company shares and stocks to government bonds. The Rules of the Nairobi Stock Exchange form the basis of

the exchange itself and regulate the relationships of brokers and their colleagues on the Exchange. These Rules also set the commission rates which the stockbroker charge for any work they might undertake to do. Really the Rules of Nairobi Stock Exchange are its "Constitution."

It was found that there are no statutory laws nor any judicial precedent in Kenya affecting the Exchange. As such, the principles of the Common Law of England, and the doctrines of Equity were applied wherever necessary. Thus the buyer-seller relationships are governed by the Common Law of Contract, while the principles of agency law regulate the broker-client relationship. Equity makes the broker a trustee of any funds in his hands for the client.

After a transaction is made, a transfer is affected by the passing of documents of title ^{to} ~~with~~ new purchaser. The Rules of the Nairobi Stock Exchange lay down the procedure to be followed. One point is however worth mention here. There are two taxes due on these transactions. Stamp Duty is charged on every transaction. And it is the duty of the broker to see that duty is paid on every sale of securities. Capital Gains Tax was recently introduced into this market. This however only affected the speculator who buys any shares and sells them within six months. That means anyone buying and not selling those shares within six months need not pay any Capital Gains Tax.

Thus, that is the legal selling of the Nairobi Stock Exchange.

At this point, it is worth perhaps to examine briefly the American Stock Exchange just for comparison and reflection. During the late 1920's there was a lot of speculation in the American Stock Exchanges. This led to a great crash in prices of Stocks between 1929 and 1933. This was the time of the great economic depression. As a result, major federal laws were passed regulating the securities industry. This was to ensure that the Stock Exchanges did not collapse to economy again by giving a false image of the economy as they had done just before 1929, and thus making investors very optimistic.

At a glance, the first Act was the Securities Act of 1933. The basic purpose of this Act was to make certain that new securities offered to the public are fully and clearly described in the registration statement and prospectus. There must be full disclosure of all significant material facts concerning a security to be offered to the public.

Then in 1934, the Securities Exchange Act was passed. This Act created the Securities Exchange Commission, commonly referred to as the S.E.C. It consists of five men appointed by the president and it administers all federal laws regulating the securities business. This Act also defined many of the terms used on the Exchange like broker, dealer, exchange etc. In 1938, the 1934 Act was amended by the

Maloney Act which provided for the regulation over-the-counter market by the S.E.C.

The Board of Governors of the Federal Reserve System also has a regulation called "Regulation T" which is concerned with the extension and maintenance of credit on securities. This applies in two ways. One, the "Special Cash Accounts." This is where customers are bound to make full cash payment for the security bought within seven days or else the broker must cancel or liquidate the transaction of the unsettled portion thereof. On the other hand there are the "Margin Accounts." This is the sum of money that an investor must deposit with his broker when purchasing securities. The difference between this sum and the purchase price of the securities must then be borrowed. Now Regulation T controls the extension of such credit to customers, brokers, dealers and members of the national securities Exchanges.

Finally, there is the Investment Company Act of 1940. The objective of this Act was to ensure that those investing in Investment Companies are fully informed and fairly treated. Thus the American Stock Exchanges are really controlled by Federal Laws. Of course there are state regulations but the S.E.C. is the overlord and it oversees that the investor is protected while the national economy is not jeopardised by over speculation.

This is perhaps something we may want to introduce into Kenya. The Stock Exchange that is left entirely in

the hands of the brokers may at one time ruin the economy as was shown by the American experiment in 1930. But at the same time one may argue that the London Stock Exchange, or even indeed the Nairobi Stock Exchange, has been operating without any state laws, in the ideal spirit of Laissez faire.

Well, these three Exchanges operate in a very different economic setting. More people in the United States of America own stocks and shares than in any other country in the world. In Kenya, very few people own stocks in companies, although this is gradually changing. Even then, it is only the business elite that is holding most of the shares.

If we want to educate our people, and let the wananchi own their industries and the business sector, then surely an Act of Parliament is needed, to legally establish the Stock Exchange, and regulate the dealings therein and at the same time protect the investor. An authority should be created by this Act to supervise the activities of the Exchange. Perhaps we do not need the diverse legislation as enacted in the United States since our country is small geographically and also the number of securities yet on the market are not many. The advantages of the company as a form of business organisation are slowly being appreciated. Ownership is represented by shares which can be sold; it is possible to have a large sum of money that could ^{not} be obtained under some other form of organisation; the owners have limited liability, so that they can only

lose what they invest, and since those who own the shares, own the company, they may share in the growth of company if the business is succesful.

Thus, if the Stock Exchange in Nairobi is controlled by the state, most people will want to invest their wealth and this will no doubt boost the activity of the Exchange. And the investors will be protected from any unscrupulous brokers, thus promoting a health business atmosphere.

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