

# AANTEKENINGE

## “OFFERS” AND THE COMPANIES ACT 71 OF 2008

The birth of the Companies Act 71 of 2008 (“the Act”) was discussed by Delport “Companies Act 71 of 2008 and the ‘Turquand’ rule” 2011 *THRHR* 132. The dangers inherent in the transplantation of foreign rules on the common law were mentioned by him. To ignore the development of an Act and the common law over many decades through importing new concepts and structures, apparently purely for the sake of change, can be even more dangerous. All of this is most patent in the provisions that regulate the offer of securities to the public (ch 4 of the Act). It is not argued that the mere importing of new concepts is detrimental to our company law, but these concepts and changes should improve and not debilitate existing law (see, however, Temkin “New company law ‘reliable, user-friendly’” *Business Day* 2011-01-10 and sources quoted).

“Securities” are defined in section 1 of the Act (if the proposed amendment by the Companies Amendment Bill 40 of 2010 is implemented) as “any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company”. A “share” is one of the units into which the proprietary interest in a profit company is divided. In the discussion below, the terms “shares” en “securities”, depending on the context, will be used interchangeably, but the principles apply to both.

It is trite law that the investor in the shares and other securities in a company must be protected beyond what is available at common law in the case of the purchase and sale of corporeals. The type of protection may vary from direct regulation of the *modus operandi* of the company, on the one hand, to *laissez faire* requiring only disclosure on the other, with various permutations between these two extremes (Loss *Fundamentals of securities regulation* (1988) 25; Gower *Review of investor protection* 1984 Cmnd 9125). South African company law has always opted for disclosure, putting emphasis on who must disclose and the extent of the disclosure depending on the market where the shares is to be issued or traded (see Cilliers *et al Cilliers & Benade Corporate law* (2000) 256 and authorities cited).

This “market” may be divided into primary and the secondary markets. As the name implies, the primary market is the first “distribution” (not to be confused with “distribution” as defined in section 1 of the Act and regulated under section 46; the term is used here initially in a colloquial sense to indicate that the shares are made available to investors of those shares). The eventual investor is a party to the contract, whatever form it may take, and the company is the other party. In many instances this is a “face-to-face” transaction. However, it can also be necessary, and prudent, for the company not to do the “distribution” itself but to utilise the services of a third party. If this third party is an agent of the company,

with or without additional obligations as to shares that are not “distributed”, basic agency principles determine that the “distribution” is by the company as principal (basically “best-efforts” underwriting). This third party can, however, also act as a principal in a different contractual relationship. This will be the case where he or she acquires the shares in the company for whatever consideration (section 40 of the Act) and then, as per the agreement with the company, “distributes” the shares to other investors. The “undistributed” shares are already acquired by the agent and therefore he or she remains the owner (basically “firm underwriting”; Loss 85ff). The common principle in the above situations is that the (ultimate) two parties to the contracts are the company who acquires the consideration for the shares (directly or indirectly) and the (eventual) investor who acquires the shares (directly or indirectly) and therefore this is the “primary market”.

South African company law incidentally does not recognise these transactions as “underwriting” and has stuck with the concept of “old-fashioned” underwriting, which is akin to insurance. This entails that an outside party (ie not the company or the third party as in the examples above) undertakes to take up the undistributed shares, and for which the company pays a premium, usually a percentage of the total share distribution (Delpont *Die verkryging van kapitaal in die Suid-Afrikaanse maatskappyereg met spesifieke verwysing na die aanbod van aandele aan die publiek* (LLD thesis UP 1987) 573ff).

The investor who acquired shares in the primary market by whatever means may want to sell the shares and this transaction takes place on the secondary market. This proposed transaction has no direct relevance for the company and due to the present principles in respect of nominee shareholding, the company may not even know about the change of ownership if the name of the buyer is not entered into the share register (see *Botha v Fick* 1995 2 SA 750 (A) and *Gerardus Gomes-Sebastiao v Quarry Cats (Pty) Ltd* unreported decision A5015/2010 of 2010-11-10 (GSJ)). This secondary market is “informal” and should be distinguished from the “formal” regulated market/s regulated by the Securities Services Act 36 of 2004. This distinction is important as the former is (and was) regulated exclusively by the common law (eg in respect of “insider trading”) and by the Companies Act and the latter by the Securities Services Act.

It is, however, critical to remember that primary and secondary markets operate strictly in numerical order as per the nomenclature and it is physically and legally impossible for the secondary market to exist before the primary market. This is true for the informal secondary market, and even more so in the formally regulated market (*Stock Exchange Inquiry Commission* (RP 47 of 1965) 4).

The basic principles that put regulation into effect is that if there is an *offer for shares* and the offer is to the *public*, disclosure is required (*Cilliers & Benade* 257). The focus of this discussion is on the offer and it will be accepted that offers of shares are to the *public*. In the primary market the offer must be intended for the conclusion of a contract for subscription (the acquisition of unissued shares). The reason why it is a subscription contract and not a contract of purchase and sale is the fact that the share, as incorporeal, is not in existence before issue and can therefore not be sold in the true sense of the word (*ibid*). The company therefore does not offer the shares for subscription, but issues an invitation to investors who then make offers to the company. The company then accepts the offers to the extent that shares are available and the allotment and issue follow (*ibid*). Initially it was accepted that subscription only takes place when the consideration for the shares is paid in cash, but this requirement has

been effectively deleted by *Gold Fields Ltd v Harmony Gold Mining Co Ltd* 2005 2 SA 506 (SCA) 510B (see Kunst, Delpont and Vorster *Henochsberg on the Companies Act* (1994) 258(3)). In the best efforts or firm underwriting constructions there are actually two offers, the first being one for allotment (and subsequent direct or indirect subscription) to the “underwriter” and his or her offer for sale (of shares or the right to allotment) to the investors. This is all clear and uncomplicated, except to determine when an offer to investors is an offer by an “underwriter” (ie a primary market underwriter transaction) and when it is a *bona fide* secondary market offer (*Cilliers & Benade* 258; Delpont *Kapitaal-verkryging* 417). The primary market underwriter transaction problem was addressed in the Companies Act 61 of 1973 (“1973 Act”) by creating a presumption that it is a primary market transaction if, *inter alia*, the shares were offered for sale to the public within 18 months of the initial allotment (s 146(2); *Henochsberg* 270).

The reason that it is important to distinguish between the primary and secondary markets is that in the former the company must disclose (by way of a prospectus) and the extent of the disclosure is substantial (ss 145 and 146 of the 1973 Act; ss 99 and 100 of the Act) while in the latter the seller must disclose and the extent is limited due to the fact that the seller does not have access to all the financial information (s 141 of the 1973 Act, s 101 of the Act). Due to confusion between the provisions that applied to the primary and the secondary markets in the Companies Act 46 of 1926, the Van Wyk de Vries Commission recommended that the provisions be in different chapters of the 1973 Act and section 141 of the 1973 Act was placed in Chapter V while the primary market regulation (s 142ff) was the new Chapter VI (*Van Wyk de Vries Commission Supplementary Report* (RP 31 of 1972) 97). The confusion was mainly as a result of the same words being used in different contexts. The meaning of the word “public” in the primary market sense and in the secondary market sense will and should obviously differ because the need for and extent of disclosure differ. The confusion was unfortunately not excluded (*Gold Fields Ltd v Harmony Gold Mining Co Ltd* 2005 2 SA 506 (SCA) 510E).

Chapter 4 of the Act now contains the equivalent of section 141 as well as the principles contained in Chapter VI of the 1973 Act. This may not seem to be a major problem, but the ambit, application and history of section 141 on the one hand and Chapter VI of the 1973 Act on the other, may tell a different story. Suffice it to say that the new Act did well to resurrect the problems of Act 46 of 1926, the predecessor of the 1973 Act.

### Primary market

Section 99 now provides, as far as it is relevant for this discussion:

- “(2) A person must not make an initial public offering unless that offer is accompanied by a registered prospectus.
- (3) Except with respect to securities that are the subject of a company’s initial public offering, a person must not make a–
  - (a) primary offer to the public of any–
    - (i) listed securities of a company, otherwise than in accordance with the requirements of the relevant exchange; or
    - (ii) unlisted securities of a company, unless the offer is accompanied by a registered prospectus that satisfies the requirements of section 100; or
  - (b) secondary offer to the public of any securities of a company, unless the offer satisfies the requirements of section 101.”

A primary offer(ing) is then defined in section 95(1) as:

- “(i) ‘primary offering’ means an offer to the public, made by or on behalf of a company, of securities to be issued by that company, or by another company—  
 (aa) within a group of companies of which the first company is a member; or  
 (bb) with which the first company proposes to be amalgamated or to merge.”

The initial public offer(ing) is defined as:

- “(e) ‘initial public offering’ means an offer to the public of any securities of a company, if—  
 (i) no securities of that company have previously been the subject of an offer to the public; or  
 (ii) all of the securities of that company that had previously been the subject of an offer to the public have subsequently been re-acquired by the company.”

An offer is defined as:

- “(g) ‘offer’, in relation to securities, means an offer made in any way by any person with respect to the acquisition, for consideration, of any securities in a company.”

### Secondary market

Section 95(1) defines the offer(ing) in this respect as:

- “(m) ‘secondary offering’ means an offer for sale to the public of any securities of a company or its subsidiary, made by or on behalf of a person other than that company or its subsidiary;”

and it is required in section 101(2) that:

- “(2) Subject only to subsection (3), a person making a secondary offering of the securities of a company must ensure that the offer is accompanied by either—  
 (a) the registered prospectus that accompanied the primary offering of those securities, together with any revisions required to address changes in any material matter since the date the prospectus was registered; or  
 (b) a written statement that satisfies the requirements of subsections (4) to (6).”

Comparisons between the 1973 Act and the new Companies Act should not be made, as the two Acts differ widely in respect of their philosophy. The former cannot be used to interpret the latter and the only aspect that should be addressed is the extent of the application of the common law in addition to the statutory provisions as it is especially the common law application that will complicate the application of the new Companies Act. This is especially patent when the two definitions of “offer” are evaluated.

The 1973 Act defines an “offer” in section 142(1) as:

- “‘offer’ in relation to shares, means an offer made in any way, including by provisional allotment or allocation, for the subscription for or sale of any shares, and includes an invitation to subscribe for or purchase any shares.”

The definition in the 1973 Act distinguishes between a contract for subscription and a contract of purchase and sale. “Sale” here clearly only refers to the underwriting constructions as the definitions in section 142 commences with the words: “In this Chapter (VI)” and the definitions can therefore not be used for the secondary market provision of section 141 in Chapter V (however, see *Gold Fields Ltd v Harmony Gold Mining Co Ltd* 2005 2 SA 506 (SCA) 510E). The definition in the new Act merely refers to “acquisition, for consideration” which includes subscription and sale, with the latter obviously applicable to the primary market (if there is a primary market underwriting transaction) or to the secondary market (s 101).

It is an accepted principle in the law of contract, with certain exceptions not relevant here, that “an offer is a declaration of the will of one party which is of such nature, and in such form, that acceptance thereof will be sufficient to constitute an agreement” (Joubert *General principles of the law of contract* (1987) 37; see also Van der Merwe *et al Contract general principles* (2007) 58). Also, an invitation to do business, or to make an offer, is not an offer and it is used by the person making the invitation “to exercise a choice in respect of the counter-party and also to communicate additional terms to the other party before finally concluding the contract” (Van der Merwe *et al* 58; Joubert 39). This is precisely the reason why a company issuing shares uses an invitation instead of an offer, as it can then accept offers from investors for less shares than the investor offers to subscribe for if there is an over-subscription (Cilliers & Benade 247; Pennington *Pennington’s company law* (2001) 346). If the company made the offer subject to the condition that acceptance by the addressee of the number of shares will be adjusted in the discretion of the company, the acceptance by the addressee actually becomes the counter offer which extinguishes the company’s offer (if there ever was one should the basic requirements of an offer be applied). The common law definition of an “offer” was therefore not sufficiently wide to cover company law contracts for subscription. This fact was recognised by the Van Wyk de Vries Commission and an invitation was incorporated in the definition of “offer” in section 142(1) (Van Wyk de Vries Commission 108; Delpont *Kapitaalverkryging* 304).

The definition of “offer” in the new Act does not expressly include an invitation, with the effect that if a company makes an invitation to subscribe for shares, it is not an offer, either under the common law or in terms of the Act. As well, the definition of “offer” provides that it is an “offer made in any way by any person with respect to the acquisition . . . of any securities in a company” which could imply that the investor is making the “offer”. Due to the fact that the investor is not offering any securities “by or on behalf of the company”, it can obviously also not be either a “primary offering” or an “initial public offering”.

It would seem that the lack of inclusion of “invitation” in the definition of “offer” was sought to be addressed in other provisions, such as section 98 which states:

“98. Advertisements relating to offers

- (1) As an alternative to any other manner of making or presenting an offer to the public, such an offer may be made or presented by way of an advertisement that—
  - (a) satisfies all of the requirements of this Act with respect to a registered prospectus; and
  - (b) is subject to every provision of this Act relating to the making of a prospectus.”

An “advertisement” is defined in section 1 as

“any direct or indirect communication transmitted by any medium, or any representation or reference written, inscribed, recorded, encoded upon or embedded within any medium, by means of which a person seeks to bring any information to the attention of all or part of the public”.

This would not seem to solve the difficulties in interpretation regarding with “offer” as set out above, as the operative word in section 98 is still “offer” (as defined) and the section merely regulates the content of the offer if it is made by way of an advertisement. Therefore, section 98 will apply if the offer is made by advertisement, not if the advertisement is an invitation. In addition, there is a

clear overlap between section 98 and, for example, section 99 which provides, *inter alia*, that a person must not make a primary offer to the public of unlisted securities of a company, unless the offer is accompanied by a registered prospectus. Therefore, a company that makes a written offer for shares must ensure that it is accompanied by a registered prospectus. However, if the offer is an “advertisement” as defined, the offer must comply with the requirements of a registered prospectus and must therefore be registered as such. The Act does not require that the “offer” must be in writing and therefore a verbal offer can be accompanied by a prospectus as contemplated in section 99. However, if that verbal offer falls within the ambit of section 98 and the definition of “advertisement”, the offer must be registered as a prospectus. Section 98(2) and (3) provide for the “tombstone advertisement”, which, if certain requirements are met, is intended to merely draw attention to the offer (see Loss 107). If the requirements are not complied with, section 98(3)(b) then provides that the “tombstone ad” is to “be regarded as having been intended to be a prospectus”. This provision now ignores the requirement that the offer must be accompanied by the (registered) prospectus and equates the offer to a “prospectus”, the latter concept not being defined in the Act. The confusion that exists under the 1973 Act as to whether a prospectus is the offer or the information that must accompany the offer is unfortunately perpetuated (Henochnberg 12(1)).

The distinction between the primary and secondary markets in respect of an offer is also ignored and the regulation thereof is confusing. Section 99(3), as quoted above, provides that:

“a person must not make a–

(a) primary offer to the public of any–

(i) listed securities of a company, otherwise than in accordance with the requirements of the relevant exchange.”

While this may be colloquially acceptable it is impossible in law as the primary and secondary markets remain separate markets. The secondary market, whether formal (as in the case of JSE Ltd listed shares) or informal, can only operate after the shares have been issued in the primary market. The “primary market offer” of “listed securities” is therefore a physical and legal impossibility. In respect of listed securities the time difference between the initial issue and the subsequent listing may be infinitesimally small, but it nonetheless remains (see also *JSE Ltd listings requirements* (2009) ch 5).

The subject of the offer, especially in the primary market of new unissued shares, is not clear. A “primary offer(ing)” is *inter alia* defined as:

“an offer . . . made by or on behalf of a company, of securities to be issued by that company, or by another company–

(aa) within a group of companies of which the first company is a member.”

The offer made by (or on behalf of) a company of securities to be issued by that company is in accordance with the general (common law) definition of an issue of shares. However, the issue by “another company . . . within a group of companies of which the first company is a member” is confusing. A “group of companies” is defined as “a holding company and all of its subsidiaries”; a “‘subsidiary’ has the meaning determined in accordance with section 3”; and “‘holding company’, in relation to a subsidiary, means a juristic person that controls that subsidiary as a result of any circumstances contemplated in section 2(2)(a) or 3(1)(a)” (s 1). All seems straightforward, until applied to the definition of “primary offer(ing)” and offer by on behalf of a subsidiary.

Sections 2(2)(a) or 3(1)(a) also provide for holding/subsidiary relationships in respect of other juristic persons such as trusts (definition of “juristic person in s 1), but the offer can only be in respect of companies in terms of the Act (s 99 and definition of “company in ss 1 and 95(1)(a)). If the offer is therefore made by (not “on behalf of”) a subsidiary company (ie “another company . . . within a group of companies of which the first company is a member”) and it is to the public, a prospectus must be issued because it is a separate legal entity. This is trite and a specific provision to regulate it is unnecessary. If the offer is made on a *pro rata* basis to existing shareholders, part of the offer or the whole offer in the case of a wholly owned subsidiary, will be to the holding company. This does not change the nature of the offer or the nature of the subsidiary as separate legal entity and the only question will be whether the holding company is “public” (a question not addressed here). The logic of this extended application of “primary offering” becomes even more obscure if one contemplates subsection (bb) which provides: “or by another company with which the first company proposes to be amalgamated or to merge” as this company is even more “remote” than the subsidiary. The obscure wording also has the unwanted effect that if the offer is made not by the particular subsidiary or target company, but on its behalf, it is not a primary offer(ing).

The interaction between the primary market and the secondary market in the sense that the secondary market transaction, with less disclosure (the written statement in terms of s 101(6)) can be used to circumvent the full registered prospectus requirement of the primary market transaction and may be more appropriate in a future discussion of the concept “public”. However, it may be necessary to point out that there is a clear overlap between the “initial public offering”, a new concept in our law, and that of the “secondary offer(ing)” as regulated in section 101 because, although the latter is clearly defined as “an offer for sale”, the use of “offer” in the definition of an “initial public offer” is, on the basis of the definition of “offer” in section 95(g), wide enough to include an offer for sale. This could lead to legal arbitrage, or worse still, confusion.

New concepts in law, and also in company law, are to be welcomed, but only when they bring certainty and clear up confusion. If these concepts have the opposite effect, especially in an area of law where the protection of (the future) shareholder/investor is paramount, change for the sake of change must be questioned.