

# **CHAPTER 4 OFFER REGULATION UNDER THE 2008 COMPANIES ACT**

by

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*Soli Deo Gloria*  
**FJ Labuschagne**  
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# CHAPTER 1

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## GENERAL ORIENTATION

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1. Introduction
2. Task objectives and demarcation of research
  - 2.1. Concept of offer regulation
  - 2.2. Premise of complete law and hypothesis
3. Methodology

## 1. Introduction

It is written that it is not money that is the root of many evils, but rather the worship of money, through which greed leads to significant problems.<sup>1</sup> Securities law aims at regulating the securities industry by setting a framework through which different mechanisms operate to ensure that the principles behind curbing the social qualm of greed are addressed. In this, the law is the witness and external deposit of our moral life. Its history is the history of the moral development of our race.<sup>2</sup> The regulation of public offers as part of securities law serves as an example of, how this body of law, through its development constantly aim to address efficacy deficiencies.

It will be shown that investor protection is the central pillar in the evolving law of financial services where new markets open up and an ever-growing number of investment vehicles are devised to entice investors and accrue capital gains for those who promote them.<sup>3</sup> The

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<sup>1</sup> Bible (1982) Holy Bible: The New King James Version, Containing the Old and New Testaments Nashville: T Nelson: 1 Timothy 6:10. The desire to be rich tempts and snares into foolish and harmful lusts, leading to destruction and perdition. Whether religious or not, there is truth in ancient philosophy concerning the source of evil when it comes to capital and the effects of the manifestation of this evil.

<sup>2</sup> Holmes OW (2003) "The Path of Law" in Patterson DM (ed) *Philosophy of Law and Legal Theory: An Anthology* Malden MA: Blackwell Pub 16 (hereinafter referred to as Patterson (2003) *Philosophy* (Holmes)).

<sup>3</sup> Fisher J *et al* (2003) *The Law of Investor Protection 2<sup>nd</sup> ed* London: Sweet & Maxwell at the foreword and preface describes growth associated with investment opportunities, commencing in the Thatcher years, which witnessed a revolution in the provision of financial services. The "Big Bang" in the City heralded a new era of the small investor in which the ordinary and the meek were invited to accumulate wealth by prudent investment in the financial markets. New types of investment vehicles developed as small shareholders were encouraged to participate in capital ventures. The size of the world shrank as computer technology enabled money to be transferred across international boundaries instantaneously at the press of a button. The time of the financial entrepreneur had arrived. Instead of acting as the intermediary between capital and labour, this was the role of the entrepreneur in classical Marxist theory, the entrepreneur acted as the intermediary between capital and the investor. Legal headlines

challenge is for the law to keep ahead and to evolve with business and financial markets instead of remaining stagnant. To this end, the rule of law is aimed at the social need it is addressing, in this case fraud through offers to the public. The role is obscured and only partially attained in consequence of the fact that the rule owes its form to a gradual historical development, juxtaposed against being reshaped as a whole, with conscious articulate reference, by the end in view.<sup>4</sup> Where offer regulatory laws developed as a result of historic attempts in evolving efficacy of same, it follows that contemporary developments should take cognisance of the past not only in avoiding similar errors but also to ensure that the future development of the law is not ignoring the foundational principles upon which it is based.

In securities law, specifically offer regulation of securities, disclosure is the primary method of regulation, in that the offer (once qualified as an offer of securities to the public) must be accompanied by a prospectus, which forms the basis of investor protection and establishing liability in the event of fraud, corporate collapse or damages suffered by investors where such corporate failures are due to negligence or intent. However, before disclosure can happen, offer regulation entails that the offer must be an offer as qualified; of securities and; to the public. Often disclosure is

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have been dominated by casualties of the changes and innovations which have occurred in the investment world, as governments and the legal system have struggled to protect the interests of investors. Investors lost money which they had invested, sometimes at the hands of dishonest men who set out to defraud their victims of their savings, but more often at the hands of the incompetent or the reckless who were trying to accumulate wealth for themselves and their clients by taking risks which the more prudent could not justify. Barlow Clowes, the Levit Group, BCCI, the Lloyd's insurance market and Barings Bank are household names associated with the dishonest or reckless loss of investor's money.

<sup>4</sup> Patterson (2003) *Philosophy* (Holmes) 16.

circumvented by virtue of creative transactional structuring to avoid the three integers which will activate the mechanism of offer regulation by way of disclosure through a prospectus. If not for creative structuring, an offer can be put forward simply as non-public by virtue of interpretation of the statutes or be interpreted as not applicable to regulatory purview. With corporate collapse, is it not only the investors that suffer damages; more often than not unable to recuperate their life savings; but also the economy that suffers. While the importance of investor protection and efficient capital markets are objectives of offer regulation, companies also benefit from adhering to the regulations therefore ensuring a good standing. This however is only possible insofar the rules which ensure capital market regulation and subsequent disclosure requirements carry meaning or value in constituting a set of complete law, thereby ensuring enforcement efficacy through compliance as ambiguity is ruled out and the liability provisions acting as deterrent. It is the aim of this work to analyse the current regulatory dispensation under the 2008 Companies Act;<sup>5</sup> particularly with reference to Chapter 4 which deals with public offerings of company securities, specifically aspects of offer regulation in the primary market and, to an extent, with necessary qualification, the secondary market in order to qualify the efficiency of the current regulatory regime in terms of enforcement efficacy through the premise of complete law, whereby the set of offer regulatory principles also comply with the *Grundnorm* applicable.

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<sup>5</sup> The Companies Act 71 of 2008 (hereinafter referred to as the 2008 Companies Act).

## 2. Task objectives and demarcation of research

As will follow from chapter 3 *infra*, the development of offer regulation in regulating the securities offered on the capital markets, followed the evolution of the company concept and manifested as mechanism to curb corporate abuse and to protect investors in an efficient capital market regime. Based on the crystallised principles of securities regulation in chapter 4 *infra*, read with its historical foundations, a review of offer regulation under the 2008 Act will follow in chapter 5. Regulation for the sake of regulation, without cognisance of the social end, will result in ineffective law or at worse, dead letter law. As far back as 2001, the Nel Commission of Inquiry into the affairs of the Masterbond Group and investor protection in South Africa<sup>6</sup> made significant recommendations concerning corporate law and securities regulation in South Africa, with a view of making it more effective and aligning it with international best practices. However, these recommendations were never implemented. Instead, a new Companies Act came onto the books with imported concepts of securities regulation based on foreign jurisdictions which intertwined with concepts of the 1973 Act as well as the 1926 Act.

The underlying philosophy of offer regulation as crystallised through its historical development, and which was patent in the previous Company Acts prior to the new dispensation, differs from the advanced rationale and philosophy of the 2008 Companies Act. A complete enquiry into the

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<sup>6</sup> South Africa (2001) *The Final Report of the Nel Commission of Inquiry into the Affairs of the Masterbond Group and Investor Protection in South Africa: Corporate Law and Securities Regulation in South Africa* Cape Town: The Commission (hereinafter referred to as the Nel Commission, and the Nel Commission Report where applicable).

statutory regulations concerning offer regulation in terms of the 2008 Companies Act has not yet been undertaken in South Africa. While certain aspects thereof were discussed by writers independently,<sup>7</sup> no complete investigation has been undertaken focusing on the identification and classification of the philosophical underpinnings, together with an analysis of the genesis of the 2008 Act, juxtaposed to the previous methods of reviewing and ultimately enacting company legislation in South Africa.

Based on the foregoing, it is patent that research and a discussion concerning the full extent of offer regulation in terms of the new dispensation together with the development of the principles of regulation, the coming into being of the 2008 Act, as well as the conflicts between the three dimensional nature of company law, the common law and the 2008 Act are required. More so, the effect of the principles of regulation in terms of its historical development and importation into Southern Africa from English law as it manifests today in the United Kingdom, United

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<sup>7</sup> See Yeats J “Public ‘Offerings’ of Company Securities: A Closer Look at Certain Aspects of Chapter 4 of the Companies Act 71 of 2008” (2010) 1 *Acta Juridica* 117; Sutherland P “The State of Company Law in South Africa” (2012) 23 *Stellenbosch Law Review* 157; Mongalo S (2010) *Modern Company Law for a Competitive South African Economy* Claremont South Africa: Juta (hereinafter referred to as Mongalo (2010) *Modern Company Law*); Delpont PA “Offers and the Companies Act 71 of 2008” (2011) 74 *THRHR* 280; Delpont PA “About Offers of Securities to the Public” (2011) 74 *THRHR* 668 and Delpont PA “Companies Act 71 of 2008 and the ‘Turquand’ Rule” (2011) 74 *THRHR* 132. See also Cassim FHI (man ed); Cassim MF *et al* (2012) *Contemporary Company Law 2<sup>nd</sup> ed* Claremont, South Africa: Juta (hereinafter referred to as Cassim *et al* (2012) *Contemporary Company Law*); Davis D & Cassim F (eds) Geach W (man ed) Mongalo T *et al* (2009) *Companies and Other Business Structures in South Africa: Commercial Law* Cape Town South Africa: Oxford University Press (hereinafter referred to as Davis *et al* (2009) *Business Structures*); Stein C & Everingham GK (2011) *The New Companies Act Unlocked* Cape Town South Africa: Siber Ink (hereinafter referred to as Stein & Everingham (2011) *Unlocked*); Delpont PA (2009) *The New Companies Act Manual* Durban: LexisNexis (hereinafter referred to as Delpont (2009) *Manual*) and Delpont PA (2011) *The New Companies Act Manual: Including Close Corporations and Partnerships Student ed* Durban: LexisNexis (hereinafter referred to as Delpont (2011) *Manual*). It is submitted with respect, that apart from the Sutherland and Delpont monographs, the remainder does not critically review the subject material.



States and Canada, should be compared to the principles underlying securities regulation under the new South African company law dispensation. Only then will the effect of the new regulatory regime be clear and the effectiveness thereof be evaluated, for in order to be effective, it must be clear and rationally understood in order to be interpreted. This would necessarily lead to the circumvention of a position where incomplete law leads to enforcement failure.

Due to the extent of offer regulation in capital markets, the enquiry is limited to offer regulation in the primary market, which is in any event the primary disclosure benchmark based on the nomenclature, as disclosure regulation in the secondary markets will follow same. However, due to the inclusion of the secondary market into Chapter 4, which deals with offer regulation, the discussion necessarily involves both markets and identifies the problems occasioned by such a system.

The philosophical side of offer regulation, as manifested through its historical development, is outlined by placing the stages of development alongside the underlying principles. It is submitted that a more naturalistic philosophical dispensation underscores the crystallised principles and it is measured utilising the views of Ronald Dworkin. Typically, it will be shown that the new dispensation has a more positivistic buttress compared to the naturalistic structure typically applied to offer regulatory laws, and the work of HLA Hart is used to illustrate this. The philosophical underpinnings of the two different dispensations are based on the

rationalisation of the enabling legislation. Furthermore, an analysis will be drawn between disclosure regulation and merit regulation as evident from the respective principles underlying the current regulatory regime.

Based on the three dimensional nature of company law, as well as the distinct nature of the company concept as vehicle enabling capital accrual in launching enterprises aimed towards optimising profits, it is not possible to excise the socio-economic side from the philosophical side and this is discussed alongside each other where applicable.

### 2.1. Concept of offer regulation

Offer regulation in terms of Chapter 4 provides, in the first instance, for substantive regulatory provisions. That is the provisions which are responsible for substantively setting up the regulatory regime starting with the definitions applicable to Chapter 4, continuing with the determinant factors which are required as to whether an offer will be regarded as falling within the scope of regulatory purview in terms of Chapter 4; that are the determinants of an “offer” to the “public” and of “securities.” The substantive regulatory provisions further provide for the disclosure requirements by means of a prospectus or written statement where an offer falls under the purview of regulation and lastly the required liability and penal provisions which come to the fore when the substantive regulatory provisions are to be enforced. Substantive regulatory provisions infer compliance to be met prior to a pro-active regulator approving the offer to the public or where with a reactionary regulator, a

market participant such as a public company which is proposing extending an offer for subscription, will be able to gauge whether the substantive requirements are to be met or not, thereby ascertaining whether it will be liable in terms of Chapter 4 concerning non-compliance or not.

Secondly, offer regulation in terms of Chapter 4 provides for an enforcement regime applicable to the enforcement of the substantive regulatory provisions. It is submitted that the substantive regulatory provisions include the enforcement provisions. However, for the sake of clarity, a divide is drawn between these two constituent pillars of Chapter 4 offer regulation insofar as provisions which provide for offer regulation form part of the substantive regulatory provisions, and provisions which are coupled with liability when contravening such provisions are provided for under the heading of enforcement.

In terms of enforcement, firstly the concept divides into enforcement of the substantive aspects by means of a regulator (regulatory enforcement), which will be either the Courts (reactive enforcement regulation) or a dedicated regulatory authority (pro-active enforcement regulation). Secondly, regulatory enforcement whether by reactive or pro-active enforcement regulation entail liability provisions establishing liability beyond what the common law has to offer. Penal provisions manifest as deterrent as well as mechanism to override common law delictual liability and the evidentiary problems in proving same.

Thirdly, the method of regulation constitutes the formalistic pillar of offer regulation, i.e., how Government provides for enforcing the substantive aspects either by means of *ex ante* regulation by means of a dedicated regulator or *ex post* where regulatory provisions establish a regulatory regime yet it is not actively enforced. It is submitted that both reactive and pro-active enforcement models will feature aspects of reactive or pro-active enforcement regulation; the difference will be in the application thereof and which system is more prevalent. For example, South Africa as will be described *infra*, features a reactive (*ex post*) enforcement model by means of the Courts as our regulatory authority as the Commission for Intellectual Property and Companies, a subdivision of the Department of Trade and Industry is not expressly tasked with the pro-active or reactive enforcement of Chapter 4. Chapter 4 features compliance based provisions, which will determine whether or not regulation is required. This determination is for market participants to make, especially whether the offer is an offer, to the public, and of securities, and whether or not an exemption applies which will exclude it from regulation by means of disclosure and the prospectus requirements. In the United States the Securities Exchange Commission is an *ex ante* pro-active enforcer actively enforcing regulation as well as the offering and disclosure.

As South Africa does not feature a pro-active regulatory model, it leans heavily on liability and penal provisions acting as deterrents for non-compliance with the substantive aspects of Chapter 4. The only pro-active regulation (not enforcement) in South Africa is the basis of Chapter 4,

requiring disclosure by means of prescribed prospectus requirements which must be filed with the CIPC. Liability in terms of Chapter 4 rests on the prospectus and prospectus requirements in addition to the regular liability of directors. This discussion will not focus on disclosure or liability issues but on the core aspects of enforcement regulation in terms of how the substantive aspects are regulated in determining the prevalence of complete law. Therefore, only the first pillar of offer regulation by means of the substantive aspects in ensuring enforcement of the type of regulatory regime, in place in South Africa, will be discussed in detail with only an overview concerning the problems envisaged with the liability provisions. This is because regulation by means of a regulator not only rests on the penal and liability provisions but is tasked with the entirety of the substantive aspects flowing from Chapter 4. This discussion will therefore cover the regulatory enforcement model in chapter 5, which is in place in South Africa prior to reviewing the substantive aspects of the underlying legislation in chapter 5 parts A to C.

## 2.2. Premise of complete law and hypothesis

The premise of this discussion is firstly to establish whether the regulatory dispensation under Chapter 4 of the 2008 Companies Act complies with the established principles of offer regulation as developed and secondly, whether the regulatory dispensation is enforceable in terms of the substantive aspects thereof.<sup>8</sup>

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<sup>8</sup> The enquiry will therefore firstly focus on the enforcement aspects as per whom and how Chapter 4 is regulated. This will establish the regulatory regime which will influence the interpretation and application of the substantive regulatory aspects. Secondly, the enquiry will review the substantive aspects of Chapter 4, that is, the provisions which must ensure effective enforcement either through the

It is stated that the law is complete as ideal premise, when all relevant applications of the law are unambiguously stated. Therefore, the substantive aspects of Chapter 4 should be understood unambiguously by all and be able to be enforced literally. Enforcement rests implicitly on the premise of complete law in terms of its design of punishment which carries a deterrent effect. Law is incomplete when it contains breaches and as such fails to address activities which may prove in hindsight to be equally harmful as those stated in law; or because law is open ended and the boundaries of the law are not circumscribed clearly; therefore neither the Legislature nor the market participants will be able to fully anticipate the scope of their rights and obligations and the outcome of the enforcement thereof. Thus when law is regarded as incomplete, enforcement failure may follow with resultant deterrence failure. For this reason, in the first instance the substantive aspects of Chapter 4 are important in determining whether they are to be regarded as complete and secondly whether the enforcement thereof will be effective.

It goes without saying that South Africa follows a reactive enforcement model with substantive requirements delineating the regulation of offers,

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Courts or a regulatory body or by means of compliance of the substantive peremptory provisions in adhering to the rule of law and in avoidance of liability. This enquiry of the substantive aspects will review whether the law is complete. Going forward, the analysis requires a determination as to the type of regulation, i.e., how and by whom are the substantive aspects regulated? Flowing from that, a determination can be made as to the type of enforcement in the first instance, i.e., whether it is reactive by means of Courts or pro-active by means of a dedicated regulatory authority. If a reactive enforcement model is used (juxtaposed to a pro-active enforcement model) the rules of enforcement can be determined, i.e., penal provisions for non-compliance to act as deterrent. Eventually, the examination will ascertain whether certain defined South African regulatory principles with regards to offer regulation succeed in their objectives based on their underlying philosophy and whether further regulation is necessary. This examination will review the requirements of offer regulation as well as the parameters thereof against the backdrop of the principles of regulation, in reaching the objectives of securities law.

coupled with liability and penal enforcement provisions as rules of enforcement. What is required is to review the substantive aspects in determining whether it falls within the scope of complete law. Whether the substantive aspects fall under complete law or not will determine whether offer regulation is efficient and effective or whether there is potential for enforcement failure. Efficiency and effectiveness are judged against the principles of regulation, especially the *Grundnorm* thereof.

The hypothesis in respect of Chapter 4 offer regulation in terms of the 2008 Companies Act can thus be set out as follows:

Effective and efficient public offer regulation is based on the premise of complete law which ensures enforcement in terms of the principles of offer regulation. Therefore, incomplete law will contribute towards enforcement failure.

In applying the hypothesis to aspects of Chapter 4 offer regulation in order to analyse same against the hypothesis, this thesis will review Chapter 4 against the historical development of regulation as well as the principles of regulation, in deriving at a conclusion in respect of the state of Chapter 4 offer regulation under the new dispensation. Recommendations, where needed, will then be made after a succinct review of the comparative disposition in the United Kingdom and the United States.

### 3. Methodology

Chapter 2 highlights the conceptual framework within which capital market regulation is manifested through disclosure. This is important to contextualise the rest of the enquiry and discussion. A divide is drawn between merit (direct regulation), disclosure regulation and a hybrid system.

Chapter 3 details the contextual development of the company and its involvement insofar as offer regulation is concerned. It discusses the historical development of securities regulation and the adaptation thereof in South African company law. It will also draw a distinction between the evolution of securities regulation in England as well as Canada, and a corollary will be drawn between reactionary regulation and the reform of regulation from the reactionary stage into a separate body of law known as securities law. The purpose of securities regulation in capital markets is touched upon where after English, Canadian and South African development is divided into three distinct stages based on its development: historical stage with reactionary motivators; the reformist stage; and the contemporary stage. The *Grundnorm* of securities regulation in capital markets by way of disclosure is identified and South Africa is discussed up to the reformist stage.

Chapter 4 firstly identifies the principles of offer regulation as crystallised and secondly the philosophy of regulation. The principles of regulation are further detailed by distinguishing between historical principles (based



on reactionary regulation) and modern principles (based on the reform of regulation). The principles are divided into objectives and principles of disclosure regulation. The objectives of securities regulation tie in with the underlying principles, based on its main motivating factors to which it owes its development.<sup>9</sup> The objectives are subdivided into investor protection and capital market principles, while the principles of disclosure are divided into enabling, deterring, and continuous disclosure principles. The philosophy of the naturalistic thinkers is briefly discussed as manifested by the philosophical framework, and the different objectives and principles are contextualised alongside the historical development and evolution of capital markets regulation. Reviewing the evolution and history of securities regulation will highlight the underlying principles of regulation through disclosure. The underlying philosophy which gave rise to the 2008 Act is considered whilst drawing a distinction between it and the principles of disclosure, reviewing the positivistic nature of the new dispensation and the potential confusion occasioned due to the importation of foreign concepts; merging of previous concepts; and resurrection of historical problems.

Chapter 5 will look into the concept of an offer; a security, and lastly the difficult concept of “public.” Key factors concerning capital market regulation are identified and discussed under the new dispensation and an analogy is drawn between same and the principles of offer regulation in

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<sup>9</sup> For a full discussion on objectives of the promotion of confidence in the markets and adverse selection see the discussion in Gillen MR (1992) *Securities Regulation in Canada* Toronto: Thomson Carswell 82-87 (hereinafter referred to as Gillen (1992) *Securities Regulation in Canada*).

levelling criticism against the current regime. This is followed by a comparative enquiry into the applicable regimes in the United Kingdom and the United States and the manifestation of offer regulation in said jurisdictions in chapter 6. Only when the origins and evolution up to the 1973 Companies Act have been correlated, reviewed against the current dispensation and rationalised against foreign jurisdictions which are ahead in their respective regulatory dispensations, can the new dispensation under the 2008 Companies Act be evaluated in determining the relevant aspects of offer regulation. Chapter 7 will revisit the conceptual framework and philosophical underpinnings and conclude with certain recommendations.

## CHAPTER 2

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### CONCEPTUAL FRAMEWORK

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1. Introduction
2. Elucidation of concepts
  - 2.1. The corporate entity
  - 2.2. Market efficiency
  - 2.3. Acquisition of capital
  - 2.4. Regulation
  - 2.5. Types of securities regulatory regimes
    - 2.5.1. Securities law
    - 2.5.2. Purpose of securities regulation
    - 2.5.3. Direct regulation
    - 2.5.4. Disclosure regulation
  - 2.6. Aspects of disclosure regulation
  - 2.7. Prospectus as disclosure tool
3. *Capita Selecta* on aspects of securities law and securities regulation
  - 3.1. Enforcement
  - 3.2. Components of regulatory system
  - 3.3. Regulatory design: enforcement
  - 3.4. Complete law
  - 3.5. Enforcement failure
  - 3.6. Purpose and relevance
4. Concluding remarks

## 1. Introduction

As stated in chapter 1, offer regulation in the capital markets primarily utilises pro-active provisions *in lieu* of reactive enforcement to achieve its objectives. The method of regulation should be easily discernible from the legislation, and the parameters succinctly set out as to provide for an effective regulatory regime.

Insight into the financial affairs of a company and its financial policy, by investors, is important in order to establish whether an investment will bear returns.<sup>1</sup> The objectives of such an appraisal can be summarised as providing a synopsis as to the sources from which a company obtains its funds and the manner in which these are applied, the extent of utilising external capital (loan funds) in relation to shareholder funds and whether the financial policy has been successful in maximising returns on investments without undue risk as well as financial soundness.<sup>2</sup>

Berle and Means state in their now classic study, *The Modern Corporation and Private Property*:

The corporate system has done more than evolve a norm by which business is carried on. Within it exists a centripetal attraction which draws wealth together into aggregation of

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<sup>1</sup> Cilliers HS *et al* (2000) *Corporate Law* rev 3<sup>rd</sup> ed Durban: Butterworths 217 (hereinafter referred to as Cilliers *et al* (2000) *Corporate Law*).

<sup>2</sup> *Ibid.*

constantly increasing size, at the same time throwing control into the hands of fewer and fewer men.<sup>3</sup>

Businesses and governments invest vast amounts of money with a very specific *spes* that they will stimulate and expand on wealth creation and generate a return on initial investments.<sup>4</sup> In addition to this, as the cornerstone to free market capitalism, efficient capital markets are a priority. These markets constitute vested interests, necessitating control over the process by which capital is acquired from the investing public. This process of control encapsulates the regulation of offers of securities in the capital markets.<sup>5</sup>

This chapter will contextualise the conceptual framework of disclosure regulation, for purposes of contingency throughout the discussion and analysis of Chapter 4 of the 2008 Companies Act, against the philosophical backdrop as well as for a contextual critique of the importation and fusion of different philosophies present in the Act. This critique will set the background for an analysis of the current regulatory dispensation and the interpretation thereof.

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<sup>3</sup> As quoted in Hahlo HR & Pretorius JT (1999) *Hahlo's South African Company Law through the Cases: A Source Book: A Collection of Cases on Company Law with Explanatory Notes and Comments 6<sup>th</sup> ed* Kenwyn: Juta 4 (hereinafter referred to as Hahlo & Pretorius (1999) *Hahlo's*).

<sup>4</sup> Yalden R *et al* (2008) *Business Organizations: Principles Policies and Practice* Toronto: Emond Montgomery Publications at Introduction and 387 (hereinafter referred to as Yalden *et al* (2008) *Business Organizations*). Capital is raised by a company for a variety of reasons, which include the purchase of assets used to produce goods and services, or to support research and development of new products or markets. Companies sell shares to raise equity capital. A company can also loan funds in the form of a bank loan or from selling bonds or debentures. Shares and debentures are, in general terms, referred to collectively as securities. Securities are distributed to investors to raise capital necessary to carry on business or to launch a new business endeavour. Securities may be distributed at the inception of a business or subsequently, where funds earned from the business are insufficient to support a new endeavour.

<sup>5</sup> *Ibid.*

If regulation of security offers derived its *raison d'être* from the requirement to regulate based on the need for fraud prevention and flowing from it, then for effective investor protection and market efficiency, it must be aligned with the developed modern company and the necessities of commerce. The obvious question to be answered is whether securities regulation has kept pace with the evolvement of business methods and practices. The law is not static and should develop to keep abreast of the community on which it aims to impose rules and regulations. For this purpose, it must be relevant and effective or else fail due to its circumvention and its dead letter nature.

## 2. Elucidation of concepts

### 2.1. The corporate entity

Capitalism is defined as the system where independent companies compete against each other for the business derived from customers. The system of capitalism is organised around the creation and allocation of capital, with the savings of individuals as the basis of all capital.<sup>6</sup> If capitalism is the system of capital generation, then the company as corporate entity is the vehicle through which the process of capital generation manifests in the free market.<sup>7</sup>

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<sup>6</sup> Funds are acquired from investors to build factories, buy machinery, and to research and develop technology. See Morck R K & Steier L (2005) *The Global History of Corporate Governance: An Introduction* NBER Working Paper No 11062 National Bureau of Economic Research Programs <http://www.nber.org/chapters/c10267.pdf> (accessed on 10 December 2013).

<sup>7</sup> Yalden *et al* (2008) *Business Organizations* at Introduction. Business organisations are an integral part of modern life. Apart from being employers, they consume vast quantities of resources and produce an enormous range of goods and services.

The modern company is held to be an important vehicle in which capital is managed in a free market capitalist system.<sup>8</sup> A company is primarily defined as a juristic person incorporated in terms of the Companies Act of 2008, a domesticated company or a juristic person that was registered in terms of the Companies Act of 1973 or the Close Corporations Act of 1984, if it has subsequently been converted.<sup>9</sup>

The importance is the confirmation of juristic personality. The essence of the juristic person is trite, being something else, other than a natural person, endowed through the operation of law with capacity to have rights and duties apart from its members.<sup>10</sup>

Following the dictum in *Stephney Corporation v Osofsky*<sup>11</sup> where the juristic person as a company is described as having no soul to be saved or body to be kicked; it can be understood that the imposed limited liability, perpetual succession, and a regulated structure enable the public company with a share capital to be an important and efficient instrument for mobilising capital funds<sup>12</sup> from the investing public.<sup>13</sup>

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<sup>8</sup> Through pension funds, venture capital funds, private equity funds, mutual funds and hedge funds.

<sup>9</sup> Section 1.

<sup>10</sup> *Webb & Co Ltd v Northern Rifles; Hobson & Sons v Northern Rifles* 1908 TS 462. For more on the *universitas* concept derived from the Roman-Dutch legal fiction of *universitas personarum*, see the judgment of Justice Smith at 464, holding, *inter alia* that the *universitas* acquire rights or incur obligations. See also the notes in Hahlo & Pretorius (1999) *Hahlo's* 9.

<sup>11</sup> *Stephney Corporation v Osofsky* [1937] 3 All ER 289 291H.

<sup>12</sup> Yalden *et al* (2008) *Business Organizations* 387. Companies sell shares to raise equity capital. Capital is raised by a company for a variety of reasons, which include the purchase of assets used to produce goods and services or to support research and development of new products or markets. A company can also loan funds in the form of a bank loan or from selling bonds or debentures. Shares and debentures are in general terms referred to collectively as securities. Securities are distributed to investors to raise capital necessary to carry on business or to launch a new business endeavour. Securities may be distributed at the inception of a business or subsequently where funds earned from the business are insufficient to support a new endeavour.

<sup>13</sup> Cilliers *et al* (2000) *Corporate Law* 198.

## 2.2. Market efficiency

The gist of efficient capital markets is that companies with good prospects raise money by issuing securities, whereas companies that are judged as poor investments will have difficulty in raising any substantial amount of capital.<sup>14</sup> Where investors are capable and enabled to rationally judge their investment decisions, capital will be allocated to companies that can use it well and kept away from companies that will misuse, apply it poorly, or commit fraud with said funds.<sup>15</sup> Efficient capital markets allocate resources in a rational manner, focusing investment towards sustainability.<sup>16</sup> This process underlies shareholder capitalism as evident in the United Kingdom and the United States as well as South Africa. Market efficiency is coupled with investor protection in that it proposes a symbiotic relationship.

## 2.3. Acquisition of capital

Risk capital for a proposed undertaking is obtained primarily in the form of share capital by issuing shares to investors.<sup>17</sup> The expected *quid pro quo* in investing is obtaining an economic return on the invested capital.<sup>18</sup>

Underlying the investment made, the company must be financially sound in order to be capable of operating commercially and bear returns.<sup>19</sup>

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<sup>14</sup> Morck & Steier (2005) *Global History* 3.

<sup>15</sup> *Ibid.* This process underlies shareholder capitalism as evident in the United Kingdom and the United States as well as South Africa. Funds are acquired from investors to build factories, buy machinery, and to do research and develop technology.

<sup>16</sup> Gray T & Kitching A (2005) *Reforming Canadian Securities Regulation, Parliamentary Information and Research Service* Canada: Federal Government.

<sup>17</sup> Cilliers *et al* (2000) *Corporate Law* 198. Investor as concept denotes both individual as well as corporate shareholders. Individual shareholders may hold the shares in their own name or invest in shares via an investment trust.

<sup>18</sup> *Ibid.*



Financial soundness constitutes the ability of the company to pay its debts when becoming due and having sufficient liquid cash.<sup>20</sup> Financial soundness also pertains to having adequate working capital to finance short-term economic activities in reaching its commercial objectives.<sup>21</sup> It follows that the question pertaining to financial soundness is of importance to any investor and shareholder.<sup>22</sup>

A company can obtain the funding it requires for its undertaking from two sources:<sup>23</sup>

i) Share capital obtained from shareholders who invest in the company.

This is the primary source (internal).<sup>24</sup>

ii) Funding from external parties obtained in the form of loans or credit supplied.

The return on a share investment must comprise two main elements:<sup>25</sup>

i) a direct return<sup>26</sup> (constituting dividends declared on shares out of available (distributable profit)); and

ii) an indirect return represented by the growth in value of the share.<sup>27</sup>

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<sup>19</sup> *Ibid.*

<sup>20</sup> Cilliers *et al* (2000) *Corporate Law* 198-9. Payment of debts remains a factual solvency query (whether the assets exceed liabilities).

<sup>21</sup> *Ibid.* Net liquid assets such as credit facilities like bank overdrafts.

<sup>22</sup> *Ibid.*

<sup>23</sup> *Ibid.*

<sup>24</sup> *Ibid.* The company may also seek to build up accumulated shareholder's equity by retaining earnings (not declaring a dividend).

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.* Dividends are only due once declared. Net profit expressed as earnings per share is therefore not a direct return on shares but accumulated profit, increasing shareholder's equity and contributing to financial soundness.

This process of capital acquisition is bound to a regulatory process in order to curb abuses and safeguard the efficiency of the capital markets. Potential share investors and shareholders<sup>28</sup> require information pertaining to:<sup>29</sup>

- a) return on investment; and
- b) the financial soundness of the company.

This is occasioned through the process of offer regulation.

#### 2.4. Regulation

It follows that the expectation of return on an investment as posited, should be against the backdrop of a system of investor protection. In regulating the process of offering and subsequently acquiring investments in an enterprise, be it a start-up or multi-national established corporate entity, the disclosure of relevant financial information manifests as a system of regulation.

Government intervention in corporate affairs is ever increasing.<sup>30</sup>

Governments are mainly involved in terms of to how to interact with and regulate business organisations, either by encouraging growth or by controlling socially uncouth behaviour.<sup>31</sup> As business evolves either positively or negatively, the law that creates the business vehicle known

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<sup>27</sup> *Ibid.*

<sup>28</sup> Including debenture holders and creditors.

<sup>29</sup> Cilliers *et al* (2000) *Corporate Law* 209.

<sup>30</sup> Farrar JH & Hannigan B (1998) *Farrar's Company Law 4<sup>th</sup> ed* London: Butterworths 8-13 (hereinafter referred to as Farrar & Hannigan (1998) *Company Law*).

<sup>31</sup> Yalden *et al* (2008) *Business Organizations* at Introduction.

as the company and which ultimately regulates said entity's conduct should evolve too.<sup>32</sup>

Among the eight major economic themes characterising the development of modern company law, the ever increasing amount of government intervention in corporate affairs is recognised amongst others.<sup>33</sup> Early Anglo-Saxon companies Acts were a blend of direct intervention and *laissez-faire*.<sup>34</sup> Historically, this is explained as follows. On registration, the company was incorporated and the registration element ensured the growth of this form of business medium.<sup>35</sup> However, the Legislature requires disclosure of an increasing amount of information regarding the company.<sup>36</sup> Disclosure of information is the basis of accountability. Corporate accountability thus rests on the doctrine of disclosure and is justified on the following policy grounds:

- i) stock market: better informed and more efficient;
- ii) fraud and abuse: minimises the risk;
- iii) secrecy: prevents excessive secrecy and distrust; and
- iv) equality: of opportunities is facilitated.<sup>37</sup>

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<sup>32</sup> *Ibid.*

<sup>33</sup> Farrar & Hannigan (1998) *Company Law* 8-13. The other economic themes are a) the growth of larger business units; b) the development of increasingly elaborate structures; c) the shift from ownership to control of the firm through agency; and d) the investing power of institutional investors of ordinary shares, i.e., pension funds, insurance companies, unit trusts and investment trusts who invest the savings of other people.

<sup>34</sup> Hahlo & Pretorius (1999) *Hahlo's* 4.

<sup>35</sup> *Ibid*

<sup>36</sup> *Ibid.*

<sup>37</sup> *Ibid.* Although counter arguments can be put forward in terms of confidentiality, utility and excessive cost, the doctrine of disclosure remains as *sine quo non* for incorporation as well as satisfying the required accountability requirements and for offering shares to the public.

Offers to the public are regulated by a combination of underlying enabling legislation, such as the Companies Act of 2008 as well as the rules of the exchange on which the shares are to be listed or already are listed.<sup>38</sup> The latter then typically takes account of the former in the regulation of offers.

Past corporate collapse underpins the issue and need for regulation of the quality and quantity of information disclosed by companies.<sup>39</sup> In the primary and secondary capital markets the importance of regulation is paramount given the spectacular collapses in securities investment schemes.<sup>40</sup> Corporate failures due to poor or no internal controls in the management of the companies, unavailability of financial information pertaining to the companies, misleading or false information, and dubious accounting practices contributed to these corporate collapses.<sup>41</sup>

## 2.5. Types of securities regulatory regimes

The processes by which a company offers and sells its securities to the public are a principle focus of regulatory activity.<sup>42</sup> This activity may vary between direct regulation of the *modus operandi* of the business, also known as merit regulation,<sup>43</sup> to *laissez faire* which only requires full

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<sup>38</sup> Swanepoel “Under the Microscope” a Webber Wentzel editorial in Business Report (8 July 2009).

<sup>39</sup> Davis *et al* (2009) *Business Structures* 115.

<sup>40</sup> Delpont “About Offers to the Public” 2011 *THRHR* 668. More recently the Sharemax security investment scheme contributed to the loss of millions of Rands from investors.

<sup>41</sup> Davis *et al* (2009) *Business Structures supra*, see also Chapter 7 of the same title.

<sup>42</sup> Ratner DL (1978) *Securities Regulation in a Nutshell* St Paul Minn: West Publishing Co 37 (hereinafter referred to as Ratner (1987) *Securities Regulation*).

<sup>43</sup> Davies PL (2012) *Gower and Davies’ Principles of Modern Company Law* London: Sweet & Maxwell 853 (hereinafter referred to as Davies (2012) *Gower and Davies’ Principles*). In this work, reference is also made to Davies PL (2008) *Gower and Davies’ Principles of Modern Company Law* London: Sweet & Maxwell (hereinafter referred to as Davies (2008) *Gower and Davies’ Principles*) as well as Davies PL (1997) *Gower’s Principles of Modern Company Law* London: Sweet & Maxwell (hereinafter referred to as Davies (1997) *Gower and Davies’ Principles*) in order to accommodate

mandatory disclosure of all material facts: with permutations between these two.<sup>44</sup>

### 2.5.1. Securities law

The branch of law concerned with businesses requiring capital<sup>45</sup> for the initiation or expansion of operations is often referred to as securities or capital markets law which specifically engages securities regulation.<sup>46</sup>

Securities regulation, in turn, is divided into different categories which regulate processes concerned with the mechanism of acquiring capital from investors utilising the company as vehicle in the capital markets.<sup>47</sup>

At the genesis of securities law is the company, which by means of its reason for existence and its functionality, is the most favourable vehicle to make offers to the public of securities.<sup>48</sup>

It has been stated in chapter 1 *supra* that business, by nature, is ever evolving and as such the law must keep abreast. Insofar as securities law

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various changes in offer regulatory law in the United Kingdom. Review of the material has shown that the earlier source material differs quite significantly from the subsequent material due to such changes.

<sup>44</sup> Delpont “About Offers to the Public” 2011 *THRHR supra*.

<sup>45</sup> Businesses raise capital for various reasons, i.e., the purchase of assets used in the production of goods or the delivery of services, or to support research and development of new products, services or markets. Shares are sold to raise equity capital or funds can be borrowed in the form of a bank loan, but may also be achieved by way of selling debentures or bonds or a combination of the two types of security (Yalden *et al* (2008) *Business Organizations* 387).

<sup>46</sup> *Ibid.*

<sup>47</sup> For example, securities regulation can be divided into categories of disclosure of financial information and records of corporations as well as access thereto, audit of corporate accounts and financial statements, disclosure regulation in the primary market, disclosure regulation in the secondary markets, regulation and supervision of intermediaries and the fiduciary duties of directors as well as insider trading. For more information see the Nel Commission Report as well as Loss L (1988) *Fundamentals of Securities Regulation* 2<sup>nd</sup> ed Boston: Little Brown (hereinafter referred to as Loss (1988) *Fundamentals*).

<sup>48</sup> The nature of the company will be touched on in a subsequent discussion. Suffice it to mention here that it is the ability to offer securities for subscription or sale with a *quid pro quo* of being investment based on the return of dividends from profit. The acquisition of capital, it is submitted, and the means thereof, is the core of securities law, flowing from it are the different aspects categorised, from insider trading to the regulation and supervision of intermediaries.

and regulation are concerned, the main criticism levelled against it is that it fails to keep ahead of the evils it seeks to cure and the sweetness it aims to infuse. Internationally, as well as locally, the evolution of company law reform has been a constant series of additions to the existing legal framework resulting from the need to address perceived deficiencies and shortcomings in the regulation of securities.<sup>49</sup>

At the onset, it is important to elucidate the concept of securities law and how it interacts with corporate law. The terms “securities regulation” and “securities law” are analogous and will be used as synonyms when describing the provisions underlying the regulation of security offers to the public. It is suggested that securities law governs the all-encompassing relationship between a business and its proposed investors as well as the ultimate investors.<sup>50</sup> This entails the regulation of offers to the public in the primary as well as secondary capital markets.<sup>51</sup> Typically, securities regulation is regarded as having the protection of investors as its main

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<sup>49</sup> See chapter 3 of the Nel Commission Report *supra*. Also see the summary of Professor Blackman in Blackman MS (1995) *Companies The Law of South Africa* Volume 4 Part 1 (hereinafter referred to as LAWSA (1995)), in respect of the evolution of company law in the United Kingdom as well as South Africa. Reference is not made to Williams and Blackman “Companies” 4(1) LAWSA (2012) due to same not sufficiently canvassing the common law disposition. It is submitted that the common law position did not change and is still applicable. See also LAWSA (1995) paragraph 226 which did not change between 1995 and publication of LAWSA (2012) as per *Current law* (2005–2008).

<sup>50</sup> Yalden *et al* (2008) *Business Organizations* 388.

<sup>51</sup> For example, defining securities, capital markets, the marketing of securities, offering of securities, disclosure requirements and liability, (Pennington RR (1973) *Company Law 3<sup>rd</sup> ed* London: Butterworths (hereinafter referred to as Pennington (1973) *Company Law*)). As per Davies (2012) *Gower and Davies’ Principles supra*, reference is also made to Pennington RR (1995) *Company Law 7<sup>th</sup> ed* London: Butterworths (hereinafter referred to as Pennington (2001) *Company Law*) as well as Pennington RR (2001) *Pennington’s Company Law 8<sup>th</sup> ed* London: Butterworths (hereinafter referred to as Pennington (2001) *Company Law*). This is in order to accommodate the extensive changes made in offer regulatory law in the United Kingdom, as influenced by the EU.

objective, together with increasing market efficiency and the efficient allocation of capital.<sup>52</sup>

The prohibition of fraud when securities are issued as well as the disclosure of enabling information at the juncture of making an offer; and periodically thereafter, are the two basic components which underlie securities law.<sup>53</sup> Securities law mandates a system of securities regulation formulated as the framework which is to provide investors in capital markets with protection from practices and activities that tend to undermine investor confidence in the fairness and efficiency of capital markets and, where it would not be inconsistent with an adequate level of investor protection, to foster the process of capital formation.<sup>54</sup>

When referring to this specific field concerning securities, securities law as term is utilised in identifying the specific branch, defined herein as that concerned with the regulation of offers, with a mandatory scope towards investor protection and market regulation in ensuring investor equality and economic efficiency. This regulation of the offered securities is occasioned by means of disclosure which, in turn, is effected by means of disclosure requirements which are legislated as the primary basis of securities regulation.<sup>55</sup>

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<sup>52</sup> Gillen (1992) *Securities Regulation in Canada* 78.

<sup>53</sup> Easterbrook FH & Fischel DR (1991) *The Economic Structure of Corporate Law* Cambridge Mass: Harvard University Press 276 – 279 (hereinafter referred to as Easterbrook & Fischel (1991) *Economic Structure*).

<sup>54</sup> Section 1A(1) of the Nova Scotia Securities Act. See also Yalden *et al* (2008) *Business Organizations* 387.

<sup>55</sup> This regulation will also form the basis of this thesis.

Company law and securities law are closely aligned due to the enabling principles behind company law, through the company entity and issue of securities, with the understanding that securities law prohibits certain acts and is mandatory.<sup>56</sup>

The principles underlying securities law, as valid as they are, started small, and were expanded on through a process of time and through the evolution of business. Some jurisdictions, most notably the United Kingdom, Canada and the United States chose to reconsider their regulatory regimes, either *in toto* or through a process of constant review, in order to address the principles behind the regulatory laws in an attempt to align the legislation with the underlying principles which gave rise to the necessity of legislation in an effort to keep up with the advances of the markets and modern business.<sup>57</sup>

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<sup>56</sup> Yalden *et al* (2008) *Business Organizations* 389. Company law or corporate law is enabling as it provides a template for the relationship between a corporation and security holders. Securities law prescribes requirements that must be adhered to by capital raisers in order not to incur liability or be the target of enforcement action by regulators or the Courts.

<sup>57</sup> In the United Kingdom, the overhaul of securities regulation commenced the review of investor protection. See Gower LCB (1982) *Review of Investor Protection: A Discussion Document* London: HMSO (Gower Review). The review was followed by the Gower Report in 1984 which proposed regulations for the financial services industry: Gower LCB (1984) *Review of Investor Protection: Report* London: HMSO (Gower Report). It led to the establishment of the Securities and Investments Board through the Financial Services Act of 1986, the forerunner to the Financial Services and Markets Act with its regulatory authority, the Financial Services Authority. In regard to securities regulation; securities and futures are regulated by the Financial Services Authority (not now the Financial Conduct Authority). In Canada, where securities regulation remains provincial, regulation did not remain stagnant, being the topic of debate for over 40 years (Yalden *et al* (2008) *Business Organizations* 392). See also the Kimber Report (1965) *Report of the Attorney General's Committee on Securities Legislation in Ontario* Toronto: Queens Printer. In the United States, state Blue Sky laws, which are primarily based on a regulatory regime of merit regulation of offers and companies, have been overshadowed after the Depression by federal securities laws (Securities Act of 1933 and Securities Exchange Act of 1934). The US Sarbanes-Oxley Act of 2002 was passed pursuant to the fallout from the large-scale market scandals such as Enron and WorldCom. The legislation purports to tighten up various aspects of financial reporting by public issuers as well as the role played by auditors in that reporting.



Corporate law governs all that is the corporate entity: its formation, rights and obligations having corporate personality, the management and division of powers as well as capital, classes of shares including allotment, and issue, profits and dividends and so forth.<sup>58</sup>

Corporate law is largely enabling<sup>59</sup> in its nature, whereas securities law is mandatory in that it prescribes requirements to be adhered to by the business in its relationship with investors and as a corporate citizen holistically.<sup>60</sup> The requirements set out in securities law fashion the securities regulatory system whereby offers to the investing public are governed.

Although no formal distinction is drawn in South African between securities law and company law, it is submitted that the link between these two sets of laws differ, as detailed above, in their underlying philosophy. The one is concerned with the origin and life of the corporate entity while the other is involved with the regulation of this entity in its operation as a vehicle for the acquisition of capital. It is further submitted that the link between company law and securities law is to be found in this distinction.

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<sup>58</sup> Pennington (1973) *Company Law*. Under this counts corporate personality, rights and liabilities, share and loan capital and management and control.

<sup>59</sup> It is stated that the primary purpose of company law is not to be regulatory but enabling, authorising commerce to organise and operate a business with the advantage of the corporate entity. Professor Ballantine's view as quoted in Sealy LS (1984) *Company Law and Commercial Reality* London: Sweet & Maxwell.

<sup>60</sup> Yalden *et al* (2008) *Business Organizations* 389.

The particular laws under company law which are concerned with share and loan capital,<sup>61</sup> inherently link company law with securities law which seeks to regulate the marketing of securities.<sup>62</sup>

Most modern systems of corporate law divide company law from securities law.<sup>63</sup> It is stated that the primary purpose of company law is not to be regulatory<sup>64</sup> but rather enabling, authorising commerce to organise and operate a business with the advantage of the corporate entity.<sup>65</sup> Securities law, on the other hand, is viewed as being mandatory in its regulatory function.<sup>66</sup>

Internationally, which has kept abreast of developments in the evolution of company law, market and commercial law, securities regulation has evolved from company law into a separate body of law. The purposes

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<sup>61</sup> The definition of a share, share capital, payment, issues, alteration and reductions of share capital, loan capital, classes of shares, profits and dividends and debentures.

<sup>62</sup> Davies (2008) *Gower and Davies' Principles* Chapter 24 describes a somewhat different dispensation evident in the United Kingdom. The crucial regulatory divide is between offers to the public and offers not to the public, with the regulatory regime being much more elaborate in the former case. Where there is no public offer, the rules are to be found in the Companies Act and common law, whereas where there is a public offer, the rules are to be found in the Financial Services and Markets Act of 2000 and the FSA Rules, (now the FCA, see also chapter 6 part A *infra* in respect of the sources of securities regulation in the United Kingdom, specifically the Prospectus Directive and Prospectus Rules). Public offers of shares entail the public company, whereas non-public offers entail the private company.

<sup>63</sup> Company laws govern the manner in which a company is created, how it from thereon conducts its activities and how it may cease to exist. It follows that company law directly influences how business is transacted. Stein & Everingham (2011) *Unlocked* 1. Company law legislation, apart from securities regulation is viewed largely as enabling, setting the framework for the flotation of the company, director and officer oversight and control, shareholder rights, and the winding up and dissolution of the company. Yalden *et al* (2008) *Business Organizations* 623.

<sup>64</sup> Regulatory provisions will be in principle be mandatory in nature.

<sup>65</sup> See fn 59 *supra*.

<sup>66</sup> Yalden *et al* (2008) *Business Organizations* 623.

served by this body of law, are to govern the relationship between business enterprises and their investors.<sup>67</sup>

A clear distinction is drawn between company law as an enabling body of law; serving as mechanism for floating a company, organising the relationship between the corporate entity; and its own rights and obligations towards that of the members and the directors; versus securities law which is largely mandatory, in that it prescribes requirements that must be adhered to by capital raisers in order not to incur liability or be subjected to enforcement action by regulators.<sup>68</sup>

Key aspects to securities regulation include the requirement of registration of persons involved in securities enterprises, prospectus disclosure on the distribution of securities, continuous disclosure of information after the distribution of securities, insider trading regulation and takeover bid regulation.<sup>69</sup>

### 2.5.2. Purpose of securities regulation

The ultimate goals of offer regulatory laws are the governing of the capital-raising process in order to fence the activities of public offers within the principles of securities regulation, to wit, investor protection,

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<sup>67</sup> *Ibid* 388. A number of international jurisdictions, amongst others Canada, have made the purpose served by securities law as a separate branch of commercial law, quite explicit. The Nova Scotia *Securities Act* as representative example formulates securities law in s. 1A(1) as follows: “...the purpose of the Act is to provide investors with the protection from practices and activities that tend to undermine investor confidence in the fairness and efficiency of capital markets and, where it would not be inconsistent with an adequate level of investor protection, to foster the process of capital formation... .” See also the Ontario *Securities Act*, section 1.1.

<sup>68</sup> *Ibid*.

<sup>69</sup> *Ibid* 392.

investor confidence, and market efficiency.<sup>70</sup> Securities regulation is a form of regulation which subjects a company or other financial institution to requirements, restrictions and guidelines, aimed at maintaining the integrity of the financial system. Supervision is handled by government or non-government organizations. The objectives are the reduction of financial crime, consumer protection, market confidence and financial stability.<sup>71</sup> Offer regulation sets requirements for companies which require capital to begin or expand business.<sup>72</sup> Offer regulation of the markets and trading is accomplished by way of statute, regulations, rules, policy statements, and, of course, judicial decisions.<sup>73</sup> In order to understand offer regulatory law, it is necessary to have a firm grasp of its historic development.

The investor in shares and other securities in a company must be protected beyond what is available at common law; this is obvious.<sup>74</sup> Apart from the old adage which rings true, that prevention is better than cure, due to the nature of invested capital and the fluidity of money, coupled with the costs of litigation and the profile of an investor; the probability of recovering a substantial part of the capital is slight. It is submitted that the

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<sup>70</sup> *Ibid.*

<sup>71</sup> United Kingdom (2014) "FSA Statutory Objectives" <http://www.fsa.gov.uk/about/aims/statutory> (accessed on 11 March 2014). The aim of the reduction of financial crime seeks to reduce the extent to which it is possible to use the company as a vehicle which can be used for committing fraud. Consumer protection aims to secure the appropriate degree of protection for consumers who wish to invest in a company pursuant to an invitation. Financial stability and market confidence underscore public policy standards, maintaining confidence in the capital markets through the protection and enhancement of the stability of the capital markets system.

<sup>72</sup> Yalden *et al* (2008) *Business Organizations* 367. At any time securities are offered, the substantive requirements of securities law (which regulates securities) are engaged.

<sup>73</sup> Condon MG Anand AI & Sarra JP (2005) *Securities Law in Canada: Cases and Commentary* Toronto Canada: Emond Montgomery Publications Ltd 17-23. In South Africa, and for purposes of this discussion, the focus will be on Chapter 4 of the 2008 Companies Act, being the genesis of securities regulation.

<sup>74</sup> Delport "Offers" 2011 *THRHR* 280.

pro-active nature of regulation of capital markets is the most distinctive feature of offer regulatory law, which, as yet, does not have a formal definition in South African law. A pragmatic definition could be that all the laws which have to do with securities fall under securities laws.<sup>75</sup> Permutations of course are allowable when different parts of securities legislation are considered.

Legislation empowers supervisors to monitor activities and enforce actions.<sup>76</sup> In defining financial regulation one is tempted to navigate the maze of what constitutes the entirety of the financial markets, including supervision of stock exchanges, insurance, insider dealing, anti-money laundering, banks and financial services providers, etcetera. The scope of this work will focus on the company in extending offers for the acquisition of securities to the public, thus primary market regulation of public offers, and, to an extent, secondary market offers.

Securities regulation primarily targets the issuers of securities. Issuers seek to raise money to fund new projects or investments or to expand.

Thus companies have an incentive to present the company and its plans in

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<sup>75</sup> Easterbrook & Fischel (1991) *Economic Structure* 276-9 holds that securities laws have had two basic components, a prohibition against fraud and requirements of disclosure when securities are issued, and periodically thereafter. The notorious complexities of securities practice arise from defining the details of disclosure and ascertaining which transactions are covered by the disclosure requirements. See also Yalden *et al* (2008) *Business Organizations* 392 where it is stated that securities law in Canada is described as having all provincial statutes being similar in nature. Firstly requiring the registration of persons involved in the securities business, prospectus requirements and disclosure on the distribution of securities, continuous disclosure of information after the distribution of securities, insider trading regulation, and takeover bid regulation. Typically, securities statutes also provide remedies following liability for misrepresentation in disclosure documents, and in some cases, liability proceedings may be taken against the gatekeepers, being lawyers, investment bankers and accountants who advise businesses as well as the businesses themselves.

<sup>76</sup> De Caria R “What is Financial Regulation Trying to Achieve?” (Sept 2011) 9 *Hayek Society Journal* [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1994472](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1994472) (accessed on 2 February 2013).

the rosier light. Securities regulation, as subset of financial regulation, should ensure that issuers disclose material information to investors and that security transactions are not based on fraudulent information or practices. Materiality, in this context, has been the source of great debate and still is, especially in securities litigation. However, the goal is to provide investors with accurate information so they are enabled to make informed investment decisions. Material information affects a reasonable investor's evaluation of the company's offer.<sup>77</sup>

Legislation was implemented to address certain inadequacies that have to be cured. In the case of securities offers to the public; primarily fraud, with the subsequent consequences on investors and the market, underscore the principles which lead to government intervention in setting regulatory frameworks within which capital markets are regulated. Securities regulation in the financial markets is occasioned by different means. However, the two major systems which manifest in relation to public offers of a company's shares are mandatory disclosure regulation and merit regulation. Disclosure and/or merit regulation act as mechanisms by which the objectives of securities regulation are occasioned. Each system has separate principles flowing from the overriding principles of securities regulation. Due to various factors the nature of the underlying transaction

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<sup>77</sup> Sarkar D (2014) Cornell University Law School, Legal Information Institute "Securities Act of 1933 (The Securities Act)" [http://www.law.cornell.edu/wex/securities\\_act\\_of\\_1933](http://www.law.cornell.edu/wex/securities_act_of_1933) (accessed on 2 February 2014). Section 100 requires adherence to "the prescribed specifications" and also contains information reasonably required by an investor to assess a company, as well as details of the assets and liabilities and financial position of the company. As per Delpont (2009) *Manual* 25, the test of what is reasonably required is subjective as to the subject matter disclosed, and not objective as to the state of mind of the investor (see also Delpont (2011) *Manual* 48).

and public policy, disclosure regulation continues to be the pre-eminent regulatory mechanism.

When reviewing offer regulatory law, one is not to get entangled in the myriad of substantive rules. One is to consider the purpose served by this body of law; which is the governing of the relationship between the company and its investors, specifically, setting safeguards against abuse of the relationship by the company.<sup>78</sup> Information disclosure is a regulatory strategy that is consistent both with the goals of investor protection and market efficiency. Disclosure requirements imposed on capital raisers and directed toward investors is the major form of regulation imposed by securities law. South African company law has always opted for disclosure, placing emphasis on the duty to disclose and the extent of the disclosure depending on the market where the securities are to be issued or traded.<sup>79</sup>

The history of the company and its evolution of becoming the economic vehicle it is today, are directly aligned to the development and evolution of principles underlying securities regulation and, in particular, disclosure regulation (with permutations thereof). To this extent, whether Anglo-Saxon jurisdictions are considered or South African, the genesis of securities regulation is traced back to the United Kingdom which served as model through the importation and adaptation of its legislation contributing towards offer regulation in South Africa. Unfortunately, the

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<sup>78</sup> Yalden *et al* (2008) *Business Organizations* 388.

<sup>79</sup> Delpont “Offers” 2011 *THRHR* 280.

overall development proved to be piecemeal, in a stopgap fashion, and continuous development did not seek to overhaul the system, but to expand on it. As the French writer M. Tarde in “*Les Lois de l’Imitation*” remarks: “...most of the things we do, we do for no better reason than that our fathers have done them or that our neighbours do them....” The same is true of a larger part than we suspect of what we think concerning securities (and company) law development.<sup>80</sup>

South Africa did not keep abreast with developments, most notably, in the United Kingdom, and chose to ignore the development subsequent to the enactment of the 1973 Act. Instead, the underlying philosophy to the 2008 Act was followed in the recent overhaul of company law in South Africa which marks a major shift in offer regulatory law in this country. Unfortunately, South Africa simply hashed up the same provisions,<sup>81</sup> merely in a different format, with the recent overhaul of company legislation, succeeding in a cosmetic attempt to simplify and improve the layout of the regulatory regime yet failing to address the real issues as illuminated in the Nel Commission Report and experienced with the 1973 Act.<sup>82</sup> Business and the investors are hard done by as a result of this

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<sup>80</sup> Patterson (2003) *Philosophy* (Holmes) 15.

<sup>81</sup> Sutherland “Company Law” 2012 *Stellenbosch Law Review* 168. Some of the rules on public offers in the 2008 Act have been copied from the Companies Act of 1973. Some sections have been copied and tweaked for accommodation into the 2008 Act, but not all consequences have been covered. Also some terminology has not been amended (for example, Chapter 4 “Public Offerings of Company Securities” still refers to subscriptions, although abolished in section 34). Further, the system of the Companies Act of 1973 has been retained in essence in the 2008 Act except that the secondary and primary markets are now regulated in the same Chapter (Delport (2009) *Manual* 12). To ignore the development of an Act (such as the 1973 Act) and the common law over many decades through importing new concepts and structures for the sake of change is precarious (Delport “Offers” 2011 *THRHR supra*.)

<sup>82</sup> Nel Commission Report *supra*.



failure, and will ultimately bear the brunt of an ineffective regulatory dispensation.

It was in the evolution of offer regulatory law, where during the latter part of the previous century, governments started to reconsider regulatory frameworks of public offers in their entirety. Locally, this was the subject of the Nel Commission Report, yet Government failed to consider or implement it. Rather, South Africa was subjected to a new Companies Act with a re-hashed public offers regulatory framework, which is so new, it is already out of date.

What could have been a major overhaul of the regulatory framework underlying security offers is a dismal disappointment, with our regulatory dispensation not only falling short of developments in foreign jurisdictions but also of the principles of offer regulation. Liability in the current dispensation, however, has been increased: vague terms expose directors to liability in class action claims, which is now a possibility in South Africa.

On the other hand, effective disclosure should not include onerous disclosure requirements making the prospectus a dead letter document. Effective disclosure fulfils the principles of offer regulation and disclosure regulation addresses materiality directly. Offer regulation in the primary market is failing and the need exists that the regulatory regime be re-examined and re-evaluated. Perhaps the philosophy behind securities

regulation must be revisited *in lieu* of merely accepting that a system originating from the 1800s is still effective in the social-economic climate of cross border transactions, multi-billion dollar listed companies and multi-nationals.

It is submitted that the principles underlying securities regulation as well as disclosure regulation are still relevant, more so today than ever. It is not the principles that must change: but rather the system and implementation thereof. Did South Africa miss the bus concerning harmonisation and effective regulatory principles? It would seem that many of the goals of the Company Law Reform process as set out in the Guidelines,<sup>83</sup> were not achieved or were only partially achieved in the Act.<sup>84</sup>

The accusation of its being “stale” topic, the subject of public offers of shares and prospectuses serves to point to the underlying and general view of South Africa on offer regulation.<sup>85</sup> A body of law is rational and civilised when every rule it contains is referred articulately and definitely

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<sup>83</sup> South Africa, Dept. of Trade and Industry (2004) *South African Company Law for the 21st Century: Guidelines for Corporate Law Reform* [S.I.]: Dept of Trade and Industry, South Africa in GN 1183 in GG 26493 of 23 July 2004 (the “Guidelines.”) This is also a policy document with broad goals and objectives, juxtaposed to principles.

<sup>84</sup> Sutherland “Company Law” 2012 *Stellenbosch Law Review supra*. The 2008 Act was preceded by a very short and abstract document, explaining broad goals of the reform process. The Memorandum on the Objects of the Companies Bill of 2008 is vague, cursory and outdated.

<sup>85</sup> *Ibid* 168 describes the discussion of Yeats in Mongalo (2010) *Modern Company Law* as bringing to life a stale topic. The contingent nature of his comment is unknown, yet may be deduced from the aloof manner in which this topic is glanced over in South African law (mostly evident from the company law reform process) juxtaposed against the lively discussion and topic it is in the United States, Canada and the United Kingdom. It may be due to class action in the United States and Canada and the Gower reforms (Gower Review and Gower Report), in the United Kingdom which contribute to the discussion. We are only aware of the double-edged sword that is the class action suit and the time is ripe that it is utilised in bringing to the fore South African securities litigation. Furthermore, South Africa deviated from the historic alignment with the development of United Kingdom company law and as such, the benefit and debate of the Gower Report has been missed, together with the Nel Commission Report, which should have spurred South African regulatory practices into a more aligned direction.

to an end which it sub-serves.<sup>86</sup> To this end the current regulatory regime falls short.<sup>87</sup>

A statute not followed (or ineffective) will be nothing but empty words, not because it is wrong, but because it is not followed or is ineffective. In attempting to negate this result, dramatic incidents should be avoided and the true basis for the philosophy discerned.<sup>88</sup> This work aims to follow the existing body of dogma into its highest generalisations. Next, to discover the dogma from history as to how it has come to be and what it is and, finally, to consider the ends which the rules seeks to accomplish, the reasons why those ends are desired, what is given up to attain them, and whether they are worth the price.

When capital markets regulation is to be reformed in direct response to financial crises such as the double-dip recession, the European bail outs, and, albeit on a smaller scale though not less serious, the recent Sharemax debacle, the first goal must be effective regulation. Second to that, investor protection must be increased through an effective offer regulatory regime. Perhaps the thinking behind offer regulation should be reconsidered, as well in an attempt to expand on the investor demographic as well as business demographic in South Africa.

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<sup>86</sup> Patterson (2003) *Philosophy* (Holmes) 15.

<sup>87</sup> Sutherland "Company Law" 2012 *Stellenbosch Law Review* 168 makes reference to the copying of the provisions of the 1973 Act without amending terminology to better accord with the 2008 Act. All the consequences of the changes have also not been covered. It is also not clear how detailed the content of prospectuses should be. The Regulations contain elaborate rules on the topic of the form and content of a prospectus, but many seem contradictory, problematic and not well adapted for the purposes of the 2008 Act (Chapter 4 of the Regulations).

<sup>88</sup> Patterson (2003) *Philosophy* (Holmes) 19.

As will be shown in the chapter dealing with the principles of disclosure, the purpose of securities regulation lies in the *Grundnorm* of fraud prevention which motivated its development.<sup>89</sup> The two main objectives flowing from this are investor protection and optimal allocation of financial resources (market efficiency).<sup>90</sup>

In order to properly assess the current South African regulatory dispensation it will be necessary to review the philosophical principles behind securities regulation in order to set a benchmark against which to draw an analytic evaluation as to whether the regulatory system in the 2008 Act succeeds in the objectives of securities regulation or not and, if not, how should it conform.

### 2.5.3. Direct regulation

Direct or merit regulation allows an offer to be extended only when it has passed qualitative tests;<sup>91</sup> whereas mandatory disclosure requires information to be disclosed from the offeror.<sup>92</sup> The former is purely a preventative regime, calling for a government agency which supervises the regulation of offers as gatekeeper to the capital market, effectively controlling access thereto.<sup>93</sup> An offer may only be made to the public if

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<sup>89</sup> The development of the *Grundnorm* is discussed in detail in chapter 3 *infra*.

<sup>90</sup> The underlying purpose is the protection of the public. Although every effort must be made to ensure the public understands the normal business risks of success and failure, it must not be protected against itself (Kimber Report *supra* paragraph 1.12).

<sup>91</sup> Ratner DL & Hazen TL (2010) *Securities Regulation: Selected Statutes Rules and Forms* St Paul Minn: West Publishing Co 37 (hereinafter referred to as Ratner & Hazen *Securities Regulation: Selected Statutes.*) Authority is vested in a regulator in deciding whether a security may be offered to the public or not.

<sup>92</sup> Davies (2012) *Gower and Davies' Principles* 853.

<sup>93</sup> Loss (1988) *Fundamentals* 30. The Blue Sky laws in the United States underscored a merit philosophy and at the time of the passage of the Securities Act of 1933, the primary role was to determine the role of the Federal Government in the protection of investors. Despite the limitations,

permitted by a regulator and if the securities on offer, or the issuer, pass certain quality tests.<sup>94</sup> It is submitted that quality control is the primary benchmark of direct regulation.

Direct regulation survives in most disclosure orientated systems as eligibility requirements.<sup>95</sup> It is submitted that it is a secondary benchmark as the evaluation of the eligibility requirements will not go into a full blown evaluation of the securities or the company, rather whether, as per the legislation, all the requirements have been met as is required to be disclosed in the prospectus.

In line with this, *ex ante* regulatory provisions, whether the regulator is pro-active or not, will set up a framework of formalistic regulation which will delineate transactions as either falling within regulatory purview or not, when applied to the substantive aspects. If the substantive aspects apply, disclosure regulation will manifest as disclosure tool.

#### 2.5.4. Disclosure regulation

Disclosure requirements, imposed on capital raisers and directed towards investors are employed as a regulatory strategy, consistent with both goals of securities regulation: investor protection and market efficiency,<sup>96</sup> and remains the major form of regulation imposed by securities law.<sup>97</sup>

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Congress opted for the British disclosure philosophy over the native merit philosophy of the Blue Sky laws. The reasoning behind same advanced were that merit regulation often resulted in unnecessary economic barriers to the capital formation process.

<sup>94</sup> Davies (2012) *Gower and Davies' Principles* 854.

<sup>95</sup> *Ibid.*

<sup>96</sup> Yalden *et al* (2008) *Business Organizations* 388.

<sup>97</sup> *Ibid.*

In order for investors to gauge the financial position and financial performance of the company the financial statements must be analysed and interpreted. In order for these statements to constitute a fair representation of the state of affairs of the company the disclosure of information is required in the financial statements.<sup>98</sup>

Misleading information or no information at all concerning the entity and its activities may lead to fraud, misrepresentation, and eventually corporate collapse.<sup>99</sup> Timeous and equal information, which is made available to market participants, underlies the interest of a regulator wishing to ensure efficient markets as a cornerstone of the economy.<sup>100</sup> Thus, where a company makes a public offer for the subscription of its shares, regulators achieve that objective by requiring certain information to be made available in the prospectus.<sup>101</sup> Regulators also require that if someone else, other than the company in question, makes an offer for the sale of the company's shares to the public, that person must make certain information available.<sup>102</sup>

Disclosure is recognised as the dominant philosophy of the modern company system.<sup>103</sup> Disclosure regulation entails that the regulatory authority has no authority to decide whether a particular security may be offered to the public. It can only insist that the issuer make full disclosure

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<sup>98</sup> Cilliers *et al* (2000) *Corporate Law* 210.

<sup>99</sup> *Ibid.*

<sup>100</sup> Swanepoel, "Under the Microscope" a Webber Wentzel editorial in *Business Report* (9 September 2009).

<sup>101</sup> *Ibid.* (Regulators also achieve this objective by prohibiting insider trading).

<sup>102</sup> *Ibid.* Section 101.

<sup>103</sup> Hahlo & Pretorius (1999) *Hahlo's* 85-101.

of all material facts.<sup>104</sup> Mandatory disclosure triumphs as predominant disclosure philosophy in the regulation of securities as a consequence of the decision that the investor has to make.<sup>105</sup> Securities regulation, through mandatory disclosure, is derived from the nature of a security<sup>106</sup> as a security has no intrinsic value as it represents specific rights.<sup>107</sup> Similarly, the value of a debenture depends on the financial condition of the *promissor* and the same principles therefore apply to debentures and shares, collectively defined as securities.<sup>108</sup>

The value of a share depends on the profitability or future prospects of the business.<sup>109</sup> Based on the valuation of those prospects, the market price is calculated depending on how much an investor is willing to pay, based on an evaluation of the financial condition, profitability or future prospects of the issuing entity.<sup>110</sup> Disclosure of information enables this evaluation which eventually will influence the judgment of a prospective investor towards exercising a choice to invest or not.

Therefore, the principal fundamental component<sup>111</sup> of securities regulation is the requirement to disclose information.<sup>112</sup> However, elements of merit

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<sup>104</sup> Ratner (1978) *Securities Regulation* 37.

<sup>105</sup> Davies (2012) *Gower and Davies' Principles* 854.

<sup>106</sup> Ratner & Hazen (2010) *Securities Regulation: Selected Statutes* 2.

<sup>107</sup> *Ibid* 1.

<sup>108</sup> *Ibid*.

<sup>109</sup> *Ibid*.

<sup>110</sup> *Ibid*.

<sup>111</sup> Securities regulation in both Canada and the United States mandates disclosure when securities are distributed to the investing public (Yalden *et al* (2008) *Business Organizations* 468). Disclosure survives in the United Kingdom as well as predominant regulatory philosophy (Davies (2012) *Gower and Davies' Principles* 854). South Africa has always opted for disclosure putting emphasis on who must disclose and the extent of disclosure, depending on the market where the securities are to be

regulation remain even in the most disclosure-oriented regimes.<sup>113</sup>

Disclosure is never all that is required and it is submitted that the ideal system of securities regulation will employ an effective two pronged regulatory regime with disclosure as basis and eligibility requirements featuring as qualitative denominator. For this reason, South African offer regulation qualifies the concepts of an “offer” to the “public” of “securities” as determinants prior to Chapter 4 regulation applying to a transaction, ensuring disclosure based on prospectus requirements.

The interest of a regulator in regulating public offers lies in efficient markets which depend on timeous and equal information being made available to market participants.<sup>114</sup> These objectives are achieved by requiring disclosure of information in a prospectus to the market when a public offer is made for the subscription of shares.<sup>115</sup>

The regulatory regime aims to assure the availability of adequate and reliable information about securities which are offered and prohibits the offer of securities unless a prospectus has been registered.<sup>116</sup>

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issued or traded (Delport “Offers” 2011 *THRHR supra* as well as Cilliers *et al* (2000) *Corporate Law* 256).

<sup>112</sup> Easterbrook & Fischel (1991) *Economic Structure supra* Chapter 2 fn 74.

<sup>113</sup> Davies (2012) *Gower and Davies’ Principles* 854.

<sup>114</sup> Swanepoel “Under the Microscope” (2009) Webber Wentzel editorial in *Business Report*.

<sup>115</sup> *Ibid.* Ancillary to this is the prohibition to insider trading. Also, this requirement is applicable to persons, other than the company, who are making an offer for the sale of shares – section 101 statements.

<sup>116</sup> Ratner (1978) *Securities Regulation* 38.



## 2.6. Aspects of disclosure regulation

In opting for a disclosure system to regulate offers to the public, South African regulation places emphasis who must disclose and the extent of disclosure.<sup>117</sup>

The enquiry regarding the obligation to disclose concerns an offer being made of securities to the public, once these three determinants are in place, Chapter 4 offer regulation will apply, ensuring compliance to the disclosure requirements. The prospectus requires standards of disclosure which must be met in order to avoid possible liability. The information in the prospectus is not evaluated, nor is the offer of securities.

Government requires the disclosure of information regarding the company as *sine quo non* for corporate accountability, and is justified on the following policy grounds:

- i) a better informed and more efficient stock market;
- ii) minimised risk of fraud;
- iii) preventing excessive secrecy and distrust; and
- iv) facilitating equality of opportunity.<sup>118</sup>

The compulsory disclosure of information serves to protect the interests of investors, shareholders and creditors of the company.<sup>119</sup> It is submitted

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<sup>117</sup> Delport “Offers” 2011 *THRHR supra*.

<sup>118</sup> Farrar & Hannigan (1998) *Company Law supra*.

<sup>119</sup> Cilliers *et al* (2000) *Corporate Law* 359.

that said disclosure should be enabling, i.e., positively placing an investor in the position to make an informed decision. In the words of Louis Brandeis' famous maxim: "*Publicity is justly commended as a remedy for social and industrial diseases. Sunlight is said to be the best of disinfectants; electric light the most efficient policeman.*" It follows that the central pillar of securities regulation is disclosure.<sup>120</sup>

Disclosure regulation is further exemplified in the English case of *Directors of Central Railway Co of Venezuela v Kisch*<sup>121</sup> where it was held by Lord Chelmsford that no misstatement or concealment of any material facts or circumstances ought to be permitted.<sup>122</sup> An important test is set *obiter* by Lord Chelmsford in that, in his opinion the public, who are invited by a prospectus to subscribe to a new adventure, ought to have the same opportunity of judging everything material, bearing on the true character of the company and the offer, as the promoters themselves possess.<sup>123</sup>

The importance of the distinction drawn between the two capital markets lies in the substantial disclosure requirements, by way of a prospectus, for offers in the primary market.<sup>124</sup> Whereas in the secondary market,<sup>125</sup> it is the seller and not the company who must disclose and the extent is limited due to the fact that the seller does not have access to all the financial

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<sup>120</sup> Nel Commission Report *supra*.

<sup>121</sup> *Directors of Central Railway Co of Venezuela v Kisch* 1867 LR 2 HL 99.

<sup>122</sup> Pretorius JT (ed) (2000) *Student Casebook on Business Entities 2<sup>nd</sup> ed* Lansdowne: Juta141.

<sup>123</sup> *Ibid.* (Own emphasis).

<sup>124</sup> Section 99 and 100.

<sup>125</sup> Section 101.

information.<sup>126</sup> The enquiry regarding the obligation to disclose and the extent thereof depends on the market where the shares are to be traded.<sup>127</sup>

### 2.7. Prospectus as disclosure tool

In terms of the 2008 Companies Act, regulation is occasioned by means of a prospectus, therefore, disclosure.<sup>128</sup> Disclosure is affected by preparing and delivering a prospectus to prospective investors (the offerees).<sup>129</sup> The prime objective of regulators is to force disclosure<sup>130</sup> in an attempt to reach the objectives of capital market regulation. Only once the proposed offer has been approved may a prospectus then be issued based on the approved offer in the case of a pro-active regulator, or, in a regulatory system such as present in South Africa, once an offer falls within the parameters of the delineating precepts. Typically the prospectus provides information about the nature of the securities offered as well as the business being invested in (the offeror)<sup>131</sup> to prevent investors from being deceived or defrauded by companies that issue capital and resulting in subsequent potential market instability.<sup>132</sup>

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<sup>126</sup> Delport “Offers” 2011 *THRHR* 280.

<sup>127</sup> Cilliers *et al* (2000) *Corporate Law* 256 and authorities. See also Delport “Offers” 2011 *THRHR* *ibid*.

<sup>128</sup> Section 99(2).

<sup>129</sup> Yalden *et al* (2008) *Business Organizations* 387.

<sup>130</sup> Swanepoel “Under the Microscope” (2009) Webber Wentzel editorial in *Business Report*.

<sup>131</sup> Yalden *et al* (2008) *Business Organizations* *supra*.

<sup>132</sup> *Ibid* See also Gray & Kitching (2005) *Reforming Canadian Securities Regulation* *supra*.

The gist of disclosure as mechanism of investor protection is summed up in the words of Kindersley VC in *New Brunswick & Canada Railway & Land Co v Muggeridge*:<sup>133</sup>

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 facts 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 inducements to take shares.

Regulation through disclosure requirements is put into effect if there is an offer for shares<sup>134</sup> and the offer is to the public.<sup>135</sup> The provisions in the 1974 Companies Act have been retained to a certain extent in the 2008 Companies Act in that it seeks to achieve similar objectives. The Legislature has attempted to simplify the regulatory framework in the 2008 Act.

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<sup>133</sup> *New Brunswick & Canada Railway & Land Co v Muggeridge* 1 Dr & Sm 363 382, 63 ER 425. See also the discussion in *LAWSA* (1995) paragraph 154.

<sup>134</sup> The term “share” is used interchangeably with that of “security”.

<sup>135</sup> Delpont “Offers” 2011 *THRHR* 280.

In South Africa, disclosure requirements entail that the prospectus must adhere to the prescribed specifications<sup>136</sup> as an objective disclosure benchmark.<sup>137</sup> Furthermore, a subjective disclosure benchmark is set in that the prospectus must contain any information reasonably required by an investor to assess a company, including details of its assets and liabilities, financial position, profits and losses, cash flow and prospects, including the securities and the rights attached thereto.<sup>138</sup>

A further continuous disclosure requirement prescribes that errors, new matters and changes in matters stated in the prospectus, which are relevant and material in terms of Chapter 4 to the Companies Act, must be registered as a supplement to the prospectus, published to known recipients and included in future distributions.<sup>139</sup> This further continuous disclosure requirement, depending on the nature of the error, new matter and changes has both objective and subjective benchmarks.

### 3. *Capita Selecta* on aspects of securities law and offer regulation

It has been established *supra* that securities law is described as a fusion of securities regulation, of legislation aimed specifically at security transactions and the general law, for example, contract, delict and criminal law.<sup>140</sup> It is submitted that security transactions are those concerned with offers by a company of its securities to the public on the capital markets.

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<sup>136</sup> Part B of the Regulations, (Requirements concerning offering of securities), specifically Regulations 58, 59, 60 and 61 read with Part C of the Regulations (items required to be included in a prospectus).

<sup>137</sup> Section 100(2)(b).

<sup>138</sup> Section 100(a).

<sup>139</sup> Section 100(11).

<sup>140</sup> Hudson A "Introduction to UK Securities Law" (2008) 13 as extracted from Hudson A (2008) *Securities Law* London: Sweet & Maxwell (hereinafter referred to as Hudson (2008) *UK Securities Law*). See also Hudson A (2012) *The Law on Financial Derivatives* 5<sup>th</sup> ed London: Sweet & Maxwell.

It should be noted that a clear distinction is made between securities legislation and offer regulation. The former denotes the empowering statutes giving rise to a framework of regulation, whereas the latter denotes the mechanism of regulation. In this discussion a differentiation will be made between these concepts on a substantive as well as formality basis. Substantive aspects denote the empowering legislation whereas formality aspects denote the regulatory part of offer regulatory law.

It is submitted that securities law signifies a regulatory principality based on the empowering legislation. It will be shown in the comparative study in chapter 6 how the regulators in the US and the UK contribute towards efficiency in regulating offers of securities to the public, based on the securities laws, in attempting to reach the overarching principles of regulation.

Insofar as regulation is concerned, not all securities markets are enforced in the same or similar manner.<sup>141</sup> There exist measurable differences in regulatory mechanisms.<sup>142</sup> What is important to note going into this discussion, is the enforcement part of securities markets. It is submitted that securities laws, sets regulation into place which are meant to give effect to the securities laws. This is due to the fact that security laws aim to regulate security markets. The substantive and formality aspects lend themselves to principles of theory in practice. As securities transactions are not static, operating in ever expanding capital markets, the application

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<sup>141</sup> Amy Aiq (2011) “How Securities Regulation Really Works: A Comparative Study of the Regulatory, Principled, and Normative Reputational Approaches to Securities Regulation, Selected Works” [http://works.bepress.com/amy\\_aiq/1](http://works.bepress.com/amy_aiq/1) (accessed on 20 March 2014).

<sup>142</sup> *Ibid.*

of the law is not supposed to be static. In South Africa as in the United Kingdom and the United States, regulatory models, which are based on the securities laws, exist in order to provide for capital raising mechanisms for private markets where such regulation focuses on the protection of the general public and the elimination of externalities from financial failure.<sup>143</sup>

Three broad hypotheses exist regarding the regulation of securities markets. First, the null hypothesis in which the optimal approach is to leave securities unregulated. Second, the government standardization of the private contracting framework; and third, a public enforcement model utilising an independent and focused regulator.<sup>144</sup>

The background norms to security regulation or offer of security regulation will always be the principles of regulation which gave rise to regulatory principles in the first place. It is submitted that the regulatory model must meet the requirements as per the principles of regulation.

### 3.1. Regulatory enforcement

It follows that securities laws set regulation of transactions in capital markets in place. It is a logical deduction that the regulation aimed at should be by means of one or the other regulator; whether it is the Courts, self-regulatory or a standalone regulator. Most jurisdictions, notably the United States and the United Kingdom, have dedicated securities

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<sup>143</sup> *Ibid* 11.

<sup>144</sup> *Ibid*. See also LaPorta R, Lopez-de-Silanes F & Shleifer A “What Works in Securities Laws?” (2006) 61 *The Journal of Finance* 1. The Null Hypothesis was originally developed by Coase and Stigler and later, further developed by Grossman, Hart, Milgrom and Roberts *et al*. The Private Contracting Model was put forth by Easterbrook and Fischel and the Public Enforcement Model was developed by Landis, Beker, Polinsky, Shavell, Glaeser, Johnson, Sheifler *et al*.

regulators. Effective enforcement is a primary concern for any legal system.<sup>145</sup> The most basic enforcement system is the Courts. In modern market economies, law enforcement by regulators is observed, rather than by the Courts alone.<sup>146</sup>

### 3.2. Components of regulatory system

It is submitted that fundamental to the design of an effective offer regulatory system or security regulatory regime are the two tiers, operating in concert with each other in establishing the regulatory regime in terms of enforcement and in purpose of its principles. In the first instance, there is the empowering legislation. In the second instance, the enforcement of such legislation, either through the Courts or a regulator. It is submitted because securities regulation aims to be pro-active and preventative, that a dedicated securities regulator is preferred above the *ex post facto* approach of Courts or a passive regulator. Such a regulator is acting only in an administrative function without enforcement ability at the stage of regulating a proposed offer in terms of allowing it to proceed or not where sufficient application has been made and the regulator is satisfied of compliance to the disclosure requirements.

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<sup>145</sup> Xu C & Pistor K “Enforcement Failure under Incomplete Law: Theory and Evidence from Financial Market Regulation” (2004) [https://dornsife.usc.edu/IEPR/Events/Papers/Katharina\\_Pistor.pdf](https://dornsife.usc.edu/IEPR/Events/Papers/Katharina_Pistor.pdf) (accessed on 8 January 2014). See also Xu C and Pistor K “Law Enforcement under Incomplete Law: Theory and Evidence from Financial Market Regulation” London School of Economics and Political Science and Columbia Law School – Discussion Paper TE/02.442 2002, The Suntory Centre Suntory and Toyota International Centres for Economics and Related Disciplines, London School of Economics and Political Science [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1160987](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1160987) (accessed on 8 January 2014).

<sup>146</sup> Xu & Pistor “Enforcement Failure” (2004) 3. See also Glaeser EL & Shleifer A “The Rise of the Regulatory State” (2003) 41 *Journal of Economic Literature* 401; Majone G “The Rise of the Regulatory State in Europe” (1994) 17 *West European Politics* 77-101.



### 3.3. Regulatory design

The design of the regulatory system is paramount for understanding the underlying enforcement mechanisms.<sup>147</sup> Courts are described as reactive enforcers and regulators as proactive enforcers, and the difference between the two amounts to deterrence of infractions on the legislation which sets regulation in place, resulting in either failure or success. A regulator can contribute to avoiding the deterrence problem of law in the proactive enjoinder of harmful actions and thereby being less dependent on the law's deterrence function.<sup>148</sup>

### 3.4. Complete law

In this discussion, law refers to statutory or case law, specifying liability, or sections for certain actions or outcomes. Law is complete if all potential harmful actions can be unambiguously specified. Otherwise law is incomplete, either because of gaps that fail to address some actions which prove to be equally harmful as those stated in law, or because the law is designed to be open-ended which denotes that the boundaries of the law are not clearly circumscribed.<sup>149</sup> As an example, broad terms to ensure comprehensive law enforcement leave law ultimately complete, whereas a highly specific provision will never be able to cover all actions which may result in the harm it prevents to seek. However, because it is

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<sup>147</sup> Xu & Pistor "Enforcement Failure" (2004) 3.

<sup>148</sup> *Ibid.*

<sup>149</sup> *Ibid* 5.

ambiguous, a broad approach could result in incomplete law which the Courts have to interpret.<sup>150</sup>

For this reason a regulator has the power to enforce law pro-actively and prevent harm by screening actions before they are undertaken and enjoining them in case the anticipated harm outweighs the benefit. This is so even where the Courts are approached for interim relief by way of interdict. Although a Court may act proactively in this regard, it will have to make a final ruling and, in the end, it is always in response to litigation brought by others.<sup>151</sup>

It is submitted that complete law is a precursor to effective enforcement, following the structure set out *supra* where the first tier is legislation enacting a regulation of some sort. When law is complete it is understood that all relevant applications of the law are unambiguously stipulated. The law can be understood unambiguously by everybody and can be enforced literally provided that evidence is established. Under complete law the assumption is that enforcement is central and therefore has the optimal design of punishment; carrying the best deterrent effect.<sup>152</sup>

Regulation, as alternative to enforcement, is defined as state intervention with the purpose of addressing market failures caused by externalities and/or informational problems.<sup>153</sup>

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<sup>150</sup> *Ibid* 6.

<sup>151</sup> *Ibid*.

<sup>152</sup> *Ibid* 3. See also Coase RH “The Problem of Social Cost” (1960) 3 *Journal of Law and Economics* 1; Becker GS “Crime and Punishment: An Economic Approach” (1968) 76 *Journal of Political Economy* 169; Stigler GJ “The Optimum Enforcement of Laws” (1970) 78 *Journal of Political Economy* 526.

<sup>153</sup> Xu & Pistor “Enforcement Failure” (2004) 4. See also Atkinson AB & Stiglitz JE (1980) *Lectures on Public Economies* New York: McGraw-Hill. It is submitted at this juncture that there is no clear

The model of securities regulation employs four players. A public company issuing a public offer of securities; an investor; a law; and an enforcer of the law. The public company seeks to make a public offering to its benefit. The investor may be benefited or harmed by this, depending on whether the issuer cheats or fails. The function of the law is to minimize the social welfare loss, resultant from cheating, by having a framework which is complementary to enforcement institutions in terms of optimizing their task. In such a case, it is the Court's task to punish offenders so as to deter future violations.<sup>154</sup>

Complete law is the benchmark. Under this all possible harmful actions, as well as levels of punishment, are specified unambiguously in the law. Conversely, when law is incomplete, not the law nor issuer nor investor can fully anticipate the scope of their obligations and the outcome of law enforcement will be uncertain.<sup>155</sup>

Deterrence becomes a failure when law is incomplete or when evidence is imperfect. Proactive enforcement of law is to devise screening methods to prevent potentially harmful actions. Disclosure and approval rules, commonly found in securities regulation, are such devices. Regulators differ from Courts in that they have the power not only to initiate such proceedings but also to enforce the law on their own by imposing fines. In addition, they have important law making functions which neither the police nor prosecutors share with them. This allows them to adapt rules to

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divergence between regulation and enforcement, as effective regulation will amount to pro-active enforcement of the empowering legislation. It is important to differentiate between such enforcement and enforcement *ex post facto* by the Courts.

<sup>154</sup> Xu & Pistor "Enforcement Failure" (2004) 6-7.

<sup>155</sup> *Ibid* 8.

observe market failures without having to wait for other agents to bring a case to their attention.<sup>156</sup>

Under optimal proactive enforcement it is stated that the efficiency of disclosure rules depends on the quality of the disclosed, firm specific information. Regulators enforce the law *ex ante* by preventing negative actions, in other words, the regulator can require the issuer to disclose certain information and to obtain regulatory approval prior to making a public offering.<sup>157</sup>

What is unassailable as an element contributing to regulatory efficiency is that sufficient information will allow the regulator to determine definitely the issue: disclosure strategy.<sup>158</sup>

The incompleteness of the law in the development of the United Kingdom's offer regulatory principles serves as an example of enforcement failure. In the United States in the 1929 stock market crash and the recent burst of the dot-com bubble is evidence that a regulatory regime is not immune to failure. But these examples highlight the conditions under which enforcement failure, which is a combination of enforcement and regulatory failure, is likely to occur.<sup>159</sup> In the development in the UK, offer regulatory laws were comparatively slow in catching up with the new challenges posed by the changing marketplace. When Courts applied the principles of contract in the stock fraud cases it

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<sup>156</sup> *Ibid* 12.

<sup>157</sup> *Ibid* 12-13.

<sup>158</sup> *Ibid* 17.

<sup>159</sup> *Ibid* 19.

became apparent that the existing law could not optimally deter fraud in the context of securities markets.<sup>160</sup>

In the United States, enforcement failure and the US stock market crash of 1929 deterrence failure occurred as a result of the investors being faced with a substantially higher burden of proof in Court which discouraged litigation and thus undermined reactive law enforcement.<sup>161</sup> Lack of reliable firm specific information undermines the efficiency of proactive law enforcement. The lower the quality of information, the greater the enforcement error, and the less effective overall levels of law enforcement. It is suggested that reactive law enforcement cannot effectively deter violations when law is highly incomplete.<sup>162</sup>

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<sup>160</sup> *Ibid.* Contract law was particularly ill-suited to addressing most cases of stock fraud as the victim of the fraud did transact with the issuing company directly, but rather with an intermediary who may not have participated in the fraudulent action. Since a claim based on contract law requires a contract between the two parties of the dispute, this seriously limits the applicability of contract law to enforcing fraud cases. Even if the victim of the fraudulent action had indeed contracted directly with the issuing corporation, by the time the fraud was discovered and legal action brought, the company had already been liquidated. Any claim against the directors of the dissolved company had to be based on the law of delict and not contract law. In accordance with the principles of the law of delict; the plaintiff has to show that the defendant intended to induce the plaintiff into taking action (in other words to buy securities); which in turn had caused harm. The complex relations between the two parties provide that the plaintiff had to be in receipt of the fraudulent statement in order to make a claim based in delict. A question of fundamental importance, sought to be addressed, was whether only a positive statement as wrongful act, or also failure to disclose such fact, gave rise to liability based on fraud. In the 19th century companies ran no legal obligation to circulate a prospectus disclosing particular information. Many fraudulent schemes emanated from wrongful information in a prospectus that was circulated, or in the failure to disclose information that, if disclosed, would have revealed information that might have deterred investors from acquiring shares.

<sup>161</sup> Xu & Pistor “Enforcement Failure” (2004) 23. Three important factors in the marketplace contributed to enforcement failure. Firstly, the expanding marketable securities, secondly the rapidly growing number of investors and the related transformation of ownership from controlled system to highly dispersed system of share ownership, and thirdly, the rapidly growing and increasingly decentralized market for financial intermediaries. In response, the 1933 and 1934 legislation (in the United States) for securities and exchange legislation were enacted. It established mandatory disclosure and registration systems for all securities that were issued to the public across state borders and charged unity over the Securities and Exchange Commission of enforcing these rights. The SEC exercised its rights attributed to it as a regulator, in particular reviewing offers, and to request additional information actively enforcing its mandate.

<sup>162</sup> *Ibid* 27-8.

### 3.5. Enforcement failure

Ultimately two types of enforcement failure manifest. First, deterrence failure which reflects the failure of reactive law enforcers to effectively deter future violations. Second, regulatory failure which refers to the inability of proactive law enforcers to prevent harmful actions in the first place. The more incomplete the law, the greater the likelihood of deterrence failure. The more expansive and/or volatile the market, the greater the incentive to cheat. When law is incomplete, the introduction of a proactive law enforcer may enhance law enforcement. The efficiency of the regulatory regime depends on the quality of firm specific information. The lower the quality of the firm specific information, the greater the likelihood of regulatory failure.<sup>163</sup> It is stated that what is crucial in the effectiveness of a regulatory authority in each of the areas it oversees is its enforcement authority.<sup>164</sup>

### 3.6. Purpose and relevance

It is submitted that securities law, based on deductions flowing from the discussion *supra*, can be broken down into substantive aspects and formal mechanisms.

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<sup>163</sup> Xu & Pistor "Enforcement Failure" (2004) 30-1.

<sup>164</sup> Silvia J (2007) "Efficiency and Effectiveness in Securities Regulation: Comparative Analysis of the United States Competitive Regulatory Structure and the United Kingdom's Single Regulator Model" Selected Works [http://www.works.bepress.com/joseph\\_silvia/3/](http://www.works.bepress.com/joseph_silvia/3/) (accessed on 16 December 2013) 3. See also US Securities and Exchange Commission (2013) "The Investor's Advocate: How the SEC Protects Investors, Maintains Market Integrity and Facilitates Capital Formation" <http://www.sec.gov/about/whatwedo.shtml> (accessed on 20 March 2014).

Enforcement action by the SEC and other regulators in the US is the most effective tool for defining the scope of regulation in the American capital markets. Enforcement is the key method for regulation in the US capital markets. This is evidenced by the fact that over half of the roughly 3100 SEC employees are within the enforcement division of the SEC.

The substantive aspects cover the empowering legislation whereas the formality mechanism is derived from the legislation and created to ensure compliance with the legislation.

The principles of offer regulation are to be found in the legislation and the enforcement thereof ideally by means of a regulatory authority rather than the Courts. That is how the United Kingdom and United States have applied the model in their jurisdictions.<sup>165</sup>

The aim of the principles of offer regulation (and what the empowering legislation ought to achieve) is to establish complete law, in furtherance of the *Grundnorm* thereby ensuring efficiency and effectiveness.<sup>166</sup>

It is also submitted that policies as stated in the Guidelines cannot be transposed through haphazard amendments to existing legislation without due consideration of the history, principles, and application of the offer regulatory regime. The insertion of a few definitions and a rehash of the regulatory regime will only add more scramble to the egg instead of offering a full buffet breakfast.

Subsequently, in a discussion of aspects of offer regulation under Chapter 4 of the 2008 Companies Act, consideration will be given in the first instance, (briefly) to the formality mechanism in place, with considerations of enforcement prior to moving onto a discussion of the

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<sup>165</sup> See the comparative discussion at chapter 6 *infra*.

<sup>166</sup> The Oxford Dictionary defines efficiency as the state of quality of being efficient. Effective is defined as the product of a desired or intended result. It is submitted that a regulatory system may be effectively, efficient.

substantive aspects thereof. A comparative analysis of the disposition in the United States and United Kingdom will follow.

#### 4. Concluding remarks

The corporate entity known as the public company is an effective and powerful vehicle to amass funding from investors. Offer regulation aim to regulate the process of extending offers for the acquisition of securities through securities laws. Offer regulation rests on statutory provisions, creating a basis of regulation either through direct regulation or through disclosure regulation or a hybrid system between these two extremes. Disclosure regulation is preferred based on the nature of the choice the investor is required to make in respect of his or her capital. In respect of the statutory provisions setting up the offer regulatory framework, it is essential for same to contribute to the rule of law as established by the need for securities law, based on the *Grundnorm* of offer regulation, i.e., fraud prevention as well as investor protection and efficient capital markets. Regulation, either through *ex post* or *ex ante* enforcement must be effective and in order to be effective, the statutory provisions must denote a set of complete laws, i.e., unambiguous and without any errors which may be used in assailing the peremptory provisions.

An overview of the underlying philosophical framework will determine a basis regarding the standard of South African securities regulation in terms of its matching up with international jurisprudence as well as fulfilling its objectives. Extensive problems with the regulatory framework exist based on the uncertainty and confusion occasioned by the



new dispensation and shifts of emphasis and philosophy as well as fusion of ideas in the underlying philosophy.<sup>167</sup> The inconsistencies in the underlying philosophy directly impact on the interpretation of the regulatory dispensation. The importation of new concepts and structures is a risky practice, and it is submitted that it is especially so with regard to legal certainty and clarity.<sup>168</sup> South African company law has always opted for disclosure.<sup>169</sup> This is in line with the historical development of securities regulation in the United Kingdom and the importation of English company law principles by way of incorporation of their laws into ours. Prior to considering the principles of disclosure, the historical development in the following chapter needs to be contextualised. In this evaluation, the historical principles underlying disclosure regulation and merit regulation will underscore that the law is not able to develop timeously with business and meet the requirements of modern society.

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<sup>167</sup> See chapter 3 *infra* for the development of the principles of offer regulation, and chapter 4 which details the philosophical framework, followed by chapter 5 which provides for the underlying principles of the new dispensation under the 2008 Act.

<sup>168</sup> Delpont “Offers” 2011 *THRHR* 280.

<sup>169</sup> *Ibid.*

## CHAPTER 3

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### HISTORICAL DEVELOPMENT

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  - 2.1. Stages of development
  - 2.2. United Kingdom
    - 2.2.1. Historic stage
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  - 5.2. Developmental flaws
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## 1. Introduction

It is important to view the historical development of company law and offer regulation against the evolvement of company law and the company as vehicle for conducting business.<sup>1</sup> This method contextualises the present in an attempt to obtain an impression of the interpretation of the underlying principles behind offer regulation in identifying the *Grundnorm* of offer regulation. This will be the focus of this chapter, whereas contingent historical aspects will be covered in the subsequent chapters, where relevant to the substantive aspects as identified.

The history of offer regulation arose and aligned itself through the development of the company concept and the subsequent rules for its operation in the market. It is not the aim of this work to restate a full exposition of the sources, history and development of company law, as well as securities law in England and subsequently in South Africa.<sup>2</sup> However, a brief analysis of the relevant history leading up to offer regulation and further developments need to be contextualised. It is to be noted that offer regulation in the United Kingdom and in the United States

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<sup>1</sup> The company, as vessel for conducting business to gain profit, has long catered for the needs of groups of persons who desire to enjoy the benefits of the separate legal personality and limited liability of a company. It goes without saying that companies play an important economic role: the maximisation of profits in the interests of the shareholders being the overriding aim. The limited liability entity, able to screen owners and controllers from personal liability arising from business ventures, has featured strongly in all free market economies and is important in all capitalist economies. The ability to be utilised as a vehicle to mobilise investment, in the form of capital from a substantial group of investors for business endeavours, has served as one of the primary factors contributing to the expansion and popularity of the company as business form. The pull for investors towards investing in a company may be attributed to various factors; the expansion of wealth being the primary factor, coupled with the limited risk they may be exposed to, perpetual succession of the company, transferability of shares and the structured order of the business form also playing a role.

<sup>2</sup> For more information see *LAWSA* (1995) paragraphs 2-5.

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as most notable jurisdictions diverged into two separate branches, differentiating between company law and securities law (which included primary market subscriptions and primary market sales as well as secondary market sales of unlisted securities and listings).

## 2. Historical development

### 2.1. Stages of development

Offer regulation is a recent phenomenon with developments manifesting during the mid-nineteenth century and most significant developments arising during the last 78 years.<sup>3</sup> In addressing market inequities, securities regulation followed the doctrine of disclosure<sup>4</sup> and anti-fraud provisions which have been introduced due to the legislators in England (and eventually in South Africa by way of importation) reacting to abuse of offers to the public for the subscription of shares.<sup>5</sup> Stronger legislative controls were put in place regarding disclosure, holding that when sufficient information regarding the company and the offer is published investors will be able to take informed decisions, therefore guarding their own interests when considering the merits of the offer.<sup>6</sup>

It is submitted that the historical development of company law included securities law, insofar as the reactionary motivators are concerned, i.e., to regulate abuses of the corporate entity in capital market transactions.

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<sup>3</sup> Gillen (1992) *Securities Regulation in Canada* 78. Securities regulation involves the law aimed at *inter alia* requiring prospectus disclosure in capital markets where offers are made to the public for the acquisition of securities.

<sup>4</sup> The doctrine of disclosure of company information and material information in exchange for separate legal personality.

<sup>5</sup> Cilliers HS *et al* (1993) *Ondernemingsreg* Durban: Butterworths paragraph 16.2.

<sup>6</sup> *Ibid.*

Underpinning this goal is the prevention of fraud and investor protection. This period is the historical stage of development with its reactionary basis.<sup>7</sup>

The reactionary basis of the historical stage of company (and securities law) development evolved into the post-historic stage, which forms the basis for what will be termed as the reformist stage of company law and securities regulation. During this stage of evolution, reform of offer regulation took place (after more corporate failures and abuses) and leading to the contemporary stage, which signifies the current securities regulatory dispensations.

It must be noted that the reactionary basis, as part of the historic stage of development, was most concerned with the development of rules in reaction to market integers of abuse concerning the corporate entity. The reformist stage involved the evolution of these rules to become more effective. The contemporary stage does not herald an end to development and evolution of company law, and per implication offer regulation as part of securities law. Rather this stage sees securities regulation as an ongoing process which is evolving as the markets do.

The majority of legislative development in company law during the historic stage has been to address inequities arising from fraud and abuse of the corporate entity.<sup>8</sup> It is submitted that this is the essence of securities

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<sup>7</sup> Historical stages in England and Canada.

<sup>8</sup> LAWSA (1995) paragraph 4.

law, dividing it from company law as a separate specialised branch of corporate law.<sup>9</sup>

## 2.2. United Kingdom

The English company law system served as model for various commonwealth jurisdictions, amongst others, Canada and South Africa. Historical events in commerce contributed to a legislative process, described as evolutionary in nature, which is to be read and interpreted against the common law which developed parallel to it.<sup>10</sup>

### 2.2.1. Historic stage

Fraudulent schemes in obtaining capital through misuse of the corporate entity, moved legislators in England to develop regulatory principles to curb abuses. The principles were aimed at investor protection. These developments mark the historical stage. The first two decades of the eighteenth century saw a wave of company flotations,<sup>11</sup> many of which constituted fraudulent schemes.<sup>12</sup> Amidst vehement speculation the government passed the Bubble Act in 1720.<sup>13</sup>

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<sup>9</sup> Disclosure of information is a regulatory strategy consistent with both the principles of investor protection and market efficiency. Disclosure requirements imposed on businesses, which offer securities to the public, are the major form of regulation imposed by securities regulation (Yalden *et al* (2008) *Business Organizations* 388).

<sup>10</sup> LAWSA (1995) paragraph 4.

<sup>11</sup> In the post-renaissance period, new trading ventures were risky and involved large capital expenditures. Risk sharing was encouraged through loans and partnerships (Gillen (1992) *Securities Regulation in Canada* 70).

<sup>12</sup> LAWSA (1995) paragraph 4.

<sup>13</sup> *Ibid.* See also Gillen (1992) *Securities Regulation in Canada supra*. Further developments of share capital companies were delayed by the South Sea Bubble fiasco. The Bubble Act was an attempt to maintain high prices for South Sea Company shares by preventing investment in other companies. The Act prohibited the sale of shares in joint stock companies unless created by Crown charter, which was difficult to obtain. It follows that the raising of capital by the sale of shares was constrained. This suppression carried on for nearly 100 years. Amidst the industrial revolution during the 19<sup>th</sup> century, pressure for easier access to capital led to the repeal of the Act in 1825. Subsequently, the Companies Act of 1844 was enacted, making it easier to organise in a corporate entity. The Bubble Act and the aftermath of the prosecutions against the prohibited acting as a corporation without charter or statute,

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The Joint Stock Companies Act was enacted in 1844 and give rise to modern company law, the gist of which is recognisable to this day.<sup>14</sup> The element of publicity retained its importance in the first hailed modern piece of company legislation, the Joint Stock Companies Act of 1856, alongside limiting liability with statutory notice of same.<sup>15</sup> From thereon forward, stricter controls and the provision of more publicity at various intervals were enacted. With the various pieces of legislation, the Courts during the 19<sup>th</sup> century developed the principles of company law, including the liability for misleading statements in prospectuses.<sup>16</sup>

#### 2.2.2. Post Historic stage

Throughout the 20<sup>th</sup> century, the UK financial services were self-regulated in nature. The main regulatory enactment being the Prevention of Fraud (Investments) Act of 1958 (PFIA), introduced to provide a degree of investor protection. Although not effective, as its scope was narrow in application and frequently open to interpretation. The British Government reconsidered the regulation of the financial services during the 1970s and 1980s after scandals hit the sector which involved miss-selling of personal pension fund schemes, endowments and split capital investment trusts.

Professor LCB Gower was appointed in 1981 to consider new legislation,

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and use of obsolete charters, resulted in the market collapsing. To an extent, the regulation of trading is manifested for the first time with the enactment of the Bubble Act, although still in an early form. Due to the dynamic nature of commerce; the difficult, expensive, and lengthy manner in incorporating was sidestepped by turning to the unincorporated company.

<sup>14</sup> The office of the Registrar of Companies was created by this Act and incorporation was attainable by simple registration. Newly formed companies were compelled to register. The general structure of directors, meetings by members, accounting records, and the filing of a balance sheet remain the same up to today (in part). This Act stressed full disclosure and continuous disclosure of *inter alia*, annual financial statements. Although it excluded limited liability it recognised the primary liability of the company, as per LAWSA (1995) paragraph 4.

<sup>15</sup> *Ibid.*

<sup>16</sup> *Derry v Peek* (1889) 14 App Cas 337 (HL). See also the discussion in LAWSA (1995) *ibid.*

and mandated, *inter alia*, to consider the levels of statutory investor protection and whether the law should be changed to improve consumer protection.

### 2.2.3. Reformist stage

It is submitted that the period of the Gower Report constitutes the beginning of the reformist stage, calling for an overhaul of the principles of investor protection and moving towards a more effective regulatory regime. The Gower Report into Investor Protection<sup>17</sup> proposed regulations for the financial services industry in the late 1980s which led to the establishment of the Securities and Investments Board: the forerunner to the Financial Services Authority. As a direct result the Financial Services Act of 1986 was enacted which created a designated agency for the supervision of investment business. The agency, the Securities and Investments Board, was the forerunner of the Financial Services Authority (now the Financial Conduct Authority.)

### 2.2.4. Contemporary stage

The contemporary stage marks the implementation of the reforms heralded during the reformist stage. The now repealed Financial Services Act of 1986 was passed to regulate the financial services industry, and divided the regulation of securities from company law. The Act employed governmental regulation as well as self-regulation, creating a Securities

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<sup>17</sup> Gower Review and Gower Report *supra*. It is worthy to note that the Gower Review also proposed a system of merit review, however in the Gower Report, Professor Gower succumbed to a disclosure system. However, the integrated and holistic approaches towards offer regulation, aligning with the principles which underpin securities law, survived and are present in modern securities regulation the United Kingdom. See chapter 6 *infra* in this regard.



and Investments Board (the forerunner of the Financial Services Authority, now the FCA). The Financial Services Act of 1986, replaced voluntary self-regulation of investment business with a system of detailed regulation; it was superseded by the Financial Services and Markets Act of 2000.<sup>18</sup> Amongst others, it repealed and replaced the Companies Act provisions relating to prospectuses.<sup>19</sup> In the United Kingdom, company law is therefore distinguished from securities regulation by means of securities law.<sup>20</sup> The FSA (as it was then) was a quasi-judicial body and the regulator of insurance, investment business and banking. When acting as the authority for listing shares on a stock exchange it is referred to as the UK Listing Authority.<sup>21</sup> The contemporary stage continues to seek answers to questions relating to more effective regulation of capital markets, through disclosure in order to protect investors and ensure effective capital markets and allocation of capital.

### 2.3. Canada

Whereas the 1973 Companies Act in South Africa was founded on general principles of English company law, the 2008 Act has been drafted with reference to the principles of, *inter alia*, Canadian company law<sup>22</sup> with the result that jurisprudence from Canada will become more relevant and persuasive in the interpretation of the 2008 Companies Act.<sup>23</sup>

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<sup>18</sup> LAWSA (1995) paragraph 4.

<sup>19</sup> *Ibid.*

<sup>20</sup> *Ibid.*

<sup>21</sup> Financial Services Authority [www.fsa.gov.uk](http://www.fsa.gov.uk) (accessed on 30 May 2012).

<sup>22</sup> Together with principles from American and English company law.

<sup>23</sup> It is argued that the 2008 Act integrates the best practices of, most notably, Canada, with South African common law and commercial requirements. In this, the 2008 Act samples concepts from various jurisdictions around the world.

As with English company law, Canadian company law's critical formative period dates from the 19<sup>th</sup> century.<sup>24</sup> Despite the occurrence of earlier forms, the genesis of the modern company as separate legal entity or legal person, apart from its members, can be traced back to the Joint Stock Companies Act of 1844.<sup>25</sup> What followed was the ascent of the company as dominant business form and associated economic significance.<sup>26</sup> For a greater part, the contextual history of Canadian company law follows that of English company law.<sup>27</sup> Early statutes were directed at securities frauds.<sup>28</sup> During 1945 and again in 1947, legislation was enacted which required specific elements to be included in a prospectus for any distribution of securities to the public.<sup>29</sup> The legislation was different from earlier fraud prevention statutes, dealing not only with fraud after the fact, but giving purchasers a statutory right of action to prove either intent or reliance.<sup>30</sup>

The prospectus requirements and disclosure regulation dealt only with disclosure on the distribution of securities. It also did not provide for ongoing disclosure of information to support secondary market trading; providing the impetus for reforms. The Kimber Report was produced in the early 1960s in response to specific problems in the regulation of

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<sup>24</sup> Yalden *et al* (2008) *Business Organizations* 216.

<sup>25</sup> *Ibid.*

<sup>26</sup> *Ibid.*

<sup>27</sup> For more corollaries see Yalden *et al* (2008) *Business Organizations* 217 and Nicholls CC (2005) *Corporate Law* Toronto Canada: Emond Montgomery Publications 8-12.

<sup>28</sup> Gillen (1992) *Securities Regulation in Canada* 74.

<sup>29</sup> Ontario Securities Act 1945, S.O. c. 22 and Ontario Securities Act 1947, S.O. c. 98.

<sup>30</sup> Gillen (1992) *Securities Regulation in Canada* 76.

markets.<sup>31</sup> This report recommended the institution of requirements for ongoing disclosure including the distribution of periodic financial statements.<sup>32</sup> The Merger Report of 1970 led to the enactment of the closed system statute, with very strong emphasis on ongoing disclosure for the purposes of the secondary market.<sup>33</sup>

### 3. *Grundnorm*

The *Grundnorm* of securities regulation developed in accordance with the stages of development of company law. In England, with its strong common law jurisprudence, the motivation to prevent fraud where the limited liability entity was used to occasion same, came strongly to the fore.<sup>34</sup> This was also the case in Canada.<sup>35</sup> Fraud prevention was eminent during the historical stage. It is submitted that the *Grundnorm* emanated from anti-fraud policies and expanded toward preventative regulation *in lieu* of reliance on the common law as *ex post* mechanism of enforcement by the Courts due to inefficiencies. The *Grundnorm* evolved towards investor protection and efficient capital markets. The *Grundnorm* applicable to offer regulation in terms of securities laws is the prevention of fraud through preventative regulation, ensuring investor protection and efficient capital markets. These concepts are expounded on below.

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<sup>31</sup> Modern Canadian securities regulation has been significantly influenced by the Kimber Report *supra* as per Gillen (1992) *Securities Regulation in Canada* *ibid*.

<sup>32</sup> *Ibid*.

<sup>33</sup> Ontario Securities Commission (1970) *Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors by Business Combinations and Private Placements* Toronto: Dept. of Financial and Commercial Affairs (the Merger Report).

<sup>34</sup> During the first two decades of the 18<sup>th</sup> century, a wave of company flotations with fraudulent and preposterous schemes flowed. It is during this time that the modern company arose, designed for trade for the benefit of its members, each contributing to a permanent fixed capital divided into transferable shares and receiving dividends (LAWSA (1995) paragraph 9).

<sup>35</sup> See general discussion at 74 – 79 of Canadian developments in Gillen (1992) *Securities Regulation in Canada* *supra*.

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### 3.1. Fraud

Fraud, being the criminal act of intentional deception for personal gain or damage, is classified under crimes against property. As part of criminal law, anti-fraud provisions in the early Acts sought to regulate conduct and proscribe threats, harm or endangerment to the welfare of the public. In terms of securities regulation, the objectives of anti-fraud provisions slotted in with two of the objectives<sup>36</sup> accepted for enforcement of criminal law: being deterrence and, if committed and capable of conviction, retribution. Restoration, as last objective in terms of securities regulation during the historic stage, is submitted to be an integer for the advancement towards the reformist stage. Restoration is a victim orientated theory of punishment and has the objective to repair injury inflicted. If capital is lost due to fraud, the amount so acquired through misrepresentation should be restored to the victim. This objective closely aligns criminal with civil law, whereby the state of affairs of the victim is placed in the same position prior to the delict if possible. In terms of the fluidity of capital, it is submitted that the penal nature of anti-fraud provisions can not effectively assist retribution, leaving investors without recourse to recovery of their funds. The malevolence had to be prevented from happening in the first place. A different type of regulatory framework was needed; either regulating the process of extending offers or regulating the offers, the former being mandatory disclosure regulation, the latter, merit regulation. Due to the limitations of fraud provisions, firstly, in effectiveness and, secondly, with investors unable to utilise

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<sup>36</sup> Retribution, deterrence, incapacitation, rehabilitation and restoration. It does not make sense to discuss the other objectives insofar securities law are concerned.

them as a remedy to recover lost capital, the need was recognised to give purchasers a statutory right of action in which they did not have to prove intent or reliance.<sup>37</sup>

### 3.2. Preventative regulation *in lieu* of anti-fraud

Not only did the bell toll for standard anti-fraud provisions, but times also changed with the Industrial Revolution giving rise to the reformist stage. Business expanded and the need for capital increased. At a public policy level, the growth and prosperity of society depends on the business community. The need to protect the investor beyond the scope of the common law criminal liability and delict, did not surface in isolation. Investor protection interlinks with the efficiency of capital markets. As far back as 1973, in the United States securities regulation was criticised as a sterile system, mainly because regulators misconceived the market it was intended to regulate,<sup>38</sup> in that it failed to keep ahead of developments such as intricate securities, multi-national companies with complicated tax regimes, and high technology companies<sup>39</sup> entering the market. Also, in the United Kingdom, the dispensation was recognised as fallible. In 1985, the Government of the United Kingdom published a White Paper setting

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<sup>37</sup> Securities regulation involving disclosure in a prospectus arose out of a concern as to the accuracy of statements in prospectuses which were mitigated by *Derry v Peek supra*. In this case, an action for misrepresentation in a prospectus was dismissed on the basis that the plaintiff had to show fraud and had failed to do so. The Court held that fraud would be proven when it was shown that the misrepresentation was made knowingly or without belief in its truth or recklessly and carelessly whether it be true or false. The reliance on intent made it difficult to sustain an action against directors for misrepresentation (Gillen (1992) *Securities Regulation in Canada* 72).

<sup>38</sup> Kripke H “The Myth of the Informed Layman” (1973) 28 *Business Lawyer (ABA) supra*.

<sup>39</sup> With the detrimental side-effect to regulation that neither the products nor the technical competitive positions are able to be discerned by interested parties.

out its proposals for a new framework for investor protection in the United Kingdom.<sup>40</sup>

Said proposals were based upon the exhaustive analysis by Professor LCB Gower of the then regulatory system in the United Kingdom and its inadequacies.<sup>41</sup> Canada, the United Kingdom as well as the United States saw a myriad of regulatory developments in order to keep up with the markets and the objectives of securities regulation.<sup>42</sup> Where investor protection defines the efforts to observe, enforce, and safeguard the rights and claims of an investor, efficient capital markets gain by preventative regulation in that countries with stronger investor protection regimes tend to grow faster than those with poor investor protection regimes.<sup>43</sup> Disclosure requirements were laid down, and were subsequently developed and expounded on, as securities regulation branched out into a separate system of law.<sup>44</sup> Mandatory disclosure rules target the issuers of securities requiring disclosure of material information and that

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<sup>40</sup> Pimlott GF “The Reform of Investor Protection in the UK: An Examination of the Proposals of the Gower Report and the UK Government’s White Paper of January 1985” (1985) 7 *Journal of Comparative Business and Capital Market Law* 141-172.

<sup>41</sup> *Ibid.*

<sup>42</sup> See Davies (2012) *Gower and Davies’ Principles* chapter 25 for a discussion on the United Kingdom against the backdrop of the *Gower Report*; Yaldon *et al* (2008) chapter 6 for a discussion on Canada and Ratner & Hazen (2010) *Securities Regulation: Selected Statutes* chapters 1 and 2 for a discussion on the United States.

<sup>43</sup> Haidar JI “Investor Protection and Economic Growth” (2009) 103 *Economics Letters*.

[http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=1112143](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=1112143) (accessed 4 September 2011) 1-4.

<sup>44</sup> The constraints in *Derry v Peek supra* were dealt with in the Directors Liability Act of 1890 (53 and 54 Victoria c. 64). Directors, promoters and others who authorised use of their name on the prospectus were liable to persons who subscribed for shares on the faith of the prospectus, if such persons sustained loss or damage by reason of any untrue statement in the prospectus. Liability was found on an untrue statement, unless it could be shown that the defendants had reasonable grounds to believe that the statements were true or that any copy or extract from a report of an expert or official person was a fair copy or extract (Gillen (1992) *Securities Regulation in Canada* 72-3). It is submitted that this formed the basis of contemporary securities regulation and the development of securities law reforms. (Canada followed with a similar statute when Ontario enacted the Directors’ Liability Act, 1891, S.O. 1891, c. 34 as per Gillen (1992) *Securities Regulation in Canada supra*).

transactions are not based on fraudulent information, with the goal underlying mandatory disclosure which is to provide investors with accurate information so that they can make informed investment decisions.<sup>45</sup> The objectives of disclosure requirements as a preventative regulatory regime (juxtaposed to no regulatory regime at all or only a reliance on anti-fraud provisions) flows directly from the anti-fraud provisions, i.e., protecting capital (property). It is submitted, however, that the nature of preventative regulation is more advanced and removed from the basics of anti-fraud provisions. Whereas modern securities regulatory regimes will always have an anti-fraud aspect, its evolution expanded upon that aspect to include more efficient regulatory practices. The objectives are investor protection and efficient capital markets.

### 3.3. Investor protection

Investor protection remains at the forefront of securities regulation and is designed to protect investors from paying more for securities than they are worth, or from selling securities for less than they are worth.<sup>46</sup> When investors finance a company, there remains a risk that the returns on their investments will not materialize.

Expropriation of capital is occasioned by theft of the capital or its profits, or when assets, or the venture, are sold at below market prices and by means of fraud: over-selling an investment when it usually is worthless. Investors are protected through the enforcement of a legal dispensation

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<sup>45</sup> Legal Information Institute, Cornell University Law School, Securities Act of 1933 [http://www.law.cornell.edu/wex/securities\\_act\\_of\\_1933](http://www.law.cornell.edu/wex/securities_act_of_1933) (accessed on 12 July 2012).

<sup>46</sup> Gillen (1992) *Securities Regulation in Canada* 47.

which provides for disclosure and accounting rules: providing investors with the information required to exercise their options.<sup>47</sup>

Securities regulation requires disclosure on the primary distribution of securities and disclosure to support the secondary market trading.<sup>48</sup>

Investor protection aims to ensure that the investing public has access to full disclosure in order to have the knowledge which enables it to distinguish between investments.<sup>49</sup>

#### 3.4. Efficient capital markets

The efficient market hypothesis asserts that financial markets are informational efficient.<sup>50</sup> Capital market efficiency connects closely with investor protection.<sup>51</sup> Conditions and practices in the capital market which serve the best interests of investors would be consistent with the best interests of the entire community.<sup>52</sup> Not only are the interests of investors served through curbing imperfections of the free and open capital market, but it also assures the efficient operation of the market.<sup>53</sup>

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<sup>47</sup> La Porta R (ed) (1999) *Investor Protection: Origins, Consequences, Reform*, NBER Working Paper Series, Issue 7428 Cambridge, Massachusetts: National Bureau of Economic Research.

<sup>48</sup> Gillen (1992) *Securities Regulation in Canada* 98. It also regulates insider trading, takeover bids and the persons involved in underwriting, brokerage, advising and portfolio management. For purposes of discussion, only disclosure in the capital markets will be addressed.

<sup>49</sup> The price at which an investor purchases or sells a security should be a fair estimate of the value of the future cash flow it will generate. All losses will therefore not be attributed to fraud or corporate collapse due to mismanagement but due to genuine economic losses just as gains are genuine economic gains (Gillen (1992) *Securities Regulation in Canada* 80).

<sup>50</sup> Desai, Sameer “Efficient market hypothesis” <http://www.indexingblog.com/2011/03/27/efficient-market-hypothesis> (accessed on 2 June 2011).

<sup>51</sup> Capital market efficiency basically consists of the development of financial institutions which assure the optimum allocation of financial resources to the community. To further this allocation, capital markets must ensure the mobility and transferability of financial resources and to provide facilities for the continuing valuation of securities (Gillen (1992) *Securities Regulation in Canada* 80-1).

<sup>52</sup> Disclosure which depicts the operations and financial position of a company will provide the capital market with the information necessary to make an efficient allocation of capital (Merger Report 1.07).

<sup>53</sup> *Ibid* 1.09 and 1.10.



Flowing from the prevention of fraud principles which underscore the historic development of securities regulation, allocative efficiency arises from the evolution of the company and capital markets and stresses a move away from purely consumer protection (or investor protection) by advancing the function of securities regulation, to promote the direction by investors of their funds on the basis of an accurate understanding of the risk and reward profile of particular projects which the issuance of securities will finance. It is, therefore, not only in the interest of investors but also of companies and of the economy generally, for effective regulation promotes the allocation of scarce investment resources to the projects with the highest returns. The question underlying the effectiveness of a regulatory regime is what sort of regulation will best achieve this objective.<sup>54</sup>

#### 4. South Africa

In South Africa, offer regulation in the primary and informal secondary markets is governed by Chapter 4 of the Act. Company law in South Africa boasts a colourful history in terms of development and evolution, leading up to the 2008 Companies Act. This section will for the purposes of context, review the most applicable aspects of the development of offer regulatory law in South Africa, as applied to public offers.

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<sup>54</sup> Davies (2012) *Gower and Davies' Principles* 853. Allocative efficiency underpins disclosure regulation instead of traditional merit regulation, based on the decisions to be made. It is for the investor to make the investment decision, not for government to intervene. As stated by Loss in (1988) *Fundamentals* each one still has the right to make a fool of himself, but another does not have the right to make a fool of him (in describing disclosure regulation). Much is to be said for the historic principles and the possibility of a hybrid system of merit review and disclosure must be considered. Historic principles of merit review and disclosure regulation are inhibiting. A hybrid system will excise negating principles and import an effective double benchmark system.

## 4.1. Van Wyk de Vries Commission

South African company law during the second half of the nineteenth century developed from the relatively sophisticated and easily accessible English company law.<sup>55</sup> The practice developed of borrowing directly or indirectly from English legislation.<sup>56</sup> Shortly after the Jenkins Committee reported in the United Kingdom, the Van Wyk de Vries Commission was appointed: its report resulting in the Companies Act of 1973.<sup>57</sup>

Recognising the growth of the number of companies in South Africa at the time, the Commission referred to the importance of an overhaul of the company law regime. Acting Judge Jan van Wyk de Vries considered amendments to the then Companies Act of 1926 required *inter alia*, to manage and administrate company law.<sup>58</sup> Under the terms of reference, the Commission considered the protection of investors as well as the

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<sup>55</sup> The English company law benefiting from the extensive development in the preceding period. LAWSA (1995) paragraph 5.

<sup>56</sup> *Ibid* LAWSA (1995). Early mercantile law systems of the two Colonies and the two Republics were not equal to the economic development in South Africa during the second half of the nineteenth century. It was inevitable that English company law would find its way into the legal system. The Cape Joint Stock Companies Limited Liability Act 23 of 1861 was almost verbatim an adaptation of the English Joint Stock Companies Act of 1844 and the Limited Liability Act of 1855 (Cilliers *et al* (2000) *Corporate Law* paragraph 2.13).

<sup>57</sup> *Ibid* LAWSA (1995) paragraph 5. The Companies Act 61 of 1973 stems directly from the research and recommendations of the J Van Wyk de Vries Commission of Enquiry into the Companies Act: South Africa (1970) *The J v Wyk de Vries Commission of Enquiry into the Companies Act: "Report on the Commission of Enquiry into the Companies Act" Main Report* Pretoria: Government Printer; South Africa (1972) *The J v Wyk de Vries Commission of Enquiry into the Companies Act: Supplementary Report and Draft Bill* Pretoria: Government Printer (RP 31 of 1972) 97), (hereinafter referred to as the Van Wyk de Vries Main Report and/or Supplementary Report and/or Commission where relevant). The 1973 Act marks a divergence from English company law. The Van Wyk de Vries Commission found that the appointment of a Commission of Enquiry approximately every 15 years into the Companies Act is not effective as means to keep up to date with modern developments of company law. As a result the Standing Advisory Committee on Company Law was created in terms of section 18 of the 1973 Act. The function of this committee is to make recommendations regarding the amendment of the Companies Act. As a result of this, various amendments in successive Acts have dealt with a broad spectrum of aspects (Cilliers *et al* (2000) *Corporate Law* paragraph 2.13).

<sup>58</sup> Van Wyk de Vries Main Report chapter 1.

public interest under the prospectus provisions in public offers.<sup>59</sup> It is self-evident that the Commission's Report gave rise to the 1973 Companies Act. The overhaul and principles considered the Jenkins Report in the United Kingdom. South Africa already had imported principles of offer regulation obtained from Britain. At the time of the Van Wyk de Vries Commission Report the disclosure philosophy of England was retained but adapted to provide for South African practice.

In 1989 the chapter entitled "Regulation of Securities" was added to the 1973 Act.<sup>60</sup> The provisions were a blend of statutory and self-regulation by the securities industry; modelled on those of the United Kingdom but adding a statutory foundation to the structure.<sup>61</sup> Schedule 4 to the Act was introduced<sup>62</sup> which sets out the requirements for the company's annual financial statements.<sup>63</sup> It is submitted that the principles of capital market regulation, especially disclosure regulation as per the United Kingdom, were retained in South Africa and applied in equal measure.

In arriving at its conclusions, the Van Wyk de Vries Commission considered English developments regarding offer regulation. Earlier securities regulation, at its most primitive, was based on the crime of fraud and contained fraud provisions. The first regulatory improvement of securities trading, by means of offer regulation through prospectus disclosure is found in section 38 of the English Companies Act of 1867,

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<sup>59</sup> Van Wyk de Vries Main Report paragraph 2.01.

<sup>60</sup> LAWSA (1995) paragraph 5.

<sup>61</sup> *Ibid.*

<sup>62</sup> Per Government Gazette 14351 GN R2921, 23 October 1992, effective from 1 April 1993.

<sup>63</sup> LAWSA (1995) *supra*.

which is a piece of highly criticised and egregious drafting. The provision held that non-disclosure of material contracts in prospectuses is actionable. It stayed on the statutes for 33 years until revised by section 33 of the Companies Act of 1900. The earlier disclosure regulation by means of prospectus did not yield any measure of success. Disclosure regulation sections were described as notorious and monumental. English (and by implication South African disclosure provisions) were criticised as combining the two opposite vices in the art of legislative drafting: being specific where it ought to be general and being general or vague where it ought to be specific. Instead of laying down a lucid and definite rule, prohibiting the omission of any material fact, it mixed up general prohibitions against the withholding of material contracts with the specific facts required.<sup>64</sup>

The prospectus and allotment provisions in the 1948 Companies Act of England was described as being confusing due to haphazard amendments in response to the dangers revealed by experience. The end result was that the prospectus became a complex document, lengthy and ineffective.<sup>65</sup>

Recommendation 60 of the Report called for a re-arrangement of the order of the sections concerning the offering of shares in fulfilment of the earlier stated principles of investor protection and public interest policy (which is

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<sup>64</sup> *Ibid.*

<sup>65</sup> Palmer Sir Frances Beaufort & Topham AF (1898-1905) *Palmer's Company Law* London: Stevens 153.

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akin to effective capital markets). Nevertheless, the approach of the Commission was on the whole conservative.<sup>66</sup>

#### 4.2. Nel Commission

In South Africa, amid spectacular corporate failures,<sup>67</sup> the Nel Commission<sup>68</sup> investigated securities regulation. Its recommendations were never implemented. Over a decade later our regulatory regime appears to be more confusing than in the time of the Nel Commission Report, and investors are still being defrauded or at risk of falling victim to fraud. Under the 2008 Act, it is expected this will be more of the case. It is surmised that an onslaught of securities litigation will come to the fore. It is important in terms of having an effective corporate law jurisprudence to at least be able to advise on liability insofar as offer regulation is concerned. The Nel Commission Report found that the systems under the 1973 Act designed to protect investors in South Africa failed during the late 1980s and early 1990s.<sup>69</sup> The Nel Commission Report called, *inter alia*, for a system of disclosure and merit review in the primary market as well as a more holistic and integrated approach towards securities regulation, in other words, a major shift away from the then regulatory dispensation.

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<sup>66</sup> LAWSA (1995) *supra*.

<sup>67</sup> Masterbond Group of Companies, the Owen-Wiggins Group of Companies, the Cape Investment Bank Group, the Supreme Group, Alpha Bank, the Equity Brokers Clearing AG (EBC) group of companies (as per the Nel Commission Report), CNA, Saambou Bank, and more recently the corporate crows nest of what constitutes the Sharemax property syndication scheme.

<sup>68</sup> Nel Commission Report *supra*.

<sup>69</sup> One of the failures was the Masterbond Group of Companies, which secured over a billion rand by promising safe investments. More than 90 percent of the capital was used for highly speculative short term projects, within the group of companies, which yielded little or no return. Little more than a Ponzi scheme, it collapsed leaving many investors destitute; many of them pensioners tempted by security and higher than normal interest rates.

It was perhaps the then political climate which was responsible for viewing an overhaul of company law unnecessary in the light of the budding democracy and the consideration of other matters. That, is, however only speculation.

#### 4.3. Dawn of the 2008 Act

Concerning the birth of the 2008 Act, see the comments of Delpont in “Companies Act 71 of 2008 and the “Turquand” Rule”<sup>70</sup> which alludes to the eclectic approach followed in borrowing extensively from foreign corporate law jurisdictions *sans* the careful grafting thereof into South African company and common law.

Some of the main objections against the 1973 Act were that it was outdated and cumbersome.<sup>71</sup> In 2003 the Department of Trade and Industry initiated a process to develop a clear, facilitating, predictable, and consistently enforced company law. *South African Company Law for the 21<sup>st</sup> Century – Guidelines for Corporate Law Reform* was published on 23 June 2004.<sup>72</sup> To fully comprehend the motivation, goals, and purposes of government in embarking on this venture, one is required to look at the Guidelines.<sup>73</sup> After formulating the blueprint in the Guidelines, the Department of Trade and Industry consulted widely over the course of

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<sup>70</sup> Delpont “Turquand Rule” 2011 *THRHR* 132.

<sup>71</sup> Stein & Everingham (2011) *Unlocked* 3.

<sup>72</sup> The Guidelines *supra* in Government Gazette 26493. See also Delpont (2009) *Manual* 1.

<sup>73</sup> The Guidelines is the only comprehensive government publication explaining the roadmap to the 2008 Companies Act in detail (Stein & Everingham (2011) *Unlocked* 3).

two years with various experts, amongst others, experts from other commonwealth countries.<sup>74</sup>

The vision of the Guidelines is summarised as providing for company law which promotes the competitiveness and development of the economy by encouraging entrepreneurship, promoting innovation and investment in domestic markets and companies through flexibility and an effective and predictable regulatory environment.<sup>75</sup> Also, it should promote efficiency, transparency and make company law compatible and harmonious with international law.<sup>76</sup>

The Guidelines mapped out five economic growth objectives with specific goals attached to each as identified by the Department of Trade and Industry, which were considered to be necessary to achieve a new company law regime as its mission.<sup>77</sup> These objectives were simplification, flexibility, efficiency, transparency,<sup>78</sup> and predictable regulation;<sup>79</sup> and, additionally harmonisation.<sup>80</sup> Each of these goals has been addressed in the Act to some extent and, it is submitted, heralds a

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<sup>74</sup> *Ibid* 4.

<sup>75</sup> Delpont (2009) *Manual* 1.

<sup>76</sup> *Ibid*.

<sup>77</sup> The desired company law regime is described as ideally bringing forth a dispensation which will be a “protective and fertile environment” for economic activity (Stein & Everingham (2011) *Unlocked* 5).

<sup>78</sup> *Ibid* 4. Regarding transparency, Government envisaged transparency and high standards of corporate governance by recognising director accountability and proper participation by other stakeholders, making public announcements, information and prospectuses subjected to the same standards regarding truth and honesty, requiring minimum standards of accounting standards for annual reports and protecting shareholder rights.

<sup>79</sup> *Ibid*. Regarding predictable regulation, company law should provide for a predictable and effective regulatory environment in South Africa, thereby promoting investment by, *inter alia*, de-criminalising company law sanctions, removing or reducing opportunities for regulatory arbitrage, enforcing company law through appropriate bodies and mechanisms and striking a balance between adequate disclosure in the interests of transparency and over-regulation.

<sup>80</sup> *Ibid*. Efficiency in management by abolishing capital maintenance and par value to a system of solvency and liquidity.

philosophical shift away from the historical development of the 1973 Act *contra* the *Grundnorm*. Furthermore, the 2008 Act samples concepts from various jurisdictions around the world, importing these into South Africa.<sup>81</sup> The 2008 Act, therefore, heralds a major shift in the philosophy which underscored the 1973 Act that *in lieu* of holistic evolvement by means of applying the principles and *Grundnorm*, the Legislature opted for grafting of foreign concepts without having due regard for the previous development of the existing body of law. The details of the philosophical differences will be alluded to in the following chapter.

As has been said, whereas the 1973 Act was founded on general principles of English company law, the 2008 Act has been drafted with reference to the principles, *inter alia*, of Canadian company law<sup>82</sup> with the result that jurisprudence from Canada will become more relevant and persuasive in the interpretation of the 2008 Act.<sup>83</sup> It is argued that the 2008 Act integrates most notably Canadian principles with South African common law and existing principles.<sup>84</sup>

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<sup>81</sup> DLA Cliffe Dekker Hofmeyr (2014) “Corporate and Commercial Alert” <http://www.cliffedekkerhofmeyr.com/en/news/publications/2014/corporate/corporate-and-commercial-alert-6-august.html> (accessed on 6 August 2014). See also DLA Cliffe Dekker Hofmeyr (2012) “Key Aspects of the New Companies Act” <http://www.cliffedekkerhofmeyr.com/export/sites/cdh/en/legal/sectors/downloads/Cliffe-Dekker-Hofmeyr-Key-Aspects-of-the-New-Companies-Act.pdf> (accessed on 1 February 2014).

<sup>82</sup> Together with principles from American and English company law.

<sup>83</sup> Fluxmans Attorneys (2010) “Point of Law” <http://www.fluxmans.com/news/display.asp?id=116&year=2010> (accessed on 1 February 2014).

<sup>84</sup> Paddock G (Prof) (2011) “Companies Act No 71 of 2008 is in Operation” Paddock’s Press Newsletter <http://www.paddocks.co.za/paddocks-press-newsletter/companies-act-no-71-of-2008-is-in-operation/> (accessed on 24 July 2012).



## 4.3.1. Purposes of the Act

The definition of a profit company in section 1 of the Act as a “company incorporated for the purposes of financial gain for its shareholders,” contradicts the Guidelines which stated a legislative framework was to be sought which reflects the company as a social as well as an economic institution and, accordingly, constraining the pursuit of economic objectives by social and environmental imperatives.<sup>85</sup> The primary duty of directors, therefore, will be to optimise profit for the shareholders, although the duty is tempered by the requirements which confers obligations on companies and confers rights to stakeholders.<sup>86</sup>

The macro-economic policy of Government is reflected in section 7 of the Act which also identifies the role which Government expects companies to play in the South African economy.<sup>87</sup> Section 7(b)(i) specifies that the policy of Government is that South Africa is a capitalist economy.<sup>88</sup>

Section 7(g) further specifies that the Act should create optimum conditions for the aggregation of capital for productive purposes, the investment of said capital, spreading economic risk: thereby encouraging a free enterprise<sup>89</sup> economy through the efficiency of commerce and business ventures.<sup>90</sup>

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<sup>85</sup> Stein & Everingham (2011) *Unlocked* 9.

<sup>86</sup> *Ibid.*

<sup>87</sup> *Ibid* 30.

<sup>88</sup> Or the more politically correct term: “Free enterprise economy,” which is essentially the same as a capitalist economy, i.e., the direct opposite of communism.

<sup>89</sup> Other acceptable synonyms include entrepreneurial, industrialist, industrial and commercial.

<sup>90</sup> Stein & Everingham (2011) *Unlocked* 30.

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Government's acceptance of, and support for the company as an essential component of the economy, and as a means of achieving social benefits and economic growth, is also reflected in section 7. The two purposes of the Act are to re-affirm the concept of the company as means of achieving economic and social benefit<sup>91</sup> and to promote the development of companies within all sectors of the economy.<sup>92</sup>

Furthermore, the integral role of companies in global and cross-border transactions is recognised by two further purposes of the Act, which are to promote innovation and investment in South African markets<sup>93</sup> and that the Act should provide for the creation and use of companies in a manner that enhances the economic welfare of South Africa as a partner within the global economy.<sup>94</sup>

Taking into account the power and influence exercised by multi-national, listed companies; Government acknowledged the importance of companies being good corporate citizens. The acceptance of the company as a vital component of local and foreign economies necessitates the requirement that laws should ensure that business is conducted in a good corporate citizen fashion.<sup>95</sup> Thereby, the following are listed as important for the purposes of investor protection:

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<sup>91</sup> Section 7(d).

<sup>92</sup> Section 7(f).

<sup>93</sup> Section 7(c).

<sup>94</sup> Section 7(e).

<sup>95</sup> Stein & Everingham (2011) *supra*.

- i) Section 7(a): promote compliance with the Bill of Rights as per the Constitution when applying company law.<sup>96</sup>
- ii) Section 7(b)(iii): promote the development of the economy by encouraging transparency and high standards of corporate governance.<sup>97</sup>

The remaining specific purpose of the Act, relating to essential company law regime and investor protection, is provided for in section 7(1) which states that the Act should provide a predictable and effective environment for the efficient regulation of companies.<sup>98</sup> Another purpose of the Act is to promote the development of the South African economy by encouraging transparency and high standards of corporate governance, given the role of business in social and economic life.<sup>99</sup>

In the wake of the 2008 Companies Act little has changed regarding securities regulation. The system formerly in operation as a result of the 1973 Companies Act has been retained in essence, with the exception that the secondary and primary markets are now regulated in the same chapter.<sup>100</sup> Ideally, the regulatory dispensation should have been assessed against international developments in securities regulation and these appropriately introduced into South African law. It appears however, from

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<sup>96</sup> Section 7(a) is to be read with section 8(2) of the Constitution which provides that the actions of private bodies must conform to the Bill of Rights as it may be applicable to them. As the Constitution supersedes other statute, no provision in the Act may be contrary to or in conflict with the Constitution.

<sup>97</sup> Stein & Everingham (2011) *supra*.

<sup>98</sup> *Ibid.*

<sup>99</sup> *Ibid* 10. Section 5(1) states that the Act must be interpreted and applied in a manner that gives effect to these purposes. Effect of this model is given through section 7(a), subsection 7(b)(iii) and (d).

<sup>100</sup> Delport (2009) *Manual* 24.

a cursory overview that the Legislature opted to recycle principles<sup>101</sup> and merge these with new concepts and structures, rather than address the objectives of securities regulation in determining and introducing effective principles through which the regulatory framework can exist.

### 5. *Capita Selecta* on developmental aspects

Chapter X of the Van Wyk de Vries Commission's Main Report discusses the prospectus and offers to the public.<sup>102</sup> The point is made that the regulatory regime under the 1926 Act is complicated owing to the order and arrangement of the numerous sections which makes offer regulation particularly confusing.<sup>103</sup> The Main Report concluded that the group of sections should be disentangled, regrouped, and rearranged in logical sequence in order to eliminate confusion.<sup>104</sup>

For the sake of clarity, the Commission firstly sought to define the difference between the concepts of subscribe as primary market transaction and sale or purchase as secondary market transaction.<sup>105</sup> The

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<sup>101</sup> The Van Wyk de Vries Commission recommended that due to the confusion between the provisions that applied to the primary and the secondary markets in the Companies Act 46 of 1926, that the provisions be in different chapters of the 1973 Act. See also Delpont "Offers" 2011 *THRHR supra* in this respect.

<sup>102</sup> Van Wyk de Vries Commission Main Report 164.

<sup>103</sup> *Ibid* paragraph 37.01. The Van Wyk de Vries Commission Main Report states that the provisions relating to offer regulation serve as best example of a point made earlier in the Report namely, that further amendment without making the entirety unintelligible, will be a difficult task. The general attitude of submissions to the Commission has been one of despair regarding the inability to come to grips with the principles concerned, calling for lucidly stated principles on the whole.

<sup>104</sup> *Ibid* paragraph 37.02. See also paragraph 10.01. After analytically examining the 1926 Act, it was found that the statute, in its then form, disclosed an absence of logical and orderly arrangement and presented a picture of considerable complexity and in many cases uncertainty. The main reason for the confusion and complexity arose from the haphazard way in which numerous amendments were grafted upon an outdated framework (See also Van Wyk de Vries Commission Main Report paragraph 10.02).

<sup>105</sup> *Ibid* paragraph 38.01. The differences in the principles / policies correspond with the discussion above. When a company offers shares for subscription it means that the public is invited to take up shares in the company, shares which have not yet been issued and will be issued for the first time to the person who takes them up. The procedure of subscribing for the shares embodies the offer to take up (usually on the application form supplied by the company), the acceptance of the offer by the company

amendment of section 80*bis* of the 1926 Act saw the section as amended placed at the end of the Chapter dealing with shares.<sup>106</sup> The exclusion of the section from the Chapter which governed offers to the public and prospectuses was due to the confusion which had arisen in regard to the interpretation of the governed transaction *viz* the section.<sup>107</sup> The overall goal was clarity in terms of ensuring an effective regulatory regime.

The Van Wyk de Vries Commission's terms of reference included consideration regarding major amendments required in company law, *inter alia* the protection afforded to investors and the public interest, and to report on the matters set out in its terms of reference and to submit a Draft Bill to give effect to the recommendations.<sup>108</sup> The working method of the Commission consisted of the gathering of evidence and information, consideration of matters of principle, including new principles, and arriving at conclusions or findings in regard thereto; and arising from the decisions and findings, the drafting of a Draft Bill.<sup>109</sup> The Commission was appointed on 14 October 1963.<sup>110</sup> The Main Report is

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(i.e., the allotment) followed by the issue of the share certificates. When an offer for the sale of shares is made, it concerns shares which have already been issued by the company or which the company has agreed to allot to the offeror. In other words, the person making the offer is already the owner or holder of the shares offered or has acquired a right to become the owner or holder of the shares offered. The offer for subscription is invariably an invitation to take up shares as per section 80*bis* of the 1926 Act and said section expressly included an invitation. Section 80*ter* which deals with the offer for sale (secondary market) did not state whether it included an invitation.

<sup>106</sup> The then section 141 of the Draft Bill (Volume II of the Van Wyk de Vries Commission Report 101).

<sup>107</sup> Volume II comment in connection with section 76 *et seq.* See also page 101 of Volume 11. This was also the case in the 1929 English Act (repealed) where the provision was separated from the prospectus sections and also the position in the Australian Acts (Volume II 102).

<sup>108</sup> Van Wyk de Vries Commission Main Report paragraphs 2.01 ((1)(b) and (2)).

<sup>109</sup> *Ibid* paragraph 4.01.

<sup>110</sup> Gazetted on 25 October 1963 (Van Wyk de Vries Commission Main Report paragraph 1.01). After considering and processing material previously presented to the Minister or Registrar, general and specific invitations were issued and, as from April 1964, the Commission heard oral evidence and representations. After same, the Commission embarked on a programme of research and study abroad, conducting *inter alia* some 90 conferences in the United States, Canada, the United Kingdom and in Europe. The principles were identified and were considered in working papers. After this phase, the

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dated 15 April 1970. The Report consists of three parts. The first part (the Main Report) deals with principles, new concepts and major amendments. The second part (Supplementary Report) deals with consequential and lesser amendments in tabular form. The third part consists of the Draft Bill.<sup>111</sup>

The gist of this short synopsis of the Van Wyk de Vries Commission's Report is to juxtapose it to the development and birth of the 2008 Act. The Report stays relevant due to the principles relating to offer regulation not changing.<sup>112</sup> The system in operation currently has been retained in essence from the previous system which was based on the recommendations of the Commission's Report, *sans* for the regulation of both markets which are now in one chapter.<sup>113</sup> It is further submitted that the transactional relativity of the delineating definitions in the 1973 Act applicable to offer regulation were not retained in the 2008 Act with the result that the 2008 Act in respect of offer regulation, fails to provide for transactional relativity in terms of the common law and harmonising offer regulation with the principles applicable to transactions of this nature. The Commission's Report is a voluminous and well researched and scientifically deduced, empirical testimony of the principles of company law together with the legislative impact thereof. It is submitted that the Commission's Report is still applicable today, as reference guide, due to

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principles decided on were translated into provisions of the Draft Bill (Main Report 4.02-06). For statistics on the Commission's work see also paragraph 5.01.

<sup>111</sup> Van Wyk de Vries Commission Main Report paragraph 7.03.

<sup>112</sup> Chapter 4 of the 2008 Act contains the equivalent of section 141 of the 1973 Act as well as the principles contained in Chapter VI of the 1973 Act (Delpont "Offers" 2011 *THRHR* 282).

<sup>113</sup> Delpont (2011) *Manual* 43. See also Cassim *et al* (2000) *Contemporary Company Law* 649.

the nature of the Commission's Report and contribution thereof in terms of jurisprudence.

Due to the fact that the 1926 Act was not consolidated, it featured an extremely unwieldy structure.<sup>114</sup> The Commission embarked on a task of restructuring the entire company law regime and making recommendations for its reform.<sup>115</sup> The danger of importing foreign concepts is patently stated in the Main Report:

While we are able to benefit from many of the findings of the Jenkins Committee (1962) and from the ensuing legislation, the English Companies Act 1967, they should be approached with some caution. The past decades have witnessed the emergence of differences between company activities and their underling concepts in the respective countries. The time has passed that South Africa can simply rewrite into its own legislation what it finds in the corresponding English legislation.<sup>116</sup>

The general approach of the Commission, which also took into account the role played by English precedent, was not to recommend major amendment or new additions unless there were compelling reasons to do so. Apart from the formal restructuring of the company law legislation,

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<sup>114</sup> LAWSA (1995) paragraph 5.

<sup>115</sup> *Ibid.*

<sup>116</sup> Van Wyk de Vries Commission Main Report paragraph 9-04.

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the Companies Act of 1973 marked a divergence English and South African company law.<sup>117</sup>

### 5.1. Company law reform and offer regulation

Juxtaposed to the Van Wyk de Vries Commission's Report, very little background to the development and contingent background of the 2008 Act are available. There have already been allusions to the development and birth of the 2008 Act.<sup>118</sup> Suffice to state for purposes of this section of the discussion that many of the so called innovations of the 2008 Act have not been fully and clearly developed and it still contains formulation errors.<sup>119</sup>

The difficulty of further reform is troubled by lack of contextual information as the Act was preceded by a short and abstract document explaining broad goals of the reform process.<sup>120</sup> There is a stark difference between the Guidelines<sup>121</sup> and the Van Wyk de Vries Commission Report, the latter, which up until today, serves as a handy reference work. It is simply not possible to equate the reform process behind the 2008 Act with that of the Van Wyk de Vries Commission's scholarly approach.<sup>122</sup>

The level of distinction achieved in 11 years simply cannot fit into a time span from 2003 to 2008. The Guidelines and the process behind the 2008 Act stands as an ill example of how to conduct a company law review

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<sup>117</sup> Cilliers *et al* (2000) *Corporate Law* 24.

<sup>118</sup> See chapter 2 *supra*.

<sup>119</sup> Sutherland "Company Law" 2012 *Stellenbosch Law Review* 158. Sutherland states that it will be the company law lawyers who will not only have the onerous task of interpreting and applying the 2008 Act, but it will also be them who will have to rid it of its flaws.

<sup>120</sup> *Ibid.*

<sup>121</sup> Guidelines *supra*.

<sup>122</sup> The basic groundwork for the 1973 Act was done by the Van Wyk de Vries Commission. Its report is a public document that often served as background to the 1973 Act.



process. The broad sweeping goals in the Guidelines were taken directly to the legislative drafting process without considering the principles behind a review process and company law in South Africa.<sup>123</sup>

The Memorandum on the Objects of the Companies Bill of 2008 is also vague, cursory, and outdated. In filling the void of the current reform process which was not publicly documented, the textbook *Modern Company Law for a Competitive South African Economy*<sup>124</sup> purports to operate as a source of reference.<sup>125</sup> A source of reference written by those responsible for the reform process and which as a result thereof lacks critical engagement and objectivity.<sup>126</sup>

## 5.2. Developmental flaws

Sutherland questions the presence of several United States based consultants, which explains the American influences in the 2008 Act (apart from substantive influences in Chapter 4). The valid point is made as to whether it is appropriate for South Africa to be led by the United States, making it difficult to develop and give content to our English-oriented company common law (and it is submitted, Roman-Dutch transactional common law).<sup>127</sup>

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<sup>123</sup> Mongalo (2010) *Modern Company Law* xvi. These guidelines formed the basis of drafting instructions (not publicly seen) prepared for the chief drafter of the 2008 Companies Act.

<sup>124</sup> *Ibid.*

<sup>125</sup> Sutherland “Company Law” 2012 *Stellenbosch Law Review* 158. See also preface to Mongalo (2010) *Modern Company Law*.

<sup>126</sup> *Ibid.* It is suggested that it be read with other objective sources.

<sup>127</sup> *Ibid* 160.

The initial round table of the local and international reference teams did not consider offer regulation.<sup>128</sup> It is submitted that it might be due to the separation in the United States of company law and security regulation which include both primary and secondary market transactions in the 1933 Securities Act. It is also submitted that it is due to this, that in essence, the regulatory principles in place with the 1973 Act were incorporated, save for the inclusion of secondary market regulation and the insertion of further transactional definitions in an attempt to comply with the Guidelines.

Sutherland opines that many of the goals of the reform process, as set out in the Guidelines, were not achieved or only partially achieved in the Act,<sup>129</sup> which in earnest reflects no truer than in Chapter 4. Following the initial round table, the Guidelines for Corporate Law Reform were drafted<sup>130</sup> from which the five objectives of company law reform emerged.<sup>131</sup>

The development of and consultation on the guidelines for corporate reform, preceded in order, the engagement of the chief drafter and the drafting process.<sup>132</sup> The Guidelines gave rise to the Draft Bill, a method of working which sidestepped a review of the then current company law and scope. The method kicked for touch by the release

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<sup>128</sup> Mongalo (2010) *Modern Company Law* vii, lists the following areas as considered: a) corporate formation; b) corporate finance; c) corporate governance; d) takeovers and business rescue; e) not-for-profit companies; and f) administration and enforcement. Compared to the Van Wyk de Vries Commission; offer regulation warranted a chapter of its own (Chapter X).

<sup>129</sup> Sutherland "Company Law" 2012 *Stellenbosch Law Review* 160.

<sup>130</sup> Mongalo (2010) *Modern Company Law* xix.

<sup>131</sup> *Ibid* xxi. These objectives were reflected at page 11 of the Guidelines and are also now reflected in section 7 of the Act dealing with the purposes of the legislation.

<sup>132</sup> *Ibid* xiv, number 4 and 5 of the reform process.

of the exposure draft for internal consultation and focus group consultations rather than playing the field in expounding on an analysis of the current law against principles.<sup>133</sup> It is submitted that only after such an analysis, the drafting of principle based law against the guidelines should have occurred. A first draft Bill was drafted based on the Guidelines and then used to iron out interpretational problems rather than drafting a Bill based on sound principles, against the Guidelines after a conducive review process. The only logical deduction to be made is that change had to occur, as long as it was different from the existing.

In a discussion of the conception of the process which eventually led to the 2008 Companies Act, it is telling that the DTI formulated the inception of the process to be the formulation of the guidelines (policy framework) which would guide the company law reform process.<sup>134</sup> Instead of guiding the company law reform process, the Guidelines guided the drafting of the Bill. In other words, reform by drafting, *in lieu* of reform by review and subsequent drafting. As a point in reference to this, participants to the 11 July 2002 round table were challenged to consider the purpose of the round table and to identify on a clean piece of paper, the fundamental principles of the desired company law for South Africa.<sup>135</sup>

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<sup>133</sup> *Ibid* as per number 6 of the reform process.

<sup>134</sup> *Ibid*. See also the Guidelines *supra*.

<sup>135</sup> Mongalo (2010) *Modern Company Law* xiv-xv. Local and International Roundtable on Company Law Reform hosted by the Department of Trade and Industry in Johannesburg on 11 and 12 July 2003. See also the Record of the Proceedings on 11 July 2003 at page 7: the round table process, the DTI's purported mechanism of a comprehensive overhaul (instead of a proper review followed by a reform)

Offer regulation was not part of the six priority areas identified for consideration.<sup>136</sup> The primary function of the working groups which considered the priority areas was to recommend broad principles for the drafting of the relevant provisions within the specified areas of consideration.<sup>137</sup>

No record exists of a secondary refining process of the broad principles. It is submitted that the broad principles were applied to the Guidelines and drafting process as were envisaged and at the time considering offer regulation, broad principles (for example clarity) were transposed in the grafting of foreign concepts into South African company law, without due consideration.

The chapter aimed at offering insight into public offerings of company securities in Mongalo is unfortunately a reproduction of an article which discusses an overview of Chapter 4 and the changes brought about in terms thereof in a cursory manner, basically serving as a guideline to the definitions and sections of Chapter 4.<sup>138</sup>

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was indicated in the words of the then Deputy Director-General, Astrid Ludin, made at the round table where the majority of participants constituted foreign jurists.

<sup>136</sup> For the six priority areas see Mongalo (2010) *Modern Company Law* xvi. See also Mongalo (2010) *Modern Company Law* xvii. Members of the international reference team were appointed on the basis of their expertise in one or more of the following areas: i) corporate formation; ii) corporate finance; iii) corporate governance; iv) takeovers and business rescue; v) not-for-profit companies; and vi) administration and enforcement. Although it can be argued that offer regulation forms part of item vi) the Guidelines does not lend itself to a proper consultation or consideration of offer regulation. Again, offer regulation in international jurisdictions does not strictly form part of company law anymore, hence the probable oversight of the experts.

<sup>137</sup> Mongalo (2010) *Modern Company Law* xvi.

<sup>138</sup> This article is reproduced with changes at chapter 14 of Cassim *et al* (2002) *Contemporary Company Law* and was published in *Acta Juridica* 2010. Ironically the chapter describes the new dispensation as providing legal clarity and certainty through the insertion of a variation of definitions and distinctions between the primary and secondary markets and related transactions.

It is submitted that as an afterthought and without due consideration of the impact of the proposed changes, offer regulation was arranged in Chapter 4, not in accordance with the principles of regulation, but as a reflection and in terms of the objectives of the Guidelines. Instead of a holistic approach, the provisions were haphazardly revised on a piecemeal basis as will be shown below and were not reformed.

Mongalo, as the authority on the reform process, concludes that the rules on public offers have been simplified and that the layout has been improved as per Yeats.<sup>139</sup> The difficulties regarding the new layout are disregarded, the problem being that some have been copied from the 1973 Act without amending terminology to accord better with the 2008 Act.

To this extent, Sutherland expresses that the term, subscription, is extensively used although the 2008 Act no longer distinguishes between subscriptions and issues of shares.<sup>140</sup> Furthermore, and as will be shown, all consequences of the changes have not been covered. An error has occurred in the devising of the Guidelines. The designers acknowledged that in devising the Guidelines, South Africa's company law reform had to be limited to core company law issues (juxtaposed to the inclusion of security issues to wit offer regulation as is the case in South African company law). Furthermore, reform as per the designers of the Guidelines should only entail broad

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<sup>139</sup> Mongalo (2010) *Modern Company Law* 129, as per Sutherland "Company Law" 2012 *Stellenbosch Law Review* 168.

<sup>140</sup> Sutherland "Company Law" 2012 *Stellenbosch Law Review* 168. See also section 38 of the 2008 Act.

based company law, i.e., that division which concerns itself with the internal affairs of the company, juxtaposed to regulatory law which concerns the imposition of broader checks and balances on companies.<sup>141</sup>

A reading of Mongalo's *Overview*<sup>142</sup> reveals the emphasis placed on the reliance of international expertise in the focus groups and on the chief drafter rather than a study of applied and evolved principles of company law and the development from that of appropriate guidelines. Even after the consideration of public comments and the revision of the Bill,<sup>143</sup> the DTI instructed the drafting team to reconsider and revise the Bill in a manner that would continue to give effect to the policies directing the project in accommodation of the concerns raised in so far as practicable,<sup>144</sup> same denoting the explicit purposes of flexibility and simplicity.<sup>145</sup> As a matter of policy, the Guidelines called for changes that would have effect of:

Encouraging entrepreneurship and enterprise diversity by simplifying the formation of companies and reducing costs associated with the formation of forming a company and

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<sup>141</sup> Mongalo (2010) *Modern Company Law* xix and xx discussing the development of and consultation on the Guidelines for corporate law reform. This is reflected on page 16 of the Guidelines *supra*.

<sup>142</sup> Introduction to Mongalo (2010) *Modern Company Law* xiii: Mongalo TH *An overview of company law reform in South Africa: From the Guidelines to the Companies Act 2008*. The title alone denotes a direct approach without intervening study or review of existing principles, rather opting for reform based on broad guidelines.

<sup>143</sup> *Ibid* xxiv. Public comments questioned and challenged many of the legal instruments and provisions that had been proposed to give effect to those policies and principles as drafted.

<sup>144</sup> *Ibid* xxiv. This is in itself a problem, addressing a problem which had at its genesis the guidelines and policies, is to be addressed within the scope thereof, but only, in accordance with the DTI, in so far as practicable within the original guidelines.

<sup>145</sup> *Ibid* 3, P Knight, *Keep it simple and set it free: The new ethos of corporate formation*.

maintaining its existence, thereby contributing to the creation of employment opportunities.<sup>146</sup>

To realise said policy, the reform guidelines proposed several principles, suggesting that company law should be:

...simple, comprehensive and accessible...<sup>147</sup>...contain a minimum of mandatory rules...ensure transparency, disclosure, the protection of legitimate interests and prevention of fraud and improper and oppressive conduct...be facilitate and enabling and flexible...<sup>148</sup>

The acquisition of capital did not feature, save for the broad policies outlined directly above. Ironically, the new dispensation is advanced as enabling protecting the vulnerable more than controlling the powerful, regulating from reason rather than arbitrary preferences and providing a firm foundation for certainty.<sup>149</sup> Unfortunately no context is given for said advancements, or for what arbitrary preferences in context are.

## 6. Concluding remarks

One of the differentiating and distinctive advantages of the company as vehicle for carrying on business, is the flexibility granted to it by modern company law in raising share capital.<sup>150</sup> In an undertaking's endeavour to obtain capital for expansion, operations or a new venture by offering of

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<sup>146</sup> *Ibid* 4. See also Guidelines 10.

<sup>147</sup> Guidelines 28.

<sup>148</sup> *Ibid* 29.

<sup>149</sup> Mongalo (2010) *Modern Company Law* 5.

<sup>150</sup> Davis *et al* (2009) *Business Structures* 67.

securities to the public, it follows from the history of the company and securities regulation that there is a potential for abuse.<sup>151</sup>

As a result of such potential abuse (and abuses) company law has evolved into securities regulation in an attempt to protect the public by requiring open, honest, and full disclosure of the affairs of a company to potential investors.<sup>152</sup> In practice, the offer to the public must be accompanied by a prospectus, the content of which is prescribed by law and to which certain disclosure requirements are to be adhered.<sup>153</sup> Not only to disclose, but also what must be disclosed, in order to adhere to the requirements.

Regulation in general occurs when government believes that a company, if left to own devices, will behave in a way that is contrary to the objectives of government and of the incorporation of the company.<sup>154</sup> Historically, corporate laws have evolved in an attempt to address abuse of the limited liability entity and to counter fraud.<sup>155</sup> Regulation is opted for in all countries relative to no regulation.<sup>156</sup>

The *Grundnorm* of securities regulation, which crystallised through the developmental stages of the company and, later, securities regulation as a separate branch, intrinsically, is associated with anti-fraud provisions in order to ensure investor protection and efficient capital markets. The

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<sup>151</sup> *Ibid* 179.

<sup>152</sup> *Ibid*.

<sup>153</sup> *Ibid*.

<sup>154</sup> Jamison MA & Berg SV (2008) *Annotated Reading List for a Body of Knowledge on Infrastructure Regulation*, Developed for the World Bank by the Public Utility Research Centre, University of Florida [http://researchictafrica.net/PGCICTPR/PGCICTPR/Module\\_5\\_files/Chapter%20IV.%20Regulating%20Overall%20Price%20Level.pdf](http://researchictafrica.net/PGCICTPR/PGCICTPR/Module_5_files/Chapter%20IV.%20Regulating%20Overall%20Price%20Level.pdf) (accessed on 21 March 2014).

<sup>155</sup> See the contextual history of the company as per LAWSA (1995) as well as in Cilliers *et al* (2000) *Corporate Law*.

<sup>156</sup> Jamison & Berg (2008) *Annotated Reading List 2*.



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principles behind the objectives will be expounded on in the following chapter, along with an analysis of the underlying philosophical framework, especially when the principles of offer regulation are analysed against the benchmarks of the *Grundnorm*.

As Winston Churchill noted in his “Beginning of the End” speech:<sup>157</sup> “...that it is not even the beginning of the end of that process but that it is no more than the end of the beginning.” The same is true for securities regulation development. It is deduced that for as long as commerce fuels capitalism the need for investor protection through securities regulation will only become stronger. With regard to multi-national companies, not only is it the investor that must be protected but also the capital markets and economy which simply cannot afford large scale corporate failures due to mismanagement or fraud.

Disclosure as a regulatory mechanism remains at the forefront of investor protection and securities regulation. It is important to review the principles of disclosure, as manifested in the development of securities regulation, in order to successfully evaluate the aspects of disclosure in South African securities regulation.

The initial version of the statute which would become the 2008 Act was so problematic it required substantial amendment prior to coming into force.<sup>158</sup> Many of the innovations in the Act have not been fully and

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<sup>157</sup> 1942, The Lord Mayor’s Luncheon, Mansion House, 10-11-1942.

<sup>158</sup> Companies Amendment Act 3 of 2011.

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clearly developed and contain several formulation errors.<sup>159</sup> The difficulty of reform is apparent from the absence of contextual information. The Act was preceded by short and abstract Guidelines, while the Memorandum on the Companies Bill of 2008 is regarded as being vague.<sup>160</sup>

Questions have been asked about the appropriateness of the American and Canadian influences contributing to the Act. Specifically, whether it is appropriate for South Africa to take its lead from foreign jurisdictions when not only diverse political and economic cultures are to be considered but also the difficulty of developing and merging English-oriented company common law in light of the American and Canadian principles.<sup>161</sup>

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<sup>159</sup> Sutherland “Company Law” 2012 *Stellenbosch Law Review* 1.

<sup>160</sup> *Ibid.* In contrast, the groundwork for the 1973 Act was done by the Van Wyk De Vries Commission, the report which served as background to the 1973 Act.

<sup>161</sup> *Ibid.* 160. It would seem that the complexities of a major company law reform project were underestimated. The Guidelines set June 2006 as the target date for the commencement of the new Act. The date was missed by almost five years. The end result speaks of a mad rush to meet deadlines. Corners are cut in mad rushes.

## CHAPTER 4

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### PRINCIPLES OF REGULATION

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1. Introduction
2. Regulation as intercession
3. Philosophical framework
4. Regulatory design
  - 4.1. Primary regulatory principles
    - 4.1.1. Investor protection
    - 4.1.2. Efficient capital markets
  - 4.2. Secondary regulatory principles
    - 4.2.1. Enabling principles
    - 4.2.2. Deterring principles
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      - 4.2.3.1. Equality principle
      - 4.2.3.2. Reduction of risk principle
5. Naturalistic tendencies
6. Company law reform process: policy shift
  - 6.1. Causal Principles
  - 6.2. Principles relating to securities regulation
7. Positivist nature of new regime
8. Cardinal errors
9. Concluding remarks

## 1. Introduction

Legal rights and obligations rest on underlying principles.<sup>1</sup> Principles give rise to legislation.<sup>2</sup> Developing from the *Grundnorm* of fraud prevention and coupled with the evolution of company and securities law, certain principles are manifested. The existence of these principles is categorised into primary and secondary regulatory principles: derived from the *Grundnorm* and developed to address insufficiency of the *Grundnorm* in addressing the shortcomings associated with it. It follows, therefore, that the subsequent development of regulatory principles seeks to achieve a level of efficacy. The extent, i.e., the sufficiency of legal rights and obligations can only be determined if the principles underlying them are identified and applied consistently.<sup>3</sup> The law does not consist of timeless rules in a conceptual warehouse awaiting discovery by a judge.<sup>4</sup> Law is found in principles which change and evolve consistently.<sup>5</sup> Due to the nature of business, which is ever evolving, as well as crime, which is as old as the law itself, securities regulation is not only constantly evolving, it also is cardinally important, based on the existence of securities regulation, that it constantly evolve in line with the underlying principles thereto.

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<sup>1</sup> Dworkin R (2003) “The Model of Rules” in Patterson DM (ed) *Philosophy of Law and Legal Theory: An Anthology* Malden MA: Blackwell Pub 46 (hereinafter referred to as Patterson (2003) *Philosophy* (Dworkin)).

<sup>2</sup> For example; it can be said that any legislation which regulates the offer of securities to the public, setting forth obligations of disclosure as well as the extent of disclosure on the company and coupled with the right of an investor to receive, in the first instance, information pertaining to the decision that must be made, as well as the right that said information should adhere to specific benchmarks, rests on underlying same principles.

<sup>3</sup> Patterson (2003) *Philosophy* (Dworkin).

<sup>4</sup> *Ibid* 47.

<sup>5</sup> *Ibid*.

As yet, South Africa has to properly analyse and implement an in depth review of securities regulation.<sup>6</sup> For purposes of this chapter, it suffices to state that The Gower Report into investor protection proposed regulations for the financial services industry in the United Kingdom, lead to the establishment of the Securities and Investments Board, the forerunner to the Financial Services Authority.<sup>7</sup> In rationalising regulation, Professor Gower purported, in his 1984 report, a legal-bureaucratic rationality.<sup>8</sup> There is no issue with the regulatory power of government. What is under discussion are the principles which should underlie regulation.<sup>9</sup> These will be expounded upon together with the underlying philosophical framework.

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<sup>6</sup> The recommendations of the Nel Commission Report was never considered or implemented. Nor was it at least adapted towards the manifestation of a more efficient regulatory regime.

<sup>7</sup> Throughout the greater part of the 20th century the United Kingdom financial services industry was largely self-regulated in its nature. A number of factors forced the government to reconsider the way financial services were regulated. These included a number of highly publicised scandals to hit the financial services sector in the 1970s and 1980s. The main regulatory legislation was the Prevention of Fraud (Investments) Act 1958 which was introduced in an attempt to provide a degree of consumer protection, but in itself did not go far enough as the scope was narrow and was frequently open to interpretation. Gower produced his report and the Government adopted a number of his proposals in a white paper (Jan 1985). The Financial Services Act 1986 (FSA Act) followed the white paper, receiving Royal assent in November 1986.

(Financial Services and Markets Bill, 121 of 1998-99 *Research Paper 99/68, 24 June 1999* <http://www.parliament.uk/business/publications/research/briefing-papers/RP99-68/financial-services-and-markets-bill-bill-121-199899> (accessed on 12 July 2012)).

<sup>8</sup> Regulation for the sake of regulation is as effective as inefficient regulation. Administrative rationality for legal legitimacy underpins securities regulation through the legal-bureaucratic rationality of society. In usurping the legitimacy of regulatory powers, legal authority is a modern form of power legitimisation.

<sup>9</sup> In answering the question as to what a regulatory system should look like, it might be worth asking the question in the negative. How should a regulatory system not look like? It has been held that regulation should not be complicated, uncertain and irrational. (As per the objective towards a legal regime which can be understood [logic and tidiness] which is a legal positivistic objective.) Furthermore, it should not be unfair (towards those it affects, the company, stakeholders and public as per the Gower Report) and inflexible, exercise excessive control in some areas and too little in others, lax in enforcement of its rules contribute to delays in it reaching its objectives.

## 2. Regulation as intercession

Regulation is opted for in all countries, relative to no regulation.<sup>10</sup> Historically, company law has evolved in an attempt to address abuse and counter fraud.<sup>11</sup> When government believes that a company, if left to its own devices, will behave in a fashion detrimental to the objectives of government and of the objectives of the company, regulation into the affairs of the company will occur.<sup>12</sup> This is done by virtue of the powers of government as well as its obligation to ensure a just society based on the rule of law.

Modern society subscribes to a rationalising tendency: requiring a rationalisation for government intervention.<sup>13</sup> By rationalisation the sociologist Max Weber understood, first, the individual cost-benefit calculation, second, the wider, bureaucratic organisation of the organisations and, finally, understanding reality in a more general sense.<sup>14</sup>

Following Weber's social theory, legal authority is the most modern form of legitimising power in controlling an advanced industrial society.<sup>15</sup>

Power, and thus control over subjects, is legitimised by legal authority

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<sup>10</sup> Jamison & Berg (2008) *Annotated Reading List supra*.

<sup>11</sup> Contextual history as per chapter 3 *supra*. Through abuse of the company vehicle, the crime of fraud was occasioned.

<sup>12</sup> Jamison & Berg (2008) *Annotated Reading List supra*.

<sup>13</sup> Malpas J (Winter 2012 ed) "Donald Davidson" *The Stanford Encyclopedia of Philosophy* Edward N Zalta (ed) <http://plato.stanford.edu/cite.html> (accessed on 12 February 2013). Features of rationalisation include increasing knowledge, growing impersonality and enhanced control of social and material life.

<sup>14</sup> As the opposite of understanding the reality through mystery and magic (Allan K (2005) *Explorations in Classical Sociological Theory: Seeing the Social World* Thousand Oaks: Pine Forge Press 151).

<sup>15</sup> Juxtaposed to the other two forms of authority posited: traditional and charismatic. Traditional, relying on conservatism of a taken for granted authority and charismatic, operating as mechanism where the charisma of a leader class ensures the seat of power rationalisation (Pimlott "Examination" 1985 *Journal of Comparative Business and Capital Market Law supra*).

mainly because the need thereof is rationalised as being required. The bureaucratisation of advanced societies in its operation develops the legal-bureaucratic rationality required for the effective functioning of modern society.<sup>16</sup>

Legal authority legitimises power by reference to a particular rationality. Gower, in diagnosing what is lacking or inadequate and its prescription for reform of the regulatory system which lacked efficiency,<sup>17</sup> aimed to recommend a regulatory system ensuring maximum administrative tidiness and uniformity of regulations,<sup>18</sup> thus setting up an effective regulatory regime.<sup>19</sup>

There is a specific requirement of efficiency with regard to securities regulation, with a positive obligation on government to put into place a regulatory regime to act as intercessory as to the ill it seeks to cure. An ointment aimed at relieving a cramp will have little to no effect on a burn, and *vice versa*. Similarly, is the obligation on government for its legitimised power to legislate, and to legislate to the effect that such power is utilised effectively. As to the question of efficiency, it is requisite

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<sup>16</sup> Weber's social theory.

<sup>17</sup> Pimlott "Examination" 1985 *Journal of Comparative Business and Capital Market Law* 7.

<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid.* The positive answer towards an efficient regime incorporates regulatory clarity and tidiness. As a result, it will be generally observed and effectively enforced (as per the Gower Report). Regulation should be reduced to a minimum and only necessary to adequately achieve its objectives as not to over regulate. An ideal regulatory regime will achieve its objectives without being disproportionate in trouble and expense or detrimental to stakeholder interest (Gower Report 6). In the United Kingdom, Gower advised against a regulatory regime which overlaps with the Banking Act as being not ideal (Gower Report 14). The regulatory regime should deal with investments and the Banking Act with banking. Compliance to both should not be requisite unless the company undertook both investment business and banking (Gower Report 15). The Banking Act playing a useful part in the protection of investors as well as depositors although never intended to do so, as its methods and provisions as administered by the Bank of England are not adapted for that purpose.)

to consider the philosophical framework underlying regulation in order to gauge efficiency.<sup>20</sup>

### 3. Philosophical framework

The principles underlying offer regulation and securities law should not be seen in isolation from each other or the *Grundnorm* and it is submitted that the principles are dependent upon each other. If the argument is that the *Grundnorm* is to comply with a single requirement, that requirement is that of efficiency. Inefficiency results or should result in developments and evolution of the law, aimed at achieving a state of efficacy in regulation.

When a foundation is not sufficient at keeping the cold out, walls are erected, a roof is added and the remaining holes are filled with doors and windows. Although the cold will be outside, the inside will have achieved a level of efficiency at keeping the cold at bay, far better than a solid foundation alone or any one of the other details to a house without being part of the greater structure.

Securities regulation aimed at efficiency should address the following two objectives<sup>21</sup> which flow directly from the *Grundnorm* of securities regulation:<sup>22</sup>

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<sup>20</sup> Positive theories of regulation examine the reasoning behind the occurrence of regulation and in general conclude that regulation is essential due to government being interested in overcoming information asymmetries, as well as aligning the outcomes of the company with that of the government, and lastly the need for protection of all involved in the markets. Normative theories conclude regulation improves economic efficiency and regulatory processes under the law which is independent, transparent, predictable, legitimate and credible. Jamison & Berg (2008) *Annotated Reading List* 6.

<sup>21</sup> Davies (1997) *Gower and Davies' Principles* 853.



- (a) investor protection;
- (b) capital market efficiency.

Both these objectives serve as primary regulatory principles based on the evolution from the *Grundnorm* which align the primary objectives towards a duality in function.

The two primary regulatory principles in regulatory philosophy further enhance efficiency through the manifestation of secondary regulatory principles.

The secondary regulatory principles are classified as:

- i) enabling principles;
- ii) deterring principles; and
- iii) continuous disclosure principles, in amplification of i) and ii).

#### **4. Regulatory design**

The primary regulatory principles flow from the *Grundnorm* and indicate disclosure as regulatory mechanism. Due to the nature of the primary principles, disclosure regulation will always be dominant, whereas merit disclosure will be secondary.<sup>23</sup> Disclosure, in itself, is not sufficient as a standalone efficient regulatory requirement. For that reason in a disclosure regulatory system elements of merit disclosure remain. To satisfy efficacy

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<sup>22</sup> Where the prevention of fraud was the *Grundnorm*, the evolution of regulatory principles brought to the fore investor protection and capital market efficiency.

<sup>23</sup> Government is unable to make an investing choice for the investor. The investor should make this choice alone. Government through legislation can only achieve regulation of the manner in which this choice is elicited and then to provide for a mechanism of enforcement and accountability in excess of that available through the application of the common law.

requirements, secondary regulatory principles of enablement, deterrence and continuous disclosure import elements of merit disclosure.

#### 4.1. Primary regulatory principles

##### 4.1.1. Investor protection

Investor protection principles aim through offer regulation, to facilitate a mechanism regulating who must disclose, as well as how, when, and the extent of disclosure once a transaction falls within regulatory purview.<sup>24</sup>

This objective is aimed at empowering the reasonable investor with reliable information to facilitate the making of an appropriate choice of investment.<sup>25</sup> This enablement is occasioned by disclosing to the prospective investor what he ought to know before buying a security, so as to avoid an investor flying blindly or being swindled into investing in a sham, or worthless securities, or securities at a higher price with doubtful returns, if any, due to inflated prospects.<sup>26</sup>

Disclosure in the context of investor protection envisages rational investment decision-making based on the premise that the market is rational and that market value fluctuates around enterprise value as a norm.<sup>27</sup> However, the value of a company or new endeavour is subjective

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<sup>24</sup> Delpont “Offers” 2011 *THRHR supra*. Disclosure as regulatory mechanism of capital markets, should facilitate investors making better informed decisions, improve confidence in markets, protect investors from price manipulation, and from corporate mismanagement. The philosophy of disclosure is derived from historical development in addressing inadequacies in investor protection and corporate failure. All of this is achieved by means of classifying the underlying philosophy.

<sup>25</sup> Ratner & Hazen (2010) *Securities Regulation: Selected Statutes supra*.

<sup>26</sup> *Ibid.*

<sup>27</sup> Kripke “The Myth of the Informed Layman” 1973 *Business Lawyer (ABA) supra*.

and is also required by the rational investor. The problem is that enterprise value is not a thing or fact: it is a judgment call.<sup>28</sup>

The approach to disclosure has always been to disclose the financial underpinnings of securities, in providing investors with sufficient information to be able to make informed investment decisions, therefore self-regulating the allocation of capital.<sup>29</sup> However, not only is disclosure of information prescribed by way of mandatory disclosure requirements, but so also is all information which investors and their advisors would reasonably require and expect for the purposes of making an informed assessment of the offer prior to making a judgment call.<sup>30</sup> Although the latter is part of mandatory disclosure requirements, its application is removed from an objective analysis of information to a subjective one. Therefore, it is submitted that the requirement is part of a broader merit requirement, juxtaposed to mandatory disclosure requirements.<sup>31</sup>

The ultimate goal is to enable the making of an informed assessment of the offer, thereby calling for a comparison of the assets and liabilities, financial position, profits and losses, and prospects of the company and the rights attaching to the securities.<sup>32</sup> Disclosure should disclose what is important to enable said judgment by providing value estimates, earnings projections, probable and potential minerals: not exclusively what is in the

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<sup>28</sup> *Ibid.*

<sup>29</sup> *Ibid.*

<sup>30</sup> *Ibid.*

<sup>31</sup> In analysing these two requirements in ascertaining their inherent requirements, one merely has to look at what is required in terms of disclosure to investors under each.

<sup>32</sup> *Ibid.*

past, and not limited to what the Legislature thinks the generic investor can handle, but also his advisor and the professional investor.<sup>33</sup>

In terms of accounting disclosure, Kripke calls for more detail, in order to provide more information, so that the analyst and informed investor make their own decisions as to what is significant.<sup>34</sup> A case is made for specific disclosure of extraordinary items such as, recurring income and expenses, as well as complete disclosure of elements going into accounting data.<sup>35</sup> Disclosure should thus be aimed towards the future and not limited to the past and what the Legislature thinks, the generic investor can handle. All possibilities, all probabilities, not only certainties, bearing on an estimate as an estimate, are what really show the value of a security.<sup>36</sup>

#### 4.1.2. Efficient capital markets

This principle flows directly from investor protection. Perfect or competitive markets (sociably desirable), depend on participants who possess full and correct information relevant to decision making.<sup>37</sup> The regulation of capital markets is aimed at allocative efficiency which promotes the direction of funds by investors on the basis of an accurate understanding of the risk and reward profile of a project which the issuance of the shares will finance.<sup>38</sup>

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<sup>33</sup> Kripke “The Myth of the Informed Layman” 1973 *Business Lawyer (ABA) supra*.

<sup>34</sup> *Ibid.*

<sup>35</sup> *Ibid.*

<sup>36</sup> *Ibid.*

<sup>37</sup> Clark RC (1986) *Corporate Law* Boston: Little Brown 1, 159, 705 and 719 (hereinafter referred to as Clark (1986) *Corporate Law*).

<sup>38</sup> Davies (1997) *Gower and Davies’ Principles supra*.

Disclosure in regulatory philosophy remains dominant as a mechanism in achieving efficient capital markets; which hinge on the decision that the investor alone must make. It is a judgment call about the future prospects, relating to the price of securities, calling for a full view of the industry and the qualities of the company and management.<sup>39</sup> Ideal regulation should provide information about present and recent activities and terms of the securities on offer; together with judicious forward-looking information which will guide the investment decision.<sup>40</sup> Uniformity is ensured in disclosure through expanded mandatory rules subjected to a review as to whether there is compliance with what is prescribed in terms of legislation.<sup>41</sup>

Under economic theories of regulation, fall market failure and public choice as motivators for regulation.<sup>42</sup> Market failure provides an economic rationale for regulation in an attempt to improve economic efficiency by correcting and prohibiting market failures.<sup>43</sup>

Capital market objectives and investor protection objectives run parallel to each other as they interlinked. Protection through disclosure is essential for market efficiency.<sup>44</sup>

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<sup>39</sup> *Ibid.*

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*

<sup>42</sup> Phillips SM & Zecher JR (1981) *The SEC and the Public Interest* Cambridge, Mass: MIT Press (hereinafter referred to as Philips & Zecher (1981) *The SEC and the Public.*)

<sup>43</sup> *Ibid.*

<sup>44</sup> Davies (1997) *Gower and Davies' Principles supra.*

## 4.2. Secondary regulatory principles

The secondary regulatory principles demonstrate disclosure as a regulatory mechanism in order to achieve the primary regulatory principles, as well as, contribute towards the encompassing yardstick of securities regulation, i.e., being effective in its curbing effect.<sup>45</sup>

## 4.2.1. Enabling principles

To enable investor protection and market efficiency as well as to safeguard against corporate collapse, the enabling principle concerns the nature of the information disclosed. It is now trite that disclosure is the predominant regulatory philosophy because of the decision that the investor must take.<sup>46</sup> A regulatory agency is unable to make this decision for an investor who must be the sole judge of the future in relation to the asking price for the securities.<sup>47</sup> This evaluation is done by means of a review of the industry, the quality of management, and the company, through the prospectus.<sup>48</sup> Enabling principles call for material facts to be disclosed of the company and securities.<sup>49</sup> This includes information necessary to understand the financial condition and changes as well as results<sup>50</sup> in order to judge the extent of risk undertaken.<sup>51</sup>

The objective of enabling principles is to disclose fully and not to limit disclosure to the general public or professional and sophisticated investor,

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<sup>45</sup> In other words, prevent fraud, the circle of the argument being complete.

<sup>46</sup> Davies (1997) *Gower and Davies' Principles supra*.

<sup>47</sup> *Ibid.*

<sup>48</sup> *Ibid.*

<sup>49</sup> Yalden *et al* (2008) *Business Organizations supra*.

<sup>50</sup> Ratner (1978) *Securities Regulation supra*.

<sup>51</sup> Pimlott "Examination" 1985 *Journal of Comparative Business and Capital Market Law* 7.

i.e., what is thought might be required to be disclosed.<sup>52</sup> Ideally it should not put emphasis on the risk features of the offer and disclaimers as this emphasis fails to enable the ultimate decision of the investor.<sup>53</sup> Rather, a statement of speculative aspects of the security offering is required.<sup>54</sup> Over-cautious disclosure is not real disclosure as it is intended, as the risk analysis is diluted in the warning. Enabling disclosure should portray a reasonable forecast of the possibilities of the company. If it only warns and no information pertaining to the future is provided, information will be sought elsewhere.<sup>55</sup> Also, in order to fully engage the investor, the company should properly disclose and assess the comparative contribution of insiders.<sup>56</sup> Enabling disclosure should not be a mere dollar accounting comparison, as that fails to provide a good investment analysis.<sup>57</sup> Enabling disclosure should contain value estimates for sceptical consideration<sup>58</sup> and information on management projections as to the registrant's future, i.e., projections as to future earnings.<sup>59</sup> Value information and projections are to be disciplined by examination regulations.<sup>60</sup> In the context of jurisdictions where no merit review is conducted, it is submitted that the information at least should be reviewed against merit disclosure principles; firstly, as to whether it is disclosed and, secondly, whether sufficient information is available. The prospectus should be the primary source of information to investors and their advisors as, according to

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<sup>52</sup> Kripke "The Myth of the Informed Layman" 1973 *Business Lawyer (ABA) supra*.

<sup>53</sup> *Ibid.*

<sup>54</sup> *Ibid.*

<sup>55</sup> *Ibid.*

<sup>56</sup> *Ibid.* Value of ideas and processes, know-how, value of effective organisation.

<sup>57</sup> *Ibid.*

<sup>58</sup> *Ibid.*

<sup>59</sup> *Ibid.*

<sup>60</sup> *Ibid.*

Kripke, the unsophisticated investors either does not exist anymore or information is made available through advisors.<sup>61</sup> A rational judgment should be enabled on the content of the prospectus for first time companies,<sup>62</sup> whereas, in the case of established companies, the prospectus will not be the primary source but the annual report to stockholders. Improved information in the annual report will enable true and full disclosure of the state of affairs of the company.<sup>63</sup>

#### 4.2.2. Detering principles

Detering principles deliver disclosure as a safeguard against dishonesty in deterrence of fraud and corporate collapse.<sup>64</sup> As per enabling principles, detering principles aim to deter fraudulent offers in calling for full disclosure or face the risk of suspicion and negative inferences as well as at the risk of liability for failure to comply with offer regulatory law.

Detering principles prohibit fraud through a merit review or eligibility requirements prior to an offer being capable of offered to the public, and enforcement if contravened. The merit review calls for a pre-vetting of any document containing an invitation or for the offer to comply with certain criteria, prior to offer regulatory legislation applying to the transaction.

Lastly, for this principle to be actively engaged in practice, enforcement should be practical and imply not only criminal liability but also civil

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<sup>61</sup> Kripke “The Myth of the Informed Layman” 1973 *Business Lawyer (ABA) supra*.

<sup>62</sup> *Ibid.*

<sup>63</sup> *Ibid.*

<sup>64</sup> Philips & Zecher (1981) *The SEC and the Public supra*. See also Ratner (1978) *Securities Regulation supra*; Ratner & Hazen (2010) *Securities Regulation: Selected Statutes surpa*; Clark (1986) *Corporate Law* 749-759.



liability. In order for effective deterrence standards of offer regulation to exist in this regard, it is essential that the qualifying criteria apply in respect of relevant transactions and that the offer regulatory laws are capable of interpretation against sufficient benchmarks for purposes of interpreting liability.

#### 4.2.3. Continuous disclosure principles

Companies should disclose on continuing basis price-sensitive information which concerns the company or its business.<sup>65</sup> The reason behind continuous disclosure is to provide all investors in the marketplace with equal access to information and thus equal access to the opportunities that information provides, as well as to reduce risk.<sup>66</sup>

Once a company may legally offer and trade in a market the objectives of mandatory disclosure do not cease to be relevant.<sup>67</sup> Continuous disclosure principles are based on the aforementioned disclosure philosophy, objectives, and principles. In essence, continuous regulatory principles hover between disclosure for the benefit of shareholders and disclosure for the benefit of investors.<sup>68</sup> The latter is advanced as the dominant objective, however the former notably is a source of benefit as well.<sup>69</sup>

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<sup>65</sup> Davies (1997) *Gower and Davies' Principles* 933.

<sup>66</sup> Yalden *et al* (2008) *Business Organizations* 456.

<sup>67</sup> Davies (1997) *Gower and Davies' Principles* 901.

<sup>68</sup> *Ibid* 903 and the quote of the European Commission's High Level Group of Company Law Experts: "Information and disclosure is an area where company law and securities regulation come together. It is a key objective of securities regulation in general to ensure that market participants have sufficient information in order to participate in the market on an informed basis. Where the relevant security is a share in a company, the information required from a securities regulation point of view overlaps with the information to be provided from a company law perspective." (The divide applicable between securities and company law in jurisdictions where separate Acts provide for these functions in both primary and secondary markets).

<sup>69</sup> *Ibid*.

Continuous disclosure obligations are divided into periodic obligations and episodic reporting obligations.<sup>70</sup> Underlying these obligations are two tertiary principles, emanating from the secondary regulatory principle of continuous disclosure: the principle of equality and the principle of risk reduction.

#### 4.2.3.1. Equality principle

The first tertiary regulatory principle, the equality principle, involves equality and concerns periodic disclosure, for example of, financial statements, management discussion and analysis and annual information forms and flows from periodic reporting obligations. Therefore it follows that this principle is motivating<sup>71</sup> periodic disclosure requirements in terms of the preparation of annual financial statements.<sup>72</sup>

The equality principle of continuous disclosure concerns the fair trade of securities on the secondary market and is relevant where an assessment is to be done of when an issuer is to update the available information to the secondary market about its securities.<sup>73</sup> Said assessment will be motivated by the obligation to disclose, in order to provide all investors in

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<sup>70</sup> *Ibid* 904-6.

<sup>71</sup> Yalden *et al* (2008) *Business Organizations* 460.

<sup>72</sup> Section 30(1).

<sup>73</sup> Yalden *et al* (2008) *Business Organizations* 456. Continuous disclosure as principle has been an important feature in Canadian securities law for over 25 years. It has also been enhanced in various ways, more recently in respect of disclosure of the corporate governance practices of reporting issuers (see NI 58-101, *Disclosure of Corporate Governance Practices*). As principle, this type of disclosure has been introduced into Canadian law, following the recommendations of the Kimber Report Part 1, paragraphs. 1.11, 1.12, 1.16 and Parts II, IV and VI.

marketplace with equal access to information and thus equal access to the opportunities that information provides.<sup>74</sup>

It is submitted that the equality principle motivates the reduction of risk principle and exists in tandem towards effective disclosure, with the proviso that the equality principle involves periodic disclosure.<sup>75</sup> This principle entails the requirement on reporting issuers to provide annual and quarterly financial statements of various kinds to investors and the regulator.<sup>76</sup> Whereas annual financial statements must be audited, interim statements need not be, although the latter must be disclosed.<sup>77</sup>

#### 4.2.3.2. Reduction of risk principle

In amplification of the listed principles and underlying disclosure objectives, the reduction of risk principle in continuous disclosure is self-evident. This principle aims to advance equality as well as reduce the risk profile of trading by mandating disclosure in the event of a material change occurring.<sup>78</sup> Two main arguments are advanced for episodic (or *ad hoc*) disclosure requirements. Primarily episodic disclosure provides information to shareholders and investors of business developments or factors which affect an entity's business, where investment or governance decisions are to be taken on the basis of the information.<sup>79</sup> Information

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<sup>74</sup> Merger Report 15. See also Yalden *et al* (2008) *Business Organizations* 456.

<sup>75</sup> Similar to disclosure of in terms of section 30(1) in South Africa.

<sup>76</sup> For example, in Canada, periodic disclosure forms part of securities law, under the distribution of securities with liability to be incurred in the event of securities litigation (Yalden *et al* (2008) *Business Organizations* 456-7).

<sup>77</sup> *Ibid* 456.

<sup>78</sup> Juxtaposed to periodic disclosure of annual financial statements etc., timely disclosure of material changes to affairs of the company are to be issued "forthwith," as per Yalden *et al* (2008) *Business Organizations* 460.

<sup>79</sup> Davies (1997) *Gower and Davies' Principles* 906.

disclosed on this basis is to be done where relevant in terms of the requirements of the shareholders and investors.<sup>80</sup> Secondary to the relevant information requirement is the prohibition of benefit to a partial contingent who may deal on the strength of non-published information.

Reduction of risk as second principle involves timely disclosure of material changes as and when they occur, thereby underlying the obligation of episodic reporting. This principle concerns the imposed responsibility on issuers, once capital has been raised, to continually disclose timely material changes in their affairs.<sup>81</sup>

A differentiation in terms is necessary to discern between a material fact and material change.<sup>82</sup> The definition of a material fact is broader than that of material change.<sup>83</sup> A material fact<sup>84</sup> denotes a fact that significantly affects, or could reasonably be expected to significantly affect the market price or value of the securities or a decision to implement a change.<sup>85</sup> For the purposes of continuous disclosure, a material change<sup>86</sup> would be a change in the business, its operations or capital of the issuer that would reasonably be expected to have a significant effect on the market price or value of any securities of the issuer.<sup>87</sup>

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<sup>80</sup> *Ibid.*

<sup>81</sup> Yalden *et al* (2008) *Business Organizations* 388 and 460.

<sup>82</sup> Both a material fact and a material change are defined in section 1 of the British Columbia Securities Act. See also section 1 of the Ontario Securities Act.

<sup>83</sup> *Pezim v British Columbia (Superintendent of Brokers)* [1994] 2 S.C.R. 557.

<sup>84</sup> A prospectus must disclose all material facts relating to the issuer and offer (*Pezim v British Columbia ibid.*)

<sup>85</sup> A material fact would be required for disclosure in a prospectus in terms of the above enabling and deterring principles (Yalden *et al* (2008) *Business Organizations* 460).

<sup>86</sup> In the event of a material change only, will the prospectus have to be changed (*Pezim v British Columbia supra.*)

<sup>87</sup> Yalden *et al* (2008) *Business Organizations* 460.

The aim of continuous disclosure requirements, specifically the reduction of risk principles, is to protect the investing public through full, true, and plain disclosure regarding material changes. Regarding the definition of a material change, in Canada it is currently based on a market impact test, and in the United States on a reasonable investor test. There is critique with regards to the inconsistency between the definitions of material fact and material change in determining the scope of disclosure. A possible move by Canadian securities regulation towards a consolidated market information test which would combine elements from the definitions of both material fact and material change, is being considered.<sup>88</sup>

#### 5. Naturalistic tendencies

The principles of securities regulation posit definite natural law tendencies. *Lex humana* comprises inherent rights, conferred not by act but by divinity, reason, or nature. Although conflated by Tomas Aquinas, there are subtle distinctions between *lex humana* and *lex posita*.<sup>89</sup> The latter, will be shown to reflect on the Guidelines and current regulatory regime.

Natural law regards law from the position of its origin, juxtaposed to positive law which regards it from its position of legitimacy. Based on the evolution of securities regulation, natural law moral theory comes to the fore. From the outset the moral standards which govern human behaviour are objectively derived from the nature of human beings and the nature of

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<sup>88</sup> *Ibid* 464.

<sup>89</sup> Himma KE “Legal Positivism” *The Internet Encyclopedia of Philosophy* <http://www.iep.utm.edu/legalpos/> (accessed on 12 February 2013). It is easy to conflate the law with another interpretation of the law for that what is sought to be defined is the same thing.

the world.<sup>90</sup> As Louis Loss notes, every human being may make a fool of himself, yet nobody has the right to make a fool of another human being.

Natural law is often conflated with the common law and the rights inherent in the values protected by securities laws, are that aligned with the *Grundnorm* and subsequent principles.

The need not to be defrauded is in direct conflict with the manifest tendency of human nature to deceive to the detriment of another. To this extent natural legal theories greatly influenced the development of English common law<sup>91</sup> which encapsulates justice,<sup>92</sup> being the source from which all rights arise.<sup>93</sup> As such, it will follow that justice serves as a primary indicator of efficacy, i.e., will justice be served by a principle or not.

This achievement is accomplished by means of the law. Fortescue's definition of law understands the same to be a sacred sanction commanding what is virtuous and forbidding the contrary. In this theory the objective is to dispose the public to virtue.<sup>94</sup> Sir Edward Coke defined law as the perfect reason which commands those things that are proper and necessary, and which prohibits contrary things. For Coke, human

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<sup>90</sup> As per natural law legal theory, the authority of legal standards is derived from considerations having to do with the moral merit of those standards (Himma KE "Natural Law" *The Internet Encyclopedia of Philosophy* <http://www.iep.utm.edu/natlaw/> (accessed on 12 February 2013).

<sup>91</sup> Blackstone W *et al* (1829) *Commentaries on the Laws of England: In Four Books with an Analysis of the Work 18<sup>th</sup> ed* London: S Sweet.

<sup>92</sup> *Ibid.* Justice being the will to give to each his or her right.

<sup>93</sup> Bracton H De (1968) *On the Laws and Customs of England* Cambridge: Published in Association with the Selden Society [by] the Belknap Press of Harvard Univ Press.

<sup>94</sup> Sir John Fortescue.

nature determined the purpose of law and that law is superior to any man's will or reason.<sup>95</sup>

Securities regulation as evolved, followed the *Grundnorm* and developed in response to become more efficient in development towards a just society.

## 6. Company law reform process: policy shift

The 1926 Companies Act modelled on the Transvaal Companies Act, which followed the English 1908 Act, shows the keenness of the Legislature to follow English legislative developments.<sup>96</sup> It was not a case of slavishly copying but rather an adaptation of principles from the source in the further evolution of company law.<sup>97</sup>

The Guidelines discusses the history of company law and the need for reform at chapter 2 thereof. The Guidelines aims, *inter alia*, to make a case for reform.<sup>98</sup> What is telling is that the Guidelines couples the need for reform directly with the history of company law, in particular, the colonial roots of our earlier company law dispensation, rather than with efficacy.

It is submitted, that the overhaul of South African company law was due owing to the age of the 1973 Act, although a full review, prior, to only an overhaul, was due. It will be shown that the unique South African history

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<sup>95</sup> Coke understood the law of nature to be that which God at the time of creation of the nature of man, infused into his heart, for his preservation and direction.

<sup>96</sup> *LAWSA* (1995) paragraph 5.

<sup>97</sup> As is the adaptation of legal principles from the Romans and Dutch widespread and acceptable practice.

<sup>98</sup> Guidelines paragraph 1.1.

as motivator served as platform to rush the company law overhaul as occurred, giving rise to the 2008 Act, without due consideration for established company law principles in South Africa.

The Guidelines expounded on the South African framework, which was founded on principles put in place by the British. In the foreword by the then Minister of Trade and Industry,<sup>99</sup> specific reference is made to Victorian England during which colonialism was advanced. It is disagreed that the previous framework was founded on principles put in place by the British. Rather, through the evolution of British company law, principles, as outlined above, crystallised, setting a platform for adaptation for, amongst others, recognised securities regulation principles insofar as the regulation of offers is concerned.

Based on an overview of the principles in the Guidelines, it will seem that, insofar as securities regulation is concerned, an over reliance was placed on the implementation of corporate governance principles and transparency in respect of accounting practices.<sup>100</sup>

It is common cause that the 2008 Act marks a new era in South African company law, which will change the existing law as well as common

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<sup>99</sup> Mandisi Mpahlwa MP.

<sup>100</sup> See paragraph 1.2 setting out the objectives of the new company law: “...ensure a regulatory framework ...good governance...” Also: “Regulation should be consistent, effective, predictable, transparent, fair and understandable.”

Company law as per the policies in the Guidelines *supra* should promote the competitiveness and development of the South African economy by, *inter alia*, encouraging transparency and high standards of corporate governance. See also chapter 3, paragraphs 3.4 to 3.4 of the Guidelines which deals with accountability and transparency. See also chapter 4 of the Guidelines, paragraph 4.4 on Corporate Governance which deals *inter alia* with shareholder and investor protection and disclosure and reporting.



law.<sup>101</sup> The Act is the product of borrowed legislation from other jurisdictions, and it may result in uncertainty insofar as it affects the common law as well as universal principles of securities regulation. To ignore the development of an Act, like the 1926 and 1973 Acts as well as the common law through the importation of new concepts and structures for the sake of change is dangerous.<sup>102</sup> To this extent, insofar as the regulation of offers of securities to the public is concerned as per Chapter 4 of the 2008 Act, the shift in principles and the possible effect on our legal system sets off several alarm bells.

The basic principle that put regulation into effect is that if there is an offer for shares and the offer is to the public, then disclosure is required.<sup>103</sup> The important difference between the primary and secondary markets must be heeded. Due to the confusion between the provisions that applied to the primary and secondary markets in the 1926 Act, the Van Wyk de Vries Commission recommended that the provisions be in different chapters in the 1973 Act.<sup>104</sup> The 2008 Act resurrected the problems and confusion occasioned by the difference between the primary market and secondary market and differences in the need and extent of disclosure. The question as to a probable cause for this haphazard revision will be expounded on *infra*.

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<sup>101</sup> Delport “Turquand Rule” 2011 *THRHR* 132.

<sup>102</sup> Delport “Offers” 2011 *THRHR* 280.

<sup>103</sup> Cilliers *et al* (2000) *Corporate Law* 257.

<sup>104</sup> Delport “Offers” 2011 *THRHR* 282. Section 141 of the 1973 Act was placed in Chapter V while the primary market regulation as per section 142 was placed in the new Chapter V1. See also Van Wyk de Vries Commission Supplementary Report. The confusion was due to the same words used in different contexts. The meaning of the word “public” in the primary market sense and in the secondary market differ due to the need for and extent of disclosure which differ.

The general principles for company law reform which, it is submitted, include securities law as per the South African context, are set out in chapter 3 of the Guidelines.

These principles sought to provide for a simple, comprehensive and accessible legal framework, accountability and transparency, and harmonisation with other company laws. Against these principles, each aspect of company law in South Africa was directed towards being what today the 2008 Companies Act is. The principles also underscore the major philosophical shift encountered in the process of overhauling company law in South Africa by not pre-empting same with a review. The principles as per the Guidelines (as applicable to offer regulation) will have been extracted and condensed to causal principles to securities regulation and principles directly related to securities regulation.

#### 6.1. Causal Principles

The foreword to the Guidelines refers to a massive programme of reform during the preceding ten years of the South African democracy, specifically in the economic and legislative frameworks.<sup>105</sup> Company law review was prioritised in South Africa for these reasons. The motivation forwarded for this priority is the fundamental change post 1994, through the introduction of a new constitutional framework. Underlying this framework is the change of political climate and the manifestation of secondary changes in the social and economic environment.

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<sup>105</sup> Legislative reform mainly refers to the Constitution and the Bill of Rights.

The question begs to be asked: Was the reform process purely change driven with regards to efficiency or politically motivated towards the dark black hole of governance in action, budgets, vision and mission statements and conducting an overhaul for its own sake, for Government to appear effective?

The identified causal principles are those of aligning company legislation with the constitutional dispensation in order to facilitate the political climate as well as the social and economic environment. It is submitted that these causal principles serve little purpose with regards to a review juxtaposed to the overhaul of company law that took place. Also, little benefit is derived insofar as securities regulation is concerned when reviewing the causal principles with the objectives of chapter 4.

#### 6.2. Principles relating to securities regulation

The Guidelines is heralded as necessary to provide guidelines and policy direction on core areas of company law reform. The 1973 Companies Act is acknowledged as being too old, namely 30 years, out of line with modern practices and deficient in critical areas, notably shareholder protection and corporate governance, amongst others.<sup>106</sup> To this extent, shareholder and investor protection as part of securities law and/or securities regulation is discussed merely three times in the Guidelines. In the introduction to general principles of new company law in the Guidelines, it is noted that the detailed provisions of the new dispensation

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<sup>106</sup> Guidelines paragraph 3.1.

will follow from an extensive review and assessment of existing provisions, international best practice and developments.

Chapter 4 of the Guidelines details the guidelines implemented in the overhaul of the company law regime. Under the heading; Corporate Governance, the topic of shareholder and investor protection is discussed as part of the guidelines to reform company law.

As part of securities law, corporate finance is the area of company law which deals with equity and debt financing, share capital, debentures, and restrictions on offerings of shares for sale. The Guidelines acknowledges the financing of companies as a core area of company law, impacting significantly on shareholders and investors. This part of company law is noted as providing investors and shareholders with adequate protection, while maximising the opportunities for companies to attract capital.

It is telling that paragraph 4 differentiates between company law and securities law. In the differentiation, a divide is drawn between the financing of companies as part of company law whilst securities law:

*“...in the form of the Security Services Bill, should regulate the trade in shares and other instruments.”*

It would seem that the Guidelines and drafters of the Companies Bill relied on an artificial distinction. The divide between the primary and secondary markets is not heeded in this section of the Guidelines. The first step of regulation starts at the primary market with the financing of the company and reliance on the Security Services Bill alone is not sufficient.

Prospectus requirements are briefly dealt with under paragraph 4.3.1, “Shares and share issuance.” The Guidelines sought to secure maximum disclosure to the investing public and adequate vetting for prospectuses without going into any further detail towards said objectives. It does not follow: describing the objective as to attain maximum flexibility in the creation of financial instruments while ignoring the core principles of securities regulation.

The last mention of securities regulation for the context of this study, in the Guidelines, is at paragraph 4.4 under the heading “Corporate Governance.” In what is submitted is an over reliance on corporate governance, is the emphasis it is given with regard to the protection of investors. Paragraph 4.4.1 discusses this issue under the heading of “Shareholder and Investor Protection.” A primary goal of company law is posited as being to ensure that shareholders, as investors of equity, are granted explicit rights and that they have effective recourse, if need be. It is assured that the clear statement of such rights and recourse provide protection. The Guidelines places a premium then on the education of shareholders about rights and that the statement of rights is easily accessible in law. This appears to mark a shift in philosophy as the established principles of security regulation aim to address the *Grundnorm*, whereas the Guidelines seeks to ensure that effective recourse to shareholder rights is the pre-eminent course of action. Prevention is sidestepped, *in lieu* of a cure.<sup>107</sup>

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<sup>107</sup> The remainder of the paragraph lists investor rights. On a sideline, in paragraph 4.4.3 of the Guidelines, under the heading “Disclosure and Reporting,” investor protection by way of prospectus is

The new principles thus include the general principles of the company law overhaul envisaged by the Guidelines;<sup>108</sup> these incorporates by reference, transparency *in lieu* of accounting measures. Furthermore, it includes principles of corporate governance *in lieu* of investor protection. The nomenclature on the division of the markets is ignored and in favour of a divide between financing the company as part of company law and the trade of securities to be regulated by the Securities Services Act. Offer regulation, is ignored in respect of a cure for the *carte blanche* of creating financial instruments.<sup>109</sup> With offer regulation, maximum disclosure as well as prospectus vetting, the philosophy shifts from the company previously being able to decide on its own as to the conduct of its business, to the Legislature attempting to prescribe how it should disclose. This may be very well; however the shift is towards merit regulation, whereby disclosure regulation will have to satisfy not only objective requirements but also subjective eligibility requirements, which have as a regulatory regime, their own requirements towards efficacy. All in all, the Guidelines and contemporary developments which lead to the 2008 Act shows towards a positivist nature.

#### 7. Positivist nature of new regime

It is obvious that *ius positum* generally describes man-made laws, which bestow privileges on, or remove them from a group. *Ius positum* consists

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mentioned only in the final paragraph which recommends consideration to be given to subject public announcements and information given to the press by officials of companies to the same rules that govern the truth and assurance of information furnished in a prospectus.

<sup>108</sup> See paragraph 6 above for the general principles.

<sup>109</sup> Kripke “The Myth of the Informed Layman” 1973 *Business Lawyer* (ABA) *supra*.

of statutory law applied at a set time, provided it is binding.<sup>110</sup> Positive law is also described as law actually and specifically enacted or adopted by proper authority for the government of a juristic society.<sup>111</sup> Positive law is socially constructed in contrast with natural law, and also has none of the moral constraints of natural law based upon the premises of reason, human rights, or divine commandment.<sup>112</sup> Based on the company law overhaul process as well as the identified principles, it follows that the current dispensation is that of a positive law system and must be evaluated as such.

## 8. Cardinal errors

A guideline is a standard setting out the goals to be reached in relation to an economic, political, or social structure.<sup>113</sup> In the present instance the overhaul of South African company law was set out in the Guidelines. A principle denotes a standard to be observed, not because it will advance or secure an economic, political, or social situation, but because of justice or fairness or a moral basis.<sup>114</sup> The positivist nature of the Guidelines and overhaul process is in direct conflict with the naturalistic nature of the principles of offer regulatory law. The difference between a guideline and a principle is therefore in essence the difference between the naturalistic established principles of securities regulation and the positivist policies

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<sup>110</sup> Kelsen H (2009) *General Theory of Law and State* Clark New Jersey: The Law Book Exchange Ltd 393.

<sup>111</sup> Positive Law definition in Garner BA (ed in chief) (2014) *Black's Law Dictionary 10<sup>th</sup> ed* St Paul Minnesota: Thomson Reuters..

<sup>112</sup> Legal Positivism: Internet Encyclopedia of Philosophy [www.iep.utm.edu/legalpos/](http://www.iep.utm.edu/legalpos/) (accessed on 12 February 2013).

<sup>113</sup> Patterson (2003) *Philosophy* (Dworkin) 51.

<sup>114</sup> *Ibid.* The definition of justice or fairness refers to the constant and unfailing will to give to each his or her right (De Bracken, Henry, 1986, Of the Laws and Customs of England as referred to in Internet Encyclopedia of Philosophy [www.iep.utm.edu/legalpos/](http://www.iep.utm.edu/legalpos/) (IEP) *supra*).

and imported principles of the current regulatory dispensation. It follows that a policy does not constitute a principle. A policy however, should construe the formulation of a principle. The goal of the policy should be a worthy one, which under the utilitarian thesis denotes policies which underlie principles of justice which, in turn, are disguised statements of goals.<sup>115</sup> It will appear, therefore, that the principles in the Guidelines are flawed as they did not start out as principles of justice, but rather principles of creating change for the sake of legislative and socio-economic and political change. The Guidelines contains political and socio-economic policies and these are advanced as objectives to leverage change. Although change was due, the review process was not a review process at all: it was an overhaul through the adoption of foreign principles and the doing away with and ignoring of established principles.

Apart from the erroneous shift in philosophy the current dispensation does not heed the established principles of regulation, relying on the Guidelines to set the tone for a system based on the general principles of corporate governance, transparency, shareholder protection and a regulatory dispensation in Chapter 4. This fails to appreciate the nuanced similarities and differences between shares and securities in the South African context insofar as regulation is concerned. Coupled to this is a failure to appreciate the division of the primary market and secondary market and the role occasioned by said division in the regulation of securities.

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<sup>115</sup> Patterson (2003) *Philosophy* (Dworkin) 52.



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**9. Concluding remarks**

In analysing principles versus legal rules, a logical distinction is drawn. At its simplest deconstruction, a set of standards based on principles, points towards a legal obligation.<sup>116</sup> In other words, principles show towards, and ultimately should give rise to rules. Principles have attached to them a dimension of weight or importance which rules do not have.<sup>117</sup> A rule can be changed whereas the impetus which created the rule has at its genesis, standards set through principles, in the sphere of offer regulation, the regulatory principles are based on standards based on the prevention of fraud and ultimately the need to effectively regulate offers in the financial markets through rules. Investor protection and efficient capital markets gave rise to the *Grundnorm* and ultimately legislation in order to address the *Grundnorm*. Intersecting principles are weighed against each other: rules are not. It is functionally impossible for rules to intersect or weigh more than another, for then they will be in conflict with each other, and one or the other will be invalid. Legal principles are separate standards different from rules. Principles are cited as justification for a new rule to be adopted or applied.<sup>118</sup> With the principles of regulation, legislation sprung forth and should be interpreted as such. With regards to the policy principles utilised in the development of the 2008 Act, the policy principles fall short of what a principle should be (an instrument towards creating efficacy or justice) and become merely a factor for establishing change for the sake of change. Furthermore, there is a direct conflict

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<sup>116</sup> *Ibid.*

<sup>117</sup> *Ibid* 54.

<sup>118</sup> *Ibid* 55.

between the *Grundnorm* and principles of securities regulation versus the policy principles. The policy principles denote a positivist approach, juxtaposed to the naturalistic nature of the *Grundnorm*.

In *Morality of Law*, Lon L. Fuller levies one of the primary criticisms against positivism, in relation to the internal morality of law.<sup>119</sup> Fuller argues that law is subject to an internal morality consisting of eight principles. These principles are: rules must be expressed in general terms, rules must be publicly promulgated, rules must be for the most part prospective in effect; rules must be expressed in understandable terms, rules must be consistent with each other, rules must not require conduct beyond the powers of the affected parties, rules must not be changed so frequently that the subject cannot rely on them and finally, the rules must be administered in a manner consistent with their wording.<sup>120</sup>

No system of rules that fails minimally to satisfy these principles, according to Fuller, is able to achieve the essential purpose of law, which is achieving social order through the use of rules that guide behaviour. Accordingly the principles are internal to law in the sense that they are built into the existence of the setting of law through rules. A total failure in any one of these eight directions does not simply result in a bad system of law: it results in something not properly called a legal system at all.<sup>121</sup>

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<sup>119</sup> See fn 112 *supra*.

<sup>120</sup> Fuller, Lon L The Morality of Law as per IEP *supra*.

<sup>121</sup> Fuller, Lon L Morality 39. See also IEP *ibid*. These internal principles constitute a morality according to Fuller. This is due to law having a positive moral value in two respects: firstly, law conduces to a state of social order and, secondly, it does so by respecting human autonomy because rules guide behaviour. Since no system of rules can achieve these morally valuable objectives without minimally complying with the principles of legality, it follows in Fuller's view, that they constitute a morality. Since these principles are built into the existing conditions for law they are eternal and represent a conceptual connection between law and morality.

Not only are the current policy principles not coherent with Fuller's list but it will be shown that the application of the principles also falls short of the requirements.

The legality principles are criticised by Hart, in that Fuller confuses the notions of morality and efficacy.<sup>122</sup> However, Hart's response overlooked the fact that the principles of efficacy double as moral ideals of fairness.<sup>123</sup> The internal operation of the principles of legality operates not as moral ideas but as principles of efficiency.<sup>124</sup> The principles are therefore built into existing conditions for law as they operate as efficacy conditions, making justice, the overriding goal, to be achieved through the efficacy of the principles and legal rules; the objective benchmark for an effective regulatory regime in this instance. There is thus a clear conflict of policy considerations. The background has now been set to review offer regulation under the 2008 Act.

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<sup>122</sup> Hart HLA "Book Review of the Morality of the Law" (1965) 78 *Harvard Law Review* 1281 1285-1286. In his views, all actions, including virtuous acts like lawmaking and impermissible acts like poisoning, have their own internal standards of efficacy.

<sup>123</sup> For example, public promulgation in understandable terms may be a necessary condition for efficacy but it is also a moral ideal. It is morally objectionable for a state to enforce a rule that has not been publicly promulgated in terms reasonably calculated to give notice of what is required. Similarly, it is wrong for a state to enact retroactive rules, inconsistent rules and rules that require what is impossible (IEP *supra*).

<sup>124</sup> Legal standards, for example, are necessary to be promulgated in general terms, which may be construed as being vague. Also, officials may fail to administer the laws in a fair and even-handed manner, even in the best of legal systems. These divergences may be *prima facie* objectionable, but they are inconsistent with a legal system only when they render a legal system incapable of performing its essential function of guiding behaviour (IEP *ibid*).

## CHAPTER 5

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### SOUTH AFRICAN OFFER REGULATION

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1. Introduction
  - 1.1. Basis of Chapter 4 regulation
  - 1.2. Subject matter of Chapter 4 regulation
  - 1.3. Features of Chapter 4 regulation
2. South African securities regulation: regulator
  - 2.1. Twin Peaks
  - 2.2. Current financial regulatory and supervisory framework
3. Concluding remarks

## 1. Introduction

This chapter provides for a review of offer regulation in terms of the 2008 Act, against the principles of regulation, and the premise of complete law as condition for regulatory efficiency and effective enforcement<sup>1</sup> in order to assess the potential of offer regulation under the current regulatory dispensation. It is submitted that regulation should be aimed at the realisation of the principles of regulation in an attempt to move as close as possible towards the *Grundnorm* in realisation of the premise of complete law.

This chapter is divided into 4 parts. Following this introduction, part A will cover offers, part B will deal with securities, part C will review the concept of public insofar as offers to the public are concerned and the chapter will conclude with a concise summary of the substantive aspects of importance in the discussion going forward.

The review undertaken in this chapter will conclude that the current regulatory regime falls short of the principles of regulation and is therefore not ideally suited to protect investors. In consequence of practical problems and interpretational difficulties the *Grundnorm* is assailed and offer regulation collapses whereby the definitions as applied in delineating the conjoined regulation of the primary and secondary markets in Chapter 4 of the 2008 Act constitutes incomplete law. The net effect is that the regulatory dispensation is at risk of enforcement failure.

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<sup>1</sup> Principles of regulation as set out in chapters 2 and 4 *supra*.

## 1.1. Basis of Chapter 4 regulation

No person may offer any shares to the public otherwise than in accordance with the provisions of the 2008 Act.<sup>2</sup> South Africa follows a model of offer regulation based on disclosure with specific eligibility requirements to be applicable to a transaction. Once a transaction qualifies as within the scope of Chapter 4 of the 2008 Act, the content of the disclosure is prescribed.<sup>3</sup> The basis of offer regulation is statutory in nature in order to evade the deficiencies of the common law.<sup>4</sup> Chapter 4 of the 2008 Act serves as the foundation for current offer regulation.<sup>5</sup> Both primary and secondary markets are regulated in this chapter dealing with offers to the public of securities of a company to raise capital, as well as offers to the public by or on behalf of the holders of securities and not concerned with the raising of capital.<sup>6</sup> In terms of regulation, the definitions in section 95 delineate the scope of regulatory purview.

The purposes of the 2008 Act as per section 7 as well as the contingent history and reasoning towards the 2008 Act as per the Guidelines have been

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<sup>2</sup> Section 99.

<sup>3</sup> Chapter 4 *supra*.

<sup>4</sup> As per chapter 3 *supra*, the development of offer regulation. See also Cilliers *et al* (2000) *Corporate Law* 188-9 in respect of the doctrine of disclosure. The application of the common law is not expressly excluded; however it will only apply where the legislation does not provide for otherwise.

<sup>5</sup> For public offerings of securities, also read with other relevant sections of the 2008 Act and the Regulations (where permitted). See also Cassim *et al* (2002) *Contemporary Company Law* 649: Chapter 4 includes provisions dealing with the application of Chapter 4 and definitions (section 95); general restrictions on offers to the public (section 99); types of offers (section 99 and 101); offers that are not offers to the public (section 96); advertisements relating to offers (section 98); prospectus requirements (section 100); prospectus liability (sections 104-106); and the allotment of securities (sections 107-111).

<sup>6</sup> Cassim *et al* (2002) *Contemporary Company Law* 649. Under the 1973 Act these concepts were dealt with separately as offers for subscription and offers for sale. Populist opinion holds that the dissolution of the divide between the regulation of these offers has simplified and clarified regulation, a point which is dissented to. It is interesting to note that no substantive arguments are provided for the simple and clear arguments (apart from stating that it delineates the concepts which are submitted, not an argument) yet sufficient substantive opposition can be offered directed against the simultaneous regulation of both markets in one chapter.

referred to in chapter 3. It is emphasised that the nature of the respective capital market transactions and the common law<sup>7</sup> were not heeded nor envisaged in the Guidelines, which rather focussed on non-specific goals, i.e., there is no concentration or substantial review of the particular focus area of offer regulation and the provisions in place which constituted offer regulation prior to the 2008 Act. This omission gave rise to a formalistic approach in terms of the Guidelines aimed at the structure of the 2008 Act and not a substantive overview of the provisions of Chapter 4 which it is submitted will show that the current regulatory dispensation is lacking the premise of complete law.<sup>8</sup>

It is submitted that the conflicts between the 1973 Act and the 2008 Act are not borne from a difficulty in harmonising the rules, rather from differences in philosophy underlying the rules.<sup>9</sup> The philosophical differences between the Van Wyk de Vries Commission Report, the 1973 Act and that of the Guidelines and 2008 Act, are important and will be alluded to below. Although it is to be remarked at this stage that the Van Wyk de Vries Commission specifically applied itself to the nature of capital market transactions in the regulation thereof. Juxtaposed to the Van Wyk de Vries Commission, the Guidelines and 2008 Act do not provide for the

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<sup>7</sup> Delpont “Offers” 2011 *THRHR* 283.

<sup>8</sup> The gist of critique against the Guidelines and the 2008 Act is that the changes were not well-thought through and were undertaken only for the sake of change. See Delpont “Offers” 2011 *THRHR* 280 and 286, also Cassim *et al* (2002) *Contemporary Company Law* 2 and 3 which highlights the problems in harmonising the two legal dispensations.

<sup>9</sup> The two Acts differ widely in respect of their respective philosophies. Because of this, the 2008 Act is unable to be compared to the 1973 Act. The only aspect to be addressed and missed by the Legislature is the extent of the application of the common law, in addition to the statutory provisions as it is the common law, especially the transactional nature of capital market contracts, which complicates the application and execution of the 2008 Companies Act (Delpont “Offers” 2011 *THRHR* 283).

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underlying transactions and practicalities involved with the regulation of capital market transactions.<sup>10</sup>

### 1.2. Subject and subject matter of Chapter 4 regulation

The subject of regulation in terms of Chapter 4 is corporate entities, a company, with the general rule being that the offer of securities to the public is prohibited unless by a company or foreign company which is subjected to regulation.<sup>11</sup> The subject matter concerned is securities as envisaged to be offered to the public. The issue concerning securities and the underlying *merx* of the subject matter to the public offer contracts will be discussed in Part B of this Chapter dealing with securities. The concept of an “issuer” will also be discussed in Part B; suffice to state that for the purposes of the subject of offer regulation, the concept of “security” is coupled to that of an “issuer.”<sup>12</sup> It is important to note that the subject matter is transactional of nature and that the parties and underlying transaction will differ in respect of the respective capital markets, i.e.,

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<sup>10</sup> It is trite that the Van Wyk de Vries Commission of Enquiry into the 1926 Companies Act *inter alia* considered the protection afforded to investors and the public interest. In this respect see Benade ML “A Survey of the Main Report of the Commission of Enquiry into the Companies Act” (1970) III *Comparative and International Law Journal of South Africa (CILSA)* 277 (hereinafter referred to as Benade “Survey” (1970) *CILSA*). For example, due to the confusion between the provisions that applied to the primary and secondary markets in the Companies Act 46 of 1926, the Van Wyk de Vries Commission recommended that the provisions be in different chapters in the 1973 Act. Section 141 of the 1973 Act was placed in Chapter V whilst the primary market regulation of section 142 was in the new Chapter VI (Delpont “Offers” 2011 *THRHR* 282), referring to the Van Wyk de Vries Commission Supplementary Report. It will be shown that the 1973 Act as based on the Van Wyk de Vries Commission’s report into the substantive requirements of company law at the time, sought to eliminate provisions which had outlived their usefulness (Benade “Survey” (1970) *CILSA* 279). Cognisance was taken of the common law application (Benade “Survey” (1970) *CILSA* 279), and the Commission found that the offer regulatory provisions (relating to prospectuses) were complicated and confusing (Benade “Survey” (1970) *CILSA* 290). Instead of tapping into the *modus operandi* followed with the 1973 Act and seeking comparative guidance from relevant jurisdictions and not only grafting but adapting the provisions to suit our common law, especially our transactional common law, the Department of Trade and Industry produced the Guidelines with a set of goals for change, none of which speaks to careful consideration of what was required. The flipside is that the proposed changes at the time were changes for the sake of change. The adage of fools rushing in, rings true.

<sup>11</sup> Section 99(1).

<sup>12</sup> Section 99(1) which provides that the issuer of a public offer for securities must be a corporate entity.



whether a primary market subscription or sale (by means of underwriting construction) is occasioned or whether a secondary market sale of unlisted securities is occasioned.

### 1.3. Features of Chapter 4 regulation

The 2008 regulatory regime mimics to an extent, the system in place during the 1973 Act, save for the regulation of both the primary and secondary markets in the same chapter.<sup>13</sup> The current regulatory regime also features definitions which fail to delineate the parameters of regulation. This combination will be shown not to have been successful.<sup>14</sup>

The 2008 Act is described as having an eclectic nature which will pose numerous novel problems as well as uncertainty.<sup>15</sup> In reviewing material concerning the 2008 Act, most provide only a cursory overview of the legislation accompanied by an incomprehensible amount of fanfare.<sup>16</sup>

It follows that the regulatory regime in providing for *ex post* regulation is to be delineated by means of definitions applicable to the subject matter

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<sup>13</sup> Delpont (2011) *Manual* 43.

<sup>14</sup> *Ibid.* The regulatory failure of the 2008 Act can be seen, *inter alia* by the confusion between the prospectus and the written statement in respect of non-consent, non-compliance and liability.

<sup>15</sup> Delpont (2011) *Manual* v. See also Cassim *et al* (2002) *Contemporary Company Law* 2, where the 2008 Act is described as having strange wording, unclear concepts imported from other jurisdictions and not being user friendly due to its unclear and ambiguous language. It follows that there is conflict between the old and new rules, not only due to the difference in wording, but the difference in philosophy to which the 2008 Act does not correspond.

<sup>16</sup> Referring to the commencement of the 2008 Act, the Guidelines is self-evident of importing cursory goals of simplification, flexibility, efficiency, transparency and predictable regulation and additionally harmonisation. The 2008 Act, itself, at section 7, stirs into the mix buzz words like enterprise efficiency, flexibility and simplicity, transparency and high standards (section 7(b)); promotion of innovation and investment (section 7(c)); economic and social benefits (section 7(d)); economic welfare and global economy (section 7(e)); creation of optimum conditions for the aggregation of capital, productive purposes, investment and the spread of economic risk (section 7(g)); efficient and responsible management (section 7(j)); predictable and effective regulatory environment (section 7(l)). Cassim *et al* (2002) *Contemporary Company Law* 2, refers to clarity and simplicity juxtaposed to brevity (in comparing the 2008 Act to the Australian and English Acts), whilst simultaneously confirming plain language adds to fuzzy (sic) law. See also Yeats "Public Offerings" 2010 *Acta Juridica* 117 as well as Cassim *et al* (2002) *Contemporary Company Law* chapter 14 authored by Yeats, where it is submitted that the 2008 Act delineates and deals with the categories of offer for sale and offer for subscription in a simpler and clearer way.

and transactional relativity sought to be regulated and that same should be unambiguous and clear. In terms of offer regulation, the basic manner of providing protection to investors and to manoeuvre unambiguously away from abuse, is by means of disclosure by way of a prospectus.<sup>17</sup> The level and nature of regulation depend on the nature of the underlying transaction, i.e., in which market the offer is made,<sup>18</sup> where it is an offer to the public and of securities: terminology, which as a matter of discourse, activates regulation.

In Shakespeare's *Richard III*, the character simply known as the "first murderer" is quoted as stating: "*Fear not, my lord, we will not stand to prate; talkers are no good doers: be assured we come to use our hands and not our tongues.*"<sup>19</sup> It is submitted that it is in not taking cognisance of the underlying transactional principles that the 2008 Act falls short of its purposes by not setting out to do what it aimed to do.<sup>20</sup>

A simple example of how easy it is to avoid transactional relativity by not applying the envisaged legislation to the subject matter it is to regulate, is to be found in the dictum in *Ex Parte NBSA Centre Ltd*<sup>21</sup> where it is stated that company law is more than the applicable statute as it has an inner logic which must be identified and mastered, with a number of areas having developed their own common law not to be found in legislation.

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<sup>17</sup> Delpont (2011) *Manual* 43.

<sup>18</sup> Delpont "Offers" 2011 *THRHR* 280.

<sup>19</sup> William Shakespeare's *Richard III*, 1594. This is easily summed up in an adage which rings true: "If one is to talk the talk, one is to walk the walk," a 20<sup>th</sup> century alternative to various sayings which epitomise the notions that "talk is cheap," and "actions speak louder than words." (As per William Shakespeare's *Richard III* (1594) "Phrases, Sayings and Idioms at the Phrase Finder" <http://www.phrases.org.uk/meanings/walk-the-walk.html> (accessed 25 August 2013)).

<sup>20</sup> Fulfilling its lofty section 7 objectives and giving thrust to what the Guidelines set out to do.

<sup>21</sup> *Ex Parte NBSA Centre Ltd* 1987 (2) SA 783 (T) 787.

This failure will be addressed in detail in the discussion of offers below, in showing how the try line of offer regulation has been missed.

In terms of regulation, South Africa features a hybrid system of merit disclosure regulation, by way of prospectus.<sup>22</sup> The CIPC as regulator of Chapter 4 regulation is responsible for the registration of a proposed prospectus once the requirements in terms of Chapter 4 have been met and a proposed prospectus has been filed within the prescribed time.<sup>23</sup> It will seem that the general nature of the prospectus requirements and review is not sufficient enough as the regulatory system which is in place calls only for a formality review, which necessitates specific and substantive rules and regulations to ensure compliance, juxtaposed to a substantive reviewing jurisdiction where general rules will muster sufficient safeguards.<sup>24</sup>

An effective regulatory regime depends not only on the prospectus requirements and certainty regarding offers, securities and the public. It also rests on the structure of the administration and enforcement of the Companies Act. Any regulatory system can only be effective if properly

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<sup>22</sup> Delpont “Offers” 2011 *THRHR* 283. Hybrid system whereby in both markets disclosure is prescribed as well as the levels of disclosure once an offer of securities is made to the public by a company for its securities.

<sup>23</sup> Section 99(9). The prescribed time is ten business days from date of prospectus. A prospectus may not be issued more than three months after the date of its registration and if done so it is deemed unregistered in terms of section 99(11).

<sup>24</sup> The Kimber Report considered under part V thereof the form, content and distribution of prospectuses. The Committee has examined prospectus requirements of the United Kingdom and the United States. The study disclosed that the model followed in the United States by the SEC in terms of the Securities Act of 1933 would be most suitable to Ontario by comparing prospectuses filed with the SEC to that with the OSC. The SEC prospectuses were clearer and more eloquent regarding the state of the affairs of the company. The difference being found that improvement rests on clearer rules and adequate trained examining staff to examine, the inference drawn that in the absence of a fully substantive examining jurisdiction, clear and substantive rules are required to compensate for a review of the substantive issues.

administered and enforced.<sup>25</sup> To this extent the point will be made that contingent to the failure in the application of the philosophy of capital market transactions towards offer regulation and ineffective prospectus requirements, the regulatory framework in place does not complement the philosophy of disclosure and offer regulation as it is defective. Due to the fact that South Africa does not boast a pro-active regulator, it is of paramount importance that the regulatory provisions constitute complete law in furtherance of the *Grundnorm* as same will be interpreted in applying the law to transactions and in terms of enforcement, applied *ex post* in reactionary enforcement by means of the liability provisions.

## 2. South African securities regulation: regulator

Chapter 8 of the 2008 Act establishes the regulatory agencies under the 2008 Act as well the provisions concerning the administration of the 2008 Act, ostensibly by means of the established regulatory agencies, and then by Part E which covers the administrative provisions applicable to the agency's.

Relevant to this discussion are Parts A and B. Part A establishes the umbrella agencies, the Companies and Intellectual Property Commission (CIPC) whereas Part B establishes the Companies Tribunal.

Insofar as securities regulation is concerned, offer regulation in South Africa is provided for in Chapter 4 of the 2008 Act. In respect of listed securities, the relevant Exchange (in this case the JSE) will regulate the

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<sup>25</sup> See ANON "A Plea for a South African Securities and Exchange Commission" [http://www.iassa.co.za/articles/002\\_may1973\\_03.pdf](http://www.iassa.co.za/articles/002_may1973_03.pdf) (accessed on 2 July 2011); as well as the Nel Commission Report. Not only is it substantive company law which must be reviewed but also the policing, administration and supervision of company law.

securities. This discussion does not pertain to the Exchange as Chapter 4 regulation is the genesis of regulatory purview in the primary market.

The CIPC is the agency tasked with the receipt of the proposed prospectus, and the registration thereof. Disclosure is mandated, yet the prospectus requirements are not subjected to a merit review prior to approval. Payment of the prescribed fee is sufficient. The liability provisions in Chapter 4 shift enforcement *ex post facto* onto the Courts.

Section 95(1)(k) provides for a definition of a “registered prospectus.” The definition provides for a prospectus complying with the 2008 Act and which has either been approved by the Exchange or otherwise, in the case of primary market offers, filed with the CIPC.<sup>26</sup>

Section 100(4) provides for situations where the filed prospectus must not be registered. This is in contrast with the definition of a filed prospectus at the CIPC which denotes registration. Apart from this, the 2008 Act is silent on a review and basis of approval or denial of a prospectus. A regulatory *lacunae* furthermore exists in terms of where the scope of application of Chapter 4 regulation begins and ends. Primary market offers are especially vulnerable in absence of the Exchange which acts as a regulator in respect of its listed securities in the first instance, acting in concert with the FSB which has broad regulatory powers but not exclusively so for Chapter 4 offer regulation.

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<sup>26</sup> A prospectus for unlisted securities is registered if it is filed with the CIPC or, in the case of one for listed securities, if approved by the relevant exchange. Where a prospectus is not required for listed securities (for example in a rights offer) it is uncertain if the documents approved by the exchange would be a registered prospectus. A written statement is not included in the definition, creating statutory liability issues. Liability in section 104 is only in respect of untrue statements in a prospectus and not in respect of a written statement (Delpont PA (2011) *Henochsberg on the Companies Act 71 of 2008* 2 v (loose-leaf) Durban: LexisNexis (hereinafter referred to as Henochsberg on the 2008 Act)).

Insofar as relevant, liability of the State is excluded by section 222 which provides that the State, the Commission, the Commissioner, the Companies Tribunal etcetera, having duties to perform under the 2008 Act will not be liable for any loss or damage as a result of *bona fide* acts or omissions relating to the performance of any duty under the Act, unless gross negligence is proved. It will therefore be assumed that the CIPC will not be hesitant to cover behind fear of liability where a registered and approved prospectus is found to have contributed to fraud or have contained untrue statements.

### 2.1. Twin Peaks

The regulatory landscape in terms of financial services in South Africa is bound to change in the next couple of years, in a move towards a regulatory system akin to the United Kingdom, where the FSA splits into two separate agencies, the Financial Conduct Authority and the Prudential Regulation Authority. Where in the UK, securities regulation, specifically offer regulation in the context of raising capital for a company, is overseen by the newly formed FCA. In South Africa the position relating to Chapter 4 offer regulation is not clear.

Basel III as third installment of the Basel Accords was developed in response to the deficiencies in financial regulation as exposed by the global financial crisis. This gave rise to the Twin Peaks model of financial regulation.<sup>27</sup> The Financial Regulatory Reform Steering Committee

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<sup>27</sup> ANON “Financial Services Twin Peaks” KPMG  
<http://www.kpmg.com/ZA/en/IssuesAndInsights/ArticlesPublications/Financial-Services/Documents/KPMG%20Twin%20peaks.pdf> (accessed on 3 December 2012).

(FRRSC), comprising the National Treasury, South African Reserve Bank and Financial Services Board, recently published for public comment a summary of the proposals for implementing the Twin Peaks model of financial regulation.<sup>28</sup> The FRRSC was tasked by the Minister of Finance and the Governor of the Reserve Bank to prepare detailed proposals on the implementation of Twin Peaks, which was proposed by the Minister in the 2011 Budget. The shift to a twin peaks approach to financial regulation was part of a broader financial regulatory reform agenda. These proposals were contained in the Government's policy document: *A safer financial sector to serve South Africa better*, and were formally approved by Cabinet in July 2011.<sup>29</sup> The "Twin Peaks" approach entails creating a prudential regulator, housed in the South African Reserve Bank (SARB), and transforming the Financial Services Board into a dedicated market conduct regulator. The objective of the prudential regulator will be to maintain and enhance the safety and soundness of regulated financial institutions. Prudential safety and soundness imply the continued financial health of regulated institutions. The market conduct regulator's objective will be to protect consumers of financial services and promote confidence in the South African financial system.

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<sup>28</sup> National Treasury Media Statement 1 February 2013  
<http://www.treasury.gov.za/twinpeaks/20131211%20-%20TwinPeaks.pdf> (accessed on 3 November 2013).

<sup>29</sup> *Ibid.* Underlying the twin peaks regulatory system will be the strengthening of the macro prudential supervision system, enhancing the Reserve Bank's powers to promote financial system stability and empowering it to become the systemic regulator; supervising and monitoring the system-wide risks caused by the financial system. The Reserve Bank will also be allocated new powers with respect to financial market infrastructure such as exchanges, clearing houses and the central securities depository (Strate).

The main proposal, which was adopted by Cabinet in July 2011, is to separate prudential and market conduct regulation and supervision i.e., to shift to the twin peaks model. Implementation of the model is a two-phase process. The first phase involves developing and tabling in Parliament, overarching legislation to empower the prudential and market conduct regulators to deliver on their mandates. The second phase comprises of harmonising specific financial sector legislation such as the Banks Act, Long- and Short-term Insurance Acts with overarching legislation and regulator mandates. Expected completion of phase one is 2013/14 while phase two may take a number of years. An overall timeline for implementation has not yet been set.<sup>30</sup>

## 2.2. Current financial regulatory and supervisory framework

The current framework for financial regulation and supervision in South Africa is fairly complex with a number of regulators. The main regulators are the Bank Supervision Department (BSD) of the South African Reserve Bank (SARB) and the Financial Services Board (FSB-SA). BSD prudentially regulates and supervises banks and the FSB-SA most non-bank financial institutions as well as securities markets, where it relies on

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<sup>30</sup> Goodspeed I “Twin Peaks”

<http://www.financialmarketsjournal.co.za/17thedition/printedarticles/twinpeaks.htm>

(accessed on 26 March 2014). In February 2013 the Financial Services Board undertook a peer review of South Africa’s progress implementing reforms in respect of inter-agency coordination and regulatory structure. The review was conducted by a team of experts drawn from the Financial Stability Board’s member institutions: Saudi Arabian Monetary Agency, Deutsche Bundesbank and Australian Securities and Investments Commission. The review recognised and welcomed South Africa’s planned move to the twin peaks model of financial regulation (“twin peaks model”), because it will, (i) enhance the significance of market conduct regulation and supervision which has historically played a less important role than prudential regulation particularly in certain financial industries such as transactional banking, and (ii) create a more resilient and stable financial system by improving both prudential and market conduct regulation, and (iii) improve the regulatory and supervisory oversight of financial conglomerates. (South Africa is a Financial Stability Board member jurisdiction and has committed to undergoing periodic peer reviews to assess implementation and effectiveness of international financial standards and policies.)



self-regulatory organisations such as the JSE and Strate. The National Credit Regulator (NCR) regulates the market conduct of all credit providers (banks and non-banks) and the National Consumer Commission (NCC), the market conduct of all consumer goods and services providers as well as banks (other financial services firms have been exempted). To add to the complexity, financial sector regulators are to varying degrees, subject to the authority of two government departments. The Department of Trade and Industry oversees the NCR and NCC, while BSD has a direct reporting line to the Minister of Finance on legislative issues and FSB-SA is subject to the general authority of the Minister of Finance.<sup>31</sup>

The twin peaks model is characterised by separate prudential and market conduct regulators. Since equal weight is given to prudential and market conduct regulation, it is regarded as the optimal way to ensure that consumer protection and market integrity receive sufficient priority and are not routinely presumed to be subservient to prudential concerns.<sup>32</sup>

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<sup>31</sup> *Ibid.* See also Financial Stability Board, February 2013 *Peer Review of South Africa*, available at [www.treasury.gov.za](http://www.treasury.gov.za); National Treasury. February 2011: *A safer financial sector to serve South Africa better*, available at [www.treasury.gov.za](http://www.treasury.gov.za); Implementing a twin peaks model of financial regulation in South Africa available at [www.treasury.gov.za](http://www.treasury.gov.za).

<sup>32</sup> Goodspeed “Twin Peaks” *ibid.* Market conduct regulation focuses on protecting customers that buy financial products or otherwise entrust funds to financial institutions. Such regulation provides consumer protection by addressing the unequal position of financial institutions relative to their customers. The most vulnerable customers are retail clients who often lack the sophistication and information necessary to protect themselves from fraud, market abuse or ill-informed advice and rely on financial institutions and their representatives to look after their interests. In South Africa this responsibility will be carried out by the Financial Services Board. Apart from protecting consumers, the market conduct regulator will be required to promote confidence in the South African financial system and ensure financial services institutions and markets function effectively and to high ethical and professional standards. Prudential regulation is applied to financial institutions such as banks, securities firms and insurance companies to ensure that they are financially sound and capable of meeting their obligations to customers. Regulators are interested in the health and strength of these financial institutions as the failure of one or more of them could result in a loss in confidence in the safety and soundness of the financial system. In South Africa the prudential regulator will form part of the SARB and will be responsible for both micro- and macro-prudential regulation and supervision. Micro-prudential regulation aims to secure the safety and soundness of individual financial institutions. Macro-prudential regulation seeks to promote the stability of the financial system as a whole. The

The major issue to be addressed under the twin peaks model is the role of the NCR. Agreement between National Treasury and the Department of Trade and Industry as to the disposition of NCR has yet to be reached. Clearly it would be preferable for South Africa to have only one market conduct regulator for financial services.<sup>33</sup>

It is submitted that Chapter 4 offer regulation will have to be included, yet stands in danger of being sidestepped due to the artificial divide of the regulatory regime as per the 2008 Companies Act, juxtaposed to other financial products.

The concept of securities, insofar as Twin Peaks is concerned, will have to be revisited in order to ensure regulatory purview across all regulators in respect of what a security is and how regulation will apply to different types of security instruments.

### **3. Concluding remarks**

Based on this overview it is established that South Africa follows a reactive regulatory model which leans heavily on the substantive regulatory provisions in Chapter 4 to regulate offers. The liability provisions act as deterrent for non-compliance to the substantive aspects of offer regulation and will ultimately only be enforced by a Court or the Tribunal. It is therefore important that such substantive aspects are

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stability function of the SARB will undertake conglomerate supervision as well as crisis management and resolution.

<sup>33</sup> *Ibid.* It is stated that this will ensure consistent market conduct standards in terms of licensing, fit and proper requirements, disclosure, consumer recourse and enforcement across the financial services industry. This will avoid confusing consumers inviting unintended consequences such as regulatory arbitrage and burdening market participants with unnecessary compliance costs such as different management information and reporting systems for credit versus other financial products.

considered to be complete law. The following discussion will focus on the determinant factors as substantive parameters whether Chapter 4 offer regulation in the first instance complies with the precept of complete law and in the second instance is therefore aligned with the principles of offer regulation.

## CHAPTER 5

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### PART A: OFFERS

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## 1. Security offer regulation

South Africa has always opted for offer regulation by means of qualifying criteria which pre-empt disclosure requirements. Once a public offer of securities is qualified, disclosure by means of prospectus requirements is provided for, with the regulatory provisions putting emphasis on when disclosure is required, who must disclose and the extent of disclosure, depending on the capital market where the shares are to be traded.<sup>1</sup> The capital markets are of course the primary and secondary markets. The basic principles that put Chapter 4 offer regulation into effect are that there is an offer for shares and the offer is to the public, disclosure is required.<sup>2</sup> The offer is in terms of the common law as well as in terms of the Companies Act and aimed at concluding a particular type of contract. Capital market transactions are divided into primary and secondary market transactions based on the nature of the transaction.

The basis of Chapter 4 public offer regulation is in the definitions<sup>3</sup> which delineate the scope and application of Chapter 4 in establishing whether an offer of securities to the public is constituted as defined and then, per the nomenclature, the extent of regulation applicable in terms of disclosure required, depending on the primary market or secondary market. The divide between the types of regulation between the markets fundamentally resides in the type of transaction underlying the primary market distribution or sale or secondary market sale of unlisted securities.

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<sup>1</sup> Delport “Offers” 2011 *THRHR* 281. See also Cilliers *et al* (2000) *Corporate Law* 256.

<sup>2</sup> *Ibid.*

<sup>3</sup> As per section 95.

Sale in the context of the primary market only refers to the underwriting constructions, other than direct allotment and distribution. In terms of a primary market transaction, the securities are made available to investors by the company, the parties consisting of the former and latter. In the secondary market, the seller must disclose to the buyer and the extent is limited due to the fact that the seller does not have access to all the financial information as would be the case in respect of a primary market transaction.<sup>4</sup>

Chapter 4 of the 2008 Act is the successor of Chapter VI in the 1973 Act. The former is titled: “*Public offerings of company securities,*” whilst the latter was titled: “*Offering of shares and prospectus.*” Chapter VI had to be read with section 141 in Chapter V of the 1973 Act, which provided for a restriction on the offering of shares for sale. Section 141 is the predecessor of section 101 in the 2008 Act, entitled: “*Secondary offers to public.*” In the 1973 Act, regulation in respect of primary market regulation by means of Chapter VI, was differentiated from regulation by means of section 141 in accordance with the division in chapters in the 1973 Act as well as the wording in section 142, which set out the definitions applicable to Chapter VI regulation: “*In this Chapter, unless the context otherwise indicates....*”<sup>5</sup> To this extent Chapter VI at section 142 contained a specific set of definitions applicable to the primary market transactions to be regulated therein. The definitions could

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<sup>4</sup> In the primary market, offer regulation is substantial and the company must disclose by way of a prospectus with substantial prospectus requirements.

<sup>5</sup> 1973 Act, section 142(1).

therefore not be used for the secondary market provision of section 141 in Chapter V.

It therefore follows that regulation in respect of primary market transactions was divided from regulation in respect of secondary market transactions on the informal secondary market.<sup>6</sup> Chapter 4 now incorporates both regulatory provisions in respect of primary market as well as secondary market regulation into one chapter. It is submitted that the ambit of differentiation does not exist in the distinction in designation between offer for subscription or offer for sale, but rather in the nature of the designated underlying transaction and regulatory principles to be complied with, a dispensation which was ultimately reflected in the regulation of offers in the 1973 Act.<sup>7</sup> In this regard, it is important to note the regulatory divide between section 141 and Chapter VI of the 1973 Act. Regulatory purview in respect of the type of transaction excluded each other.<sup>8</sup>

The system of conjoined regulation ostensibly includes the primary market sale and secondary market sale of unlisted securities. It is trite that the philosophy and law behind Chapter 4 offer regulation ought to be the protection of the investor in the shares and other securities of a company, beyond what is available at common law in the case of the purchase and sale of corporeals.<sup>9</sup> Central to Chapter 4 of the Act are the provisions holding that offers to the public in the primary market are to be

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<sup>6</sup> As differentiated from regulation of the formal secondary market in terms of the Financial Markets Act of 2012 which regulates listings on the exchange read with the JSE Listing Requirements.

<sup>7</sup> *Supra* fn 5.

<sup>8</sup> Regulatory purview includes liability and disclosure provisions.

<sup>9</sup> Delpont "Offers" 2011 *THRHR* 280. See also chapter 4 *supra*.



accompanied by a registered prospectus in relation to which specific requirements regarding disclosure are observed and that there should be control of the allotment of shares pursuant to such offers.<sup>10</sup> In the secondary market the publication and possible registration of a written statement entails the equivalent.<sup>11</sup> This disclosure is achieved through the prospectus requirements, and full disclosure is encouraged through the civil and penal provisions<sup>12</sup> regarding untrue statements.<sup>13</sup>

The starting point in terms of the concept of an “offer” is to look at the type of transaction which underlies the offer in terms of what is offered, which is done by defining the capital market where the type of transaction occurs. The enquiry will then move to the application of Chapter 4 regulation as delineated by the definitions in section 95, to the underlying capital market transactions in defining the scope of regulatory purview applicable to the respective offerings.

### 1.1. Capital market transactions

Offer regulation aims to protect investors and the public interest by, in its essence, requiring disclosure by way of a prospectus, so as to enable the investor to determine and make a value decision as to whether the consideration for the incorporeal is fair in relation to its value, amplified

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<sup>10</sup> Henochsberg on the 2008 Act as per the discussion on sections 99(2) and (3). It is submitted that it is said disclosure requirements that are aimed at ensuring a state of efficacy. The information relates to the company as well as to the securities and is set out in the prospectus. Truthfulness, or rather the correctness of information, is sought to be achieved by civil and criminal liability for untrue statements (Cilliers *et al* (2000) *Corporate Law* 268). Potential share investors and shareholders (including debenture holders and creditors) require information pertaining to: (a) return on investment; and (b) financial soundness of the company (Cilliers *et al* (2000) *Corporate Law* 209).

<sup>11</sup> Henochsberg on the 2008 Act 363, read with section 101.

<sup>12</sup> Liability shall vest where omissions or untrue statements feature in a prospectus.

<sup>13</sup> LAWSA (1995) paragraph 144.

by liability provisions. For this reason, the buyer is dependent on disclosure of the information which is in the possession of the seller. Offer regulation dictates the disclosure of said information, together with requirements to ensure the relevance and integrity of the information.<sup>14</sup> An offer in terms of the law of contract is aimed at the conclusion of a type of contract.<sup>15</sup> Following the precepts of the law of contract, a contract as an agreement creating rights and obligations consists of an invitation to consent to the creation of obligations between the parties, called an offer and an affirmative response called an acceptance.<sup>16</sup> To constitute an offer, a declaration of intent must set out the essential and material terms of the envisaged contract to such an extent that mere acceptance by the offeree will constitute an agreement. Therefore the terms and conditions need to be objectively ascertainable.<sup>17</sup>

Capital market transactions are divided into primary and secondary markets based on the nature of the transaction. Where a company issues securities to investors, the transaction takes place in the primary market; being first in time where the securities are offered, subscribed to, and issued. The transaction takes place for the first time chronologically.

Where the investor decides to trade his or her securities, the sale occurs on

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<sup>14</sup> Delpont (2011) *Manual* 43.

<sup>15</sup> In this respect see Cilliers *et al* (2000) *Corporate Law* 257. An offer should be aimed at the conclusion of a particular type of contract and an invitation to do business is not a contract. However, section 142(2) of the 1973 Act defined an offer to include an invitation. The offer (or invitation) was aimed at concluding a contract for subscription or sale of shares. See also Van Wyk de Vries Commission Main Report 108, Delpont PA (1987) *Die Verkryging van Kapitaal in die Suid-Afrikaanse Maatskapperyeg met Spesifieke Verwysing na die Aanbod van Aandele aan die Publiek*, LLD Thesis, Universiteit van Pretoria 304 (hereinafter Delpont *Die verkryging van kapitaal* (1987)) and Delpont "Offers" 2011 *THRHR* 284. For this reason, the Van Wyk de Vries Commission recommended the inclusion of an invitation into the definition of an offer.

<sup>16</sup> Van der Merwe S *et al* (2007) *Contract: General Principles 3<sup>rd</sup> ed* Lansdowne South Africa: Juta 42 (hereinafter referred to as Van der Merwe *et al* (2007) *Contract: General Principles*).

<sup>17</sup> *Ibid* 44.

the secondary market. The levels of disclosure in both markets differ substantially based on the access to information pertaining to each transaction.<sup>18</sup> It has been stated that the principles which engage Chapter 4 offer regulation, to determine whether disclosure is required or not, is that there must be an offer, of securities to the public. The offer is in terms of the common law as well as in terms of the Companies Act and is supposed to be aimed at concluding a particular type of contract. Liability *ex contractu* is based on the agreement of the parties. Our law does not provide for an obligation to be created voluntarily by an unilateral act, as was possible under Roman law by *pollicitatio*. An ordinary contractual offer, such as provided for in section 95(1)(g) in Chapter 4 which defines an offer, does not in itself create rights and duties between offeror and offeree, mainly because the offeror is, in terms of the definition, the investor and is unable to make the offer. In terms of the law of contract, an offer gives rise to the *spes* of a future right, based on the offerees capacity to create by acceptance, the obligations envisaged in the offer.<sup>19</sup> In terms of acceptance, same constitutes a declaration of will which indicates assent to the proposal contained in the offer.<sup>20</sup> An offer can be validly accepted only by the person with whom the offeror intended to contract.<sup>21</sup> These aspects will be alluded to below, save to state that it follows that a contract of subscription, unless provided for in the definitions, is unable to muster the common law requirements as the subject matter is not in existence as of yet.

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<sup>18</sup> *Ibid.*

<sup>19</sup> *Ibid* 45-6.

<sup>20</sup> *Ibid* 48.

<sup>21</sup> *Ibid* 49.

## 1.1.1. Primary market transactions

The application of primary market regulation underscores a fundamental difference from secondary market regulation in terms of the basis of regulation and disclosure required. Based on the risk profile of these types of offers as well as the ability of the company to provide sufficient information, more stringent regulation applies to these transactions. In the primary market, the offer must be intended for the conclusion of a contract for subscription (the acquisition) of unissued shares.<sup>22</sup> From the foregoing exposition, it follows that an offer in terms of the law of contract is aimed at the conclusion of a type of contract,<sup>23</sup> and that the contract by which a subscriber agrees to take a number of shares and the company agrees to allot the shares to such person is subject to the ordinary rules of contract, as modified by express stipulation of the Companies Act.<sup>24</sup>

An offer in the primary market is for subscription of the unissued shares of a company, by the company. This is occasioned by extending an invitation to investors to make offers to the company for its securities. The procedure of subscribing requires an application, usually described as an offer, by the applicant, to take up a number of securities by means of the

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<sup>22</sup> Delpont “Offers” 2011 *THRHR supra*. The reason why it is a subscription contract and not a contract of purchase and sale as is the case in the secondary market is due to the fact that the share is incorporeal, not in existence before issue and therefore is unable to be sold as per the nomenclature of such a type of contract.

<sup>23</sup> Joubert DJ (1987) *General Principles of the Law of Contract* Cape Town: Juta 37, 39 as quoted in Cilliers *et al* (2000) *Corporate Law* 257. An invitation to do business is not an offer in the normal sense of contract law.

<sup>24</sup> This modification is in terms of the *Grundnorm* of offer regulation, aimed to prevent rather than cure fraudulent trading. Where the common law is lacking, the Companies Act and the goal of offer regulation is to provide for an offer regulatory system which complies with the principles of offer regulation, see Cilliers *et al* (2000) *Corporate Law* 247 as well as Pennington (1995) *Company Law* 366.

completed application form accompanied by payment. This is followed by the acceptance of the offer by the company via the allotment to the subscriber of the security. Due to the immaterial nature of the securities which are not yet in issue, the contract is of subscription.<sup>25</sup>

The application for and allotment and issue of shares commences with a contract to acquire shares from the company. This contract to acquire shares is not a contract of sale but a contract to subscribe for shares.<sup>26</sup> To subscribe means to enter into an agreement to take shares by a formal application or otherwise, under which there is liability to pay.<sup>27</sup>

The contract *essentialia* entails the offer from the company for subscription; the application of the subscriber; and the allocation of shares to the subscriber. The contract is perfected when the subscriber pays for the shares and they are issued to the subscriber.<sup>28</sup>

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<sup>25</sup> See Cilliers *et al* (2000) *Corporate Law* 247-253 for allotment and issue of shares in re: general procedure. In terms of the nomenclature, consistent with the principles of regulation, where share capital is to be obtained from the public, the company directs a written invitation in the form of a prospectus, known as the offer for subscription, to the public. This is accompanied by an application form. A certain number of shares are applied for and submitted with the issue price, to the company. In terms of *Re National Savings Bank Association; Hebb's Case* (1867) L.R. 4 Eq. 9; *African Finance & Investments Ltd v Van der Spuy* 1920 CPD 596 this offer can be revoked at any time before its acceptance by the other contracting party. Acceptance is usually effected by a resolution of the board of directors to allot the shares to the applicant, should the offer not be accepted, it will lapse. See also the discussion in Cilliers *et al* (2000) *Corporate Law* 247. The general principles of contract law prescribe that the agreement is concluded only when the acceptance (allotment) comes to the notice of the applicant (see *Ex Parte The Master: In Re The Niagara, Ltd [In Liquidation]* 1912 TPD 896; *Pretorius and Another v Natal South Sea Investment Trust Ltd (Under Judicial Management)* 1965 (3) SA 410 (W), or when posted. Also refer to the discussion and citations in Cilliers *et al* (2000) *Corporate Law* 248). The applicant may waive the right to allotment. See also Cilliers *et al* (2000) *Corporate Law* 257 paragraph 16.06.

<sup>26</sup> *Re VGM Holdings Ltd* [1942] Ch 235 (CA) 224. See also LAWSA (1995) paragraph 199.

<sup>27</sup> *Arnison v Smith* (1889) 41 Ch D 348 (CA) 357. See also *Moosa v Lalloo and Another* 1957 (4) SA 207 (N) 219 denoting the meaning of allocation as well as subscription in terms of where a contract is referred to.

<sup>28</sup> In *Mosely v Koffyfontein Mines Ltd* [1911] 1 Ch. 73 84 it was stated that the words "creation," "issue" and "allotment" are used with three different meanings and that there are three steps with regard to new capital. First it is created; until it is created the capital does not exist at all. When it is created, it remains unissued. When it is issued it may be issued on such terms as appear for the

The nature of securities, in particular shares, will be addressed to in full in paragraph 3 below, suffice to say that it is the nature of the security which denotes the difference in the underlying transaction in the primary and secondary markets.

The subscription contract is the contract whereby the company creates shares.<sup>29</sup> The contract follows the basic principles of invitation, offer and acceptance.<sup>30</sup> The share as incorporeal which consists of rights against the company is not in existence before issue, it can therefore not be sold in terms of a contract for purchase and sale. The company therefore invites offers from investors, which make an offer to the company for a number of shares. The company then allots the shares to the offeror. This is a unilateral internal act of the company and is in essence the acceptance of the offer.<sup>31</sup> The issue of the shares is the act which ends the transaction and ends in the issue of the shares to a specific person. It involves a set of proceedings which result in the applicant becoming a shareholder.<sup>32</sup>

Necessity however dictates the need for a company not to conduct the distribution itself and to utilise the services of a third party, commonly known as an underwriter. In terms of an underwriting construction, it follows a risk based shift in terms of the securities not being taken up all at once and the company not obtaining the minimum required subscription

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moment. Next comes allotment. It is clear that the allotment of shares precedes their issue. See also *Building Material Manufacturers Ltd v Marais NO* 1990 (1) SA 243 (O) 247 which states that the conclusion of the contract creating rights and obligations and the carrying out of the rights and obligations created by the contract are two separate acts.

<sup>29</sup> Section 35(4) and Delpont (2011) *Manual* 35.

<sup>30</sup> Nagel CJ *et al* (2006) *Commercial Law 3<sup>rd</sup> ed* Durban: LexisNexis Butterworths 42 (hereinafter referred to as Nagel *et al* (2006) *Commercial Law*). See also Delpont (2011) *Manual ibid*.

<sup>31</sup> Delpont (2011) *Manual* 35.

<sup>32</sup> *Central Piggery Co. Ltd v McNicoll* (1949) 78 CLR 594 Aust HC 598.

or insufficient capital to fund the venture. The company allots or agrees to allot the unissued securities to an intermediary, such as a merchant bank, who then offers the shares to the public. The price of the allotment will be lower than the selling price to the public and the company will receive the capital whereas the intermediary will be entitled to the difference in the allotment price and the selling price as remuneration in disposing the securities.<sup>33</sup> Where the third party is utilised in an agency relationship to distribute the shares on behalf of the company, with the company as the principal with or without additional obligations, agency principles dictate that the “distribution” is by the company as principal and this construction in essence denotes “best-efforts” underwriting (regardless whether any obligations manifest as to the shares not distributed). A second scheme is where the “undistributed” shares are acquired in terms of section 40 by the agent and therefore he remains the owner (firm underwriting), and as per the agreement with the company, “distributes” the securities to other investors.<sup>34</sup> The common principle is that in the above situations, the ultimate two parties to the contracts are the company who acquires the consideration for the shares (directly or indirectly) and the investor who directly or indirectly acquires the securities and therefore this is a primary market transaction, termed *sale*<sup>35</sup> for purposes of distinction juxtaposed to a *subscription*.<sup>36</sup> If the securities have been allotted with a view to offer them to the public it will be a primary market transaction and the

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<sup>33</sup> Section 146(1)(a) of the 1973 Act provided for these types of transactions. Section 146(1)(b) provided for simultaneous listings on an exchange (the JSE) as it is a primary market transaction in the first instance and not a mere trade in the secondary market.

<sup>34</sup> These “undistributed” shares as acquired by the agent remain the property of the agent prior to the “distribution” thereof.

<sup>35</sup> See Delpont “Offers” 2011 *THRHR* 281 as well as Loss (1988) *Fundamentals* 85.

<sup>36</sup> Delpont “Offers” 2011 *THRHR* *ibid*.

regulatory principles in terms thereof under Chapter 4 ought to apply.<sup>37</sup> It is submitted that this ought to be the objective test: have the securities been allotted with a view to offer them to the public?<sup>38</sup>

South African company law does not recognise these transactions as “underwriting” (as it is merely primary market strategies). Underwriting in terms of South Africa law has always been considered as “old-fashioned” underwriting, which is akin to insurance. This entails that an outside party undertakes to take up the undistributed shares for which the company pays a premium which is usually a percentage of the total share distribution.<sup>39</sup> In terms of an underwriting construction, it follows a risk based shift in terms of the securities not being taken up all at once.<sup>40</sup> The avoidance of this regulatory principle in terms of underwriting transactions has been made difficult in terms of the presumption under section 146(2) of the 1973 Act which provided for the deeming provision that an issue will be considered to have been allotted with a view to being offered to the public, if the offer for sale is within 18 months of the allotment. In such a case agency principles dictate that the distribution is

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<sup>37</sup> Section 146(1)(a) of the 1973 Act provided for these types of transactions. Section 146(1)(b) provided for simultaneous listings on an exchange (the JSE) as it is a primary market transaction in the first instance and not a mere trade in the secondary market.

<sup>38</sup> If viewed as underwriting in the context of the Securities Act of 1933 in the United States, liability and regulatory obligations will befall the underwriter. Here, the company as issuer is responsible.

<sup>39</sup> Delpont “Offers” 2011 *THRHR* 281 and Delpont *Die verkryging van kapitaal* (1987) 573-7. Old fashioned underwriting protects investors in a negative manner as it provides for sufficient capital as per the capitalising requirements.

<sup>40</sup> The company allots or agrees to allot the unissued securities to an intermediary, such as a merchant bank, who then offers the shares to the public. The price of the allotment will be lower than the selling price to the public and the company will receive the capital whereas the intermediary will be entitled to the difference in the allotment price and the selling price as remuneration in disposing of the securities.



by the company and not the third party (regardless whether any obligations manifest as to the shares not distributed).<sup>41</sup>

It is evident that sale in this context only refers to the underwriting constructions.<sup>42</sup> By way of background, in England, the Greene Committee considered offers for sale.<sup>43</sup> The structure of offering for sale through an intermediary had in many cases been adopted to circumvent the strict requirements of the law pertaining to prospectuses, with the result that the public had been deprived of the intended protection.<sup>44</sup> The

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<sup>41</sup> Delpont “Offers” 2011 *THRHR* 281. South African company law does not recognise these transactions as underwriting and groups it under the concept of “old fashioned” underwriting, akin to insurance. This entails that the outside party (not the company or third party as above) undertakes to take up the undistributed shares and for which the company pays a premium, usually a percentage of the total share distribution. See also Delpont *Die verkryging van kapitaal* (1987) 573. When a new company offers shares to the public for subscription, it is obviously important for the issue to be nearly as possible, fully subscribed. Should the issue not generate the amount mentioned in the prospectus as the amount which, in the opinion of the directors, must be raised in order to achieve the minimum objects of the offer, the issue fails as (in the absence of an underwriting agreement) the company can not proceed with the allotment of shares. An established company attempting to raise capital by way of an offer for subscription by way of rights or otherwise, will want to eliminate the risk of the offer being undersubscribed (meaning that the aggregate of shares which are applied for pursuant to an offer for subscription is less than the number of shares offered.) The opposite is oversubscription where more shares are applied for than are available and the available shares are apportioned between the applicants on some or other basis. Underwriting is the way of ensuring that the necessary amount of capital is raised by subscription or that the shares to be sold are disposed of, by having the offer underwritten. This contract between the underwriter (usually a financial institution) and the company or seller in terms of which the underwriter agrees to subscribe for or purchase, for a commission, any or a specified portion of the shares which are not subscribed for or purchased by the persons to whom they are offered (Cilliers *et al* (2000) *Corporate Law* 282-3 and 258 (for offer of sale)).

<sup>42</sup> Delpont “Offers” 2011 *THRHR* 283. Sale in the context of Chapter VI (as per the definition of an offer) only refers to underwriting constructions. As per Delpont “Offers” 2011 *THRHR* 282, 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 secondly his offer for sale (of shares or the right to allotment) to the investors.

<sup>43</sup> Blackman MS, Jooste RD & Everingham GK (2002) *Commentary on the Companies Act 3 v* (loose-leaf) Lansdowne South Africa: Juta 6-18 (hereinafter referred to as Blackman *et al* (2002) *Commentary*). See also the Greene WA, Great Britain Board of Trade, Company Law Amendment Committee (1925-1926) *Report Presented to Parliament by Command of His Majesty, Series: Great Britain, Parliament Papers by Command, Cmd. 2657* London: HMSO paragraph 40 (Greene Committee).

<sup>44</sup> Blackman *et al* (2002) *Commentary ibid*. The recommendation in that regard was designed to hit those cases and those cases only where “the offer is or may properly be deemed to be made in complicity with the company itself.” It would not affect cases where the independent holder of a block of shares desires to realise them by means of a public offer. In the last mentioned case it may obviously be impossible for the holder of the shares to obtain from the company the necessary information to comply with the law relating to prospectuses, and there could be no justification for placing the company under any liability in the matter. On the other hand, in those cases where the shares are

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recommendation had been accepted and section 38 of the 1929 Companies Act rendered the provisions of the Act relating to primary market offer regulation, by means of a prospectus, applicable also in the case of offers for sale for the purchase of shares or debentures which a company had allotted or agreed to allot “with a view to all or any of those shares or debentures being offered for sale to the public.”<sup>45</sup>

In South Africa, the Lansdown Commission pointed out that primary market offer regulation, by means of mandatory merit disclosure requirements, might lead to an increase in the practice of allotting securities to another company or individual for offer to the public in order to evade primary market regulation.<sup>46</sup> A recommendation was made<sup>47</sup> for the inclusion of the equivalent of section 38 of the English Companies Act of 1929, qualifying certain sales as primary market transactions. In these circumstances, a prospectus was required, clearly differentiating between section 141 secondary market regulation and Chapter VI primary market regulation, even though reference is made to a contract of sale transaction.<sup>48</sup> The differentiation does not exist in the distinction in designation between offer for subscription or offer for sale, but rather in the nature of the designated underlying transaction and regulatory principles to be complied with which were ultimately reflected in the 1973

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acquired in contemplation of an offer to the public, the persons acquiring them can have no difficulty in imposing on the company as a term of the contract, the obligation of furnishing the necessary information. Moreover, we consider that where a company issues shares in such circumstances and the directors know that there is going to be a public offer, they should be under the same liability to see that the public has proper information as they would be if the company itself were issuing a prospectus (Greene Committee *ibid*).

<sup>45</sup> *Ibid* Blackman *et al* (2002) *Commentary*.

<sup>46</sup> South Africa Company Law Commission (Lansdown) (1935-1936) *Report of the Companies Law Commission (UG 45 of 1936)* Pretoria: Govt. Printer 16 paragraph 80.

<sup>47</sup> Blackman *et al* (2002) *Commentary* 6-18.

<sup>48</sup> Section 146 of the 1973 Act.

Act.<sup>49</sup> The potential for abuse is patent where underwriting constructions are not provided for as primary market sales. In such instances the onerous prospectus requirements can be circumvented for the more lenient secondary market disclosure and liability provisions. It is for this reason that a primary market sale formed part of the nomenclature in terms of the delineating definitions in the 1973 Act, juxtaposed to secondary market resales of shares (or sale in the context of a secondary market transaction).

#### 1.1.2. Secondary market transactions

The secondary market comes into the fore where the investor who has acquired by whatever means as expounded on above, the securities and wishes to sell them. This subsequent transaction is a contract of sale and it occurs in the secondary market. This transaction has no relevance for the company, because as already stated, primary and secondary markets operate in strict numerical order as per the nomenclature. It is thus physically and legally impossible for the secondary market to exist prior to the primary market in respect of both the formal and informal secondary markets. This contract for a share transfer thus occurs in the secondary market and is in essence a resale of securities. Generally no formalities are required, there must however be an offer and an acceptance. The offer is governed by the ordinary rules of contract, except

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<sup>49</sup> Fundamental difference between section 141 and Chapter VI regulation. The distinction being a prospectus is required if the shares are allotted with a view of offering them to the public. See Cilliers *et al* (2000) *Corporate Law* 258.

where the offer is made to the public, in which case regulatory principles apply.<sup>50</sup>

As alluded to above, the secondary market is where the party offering the shares acts independently of the company and is in no position to meet the requirements for the issue of a prospectus.<sup>51</sup> The written statement or a copy of the registered prospectus may then be utilised to provide for the sale of shares when effecting a transfer of shares. In its technical sense the transfer of a share consists of an agreement to transfer, the cession of the rights attaching to the share, the execution of a deed of transfer, the delivery of the deed of transfer and the share certificate to the transferee, and finally, the registration by the company of the transfer.<sup>52</sup> The secondary market is informal and ought to be distinguished from the formal regulated market which is regulated by the Financial Markets Act 19 of 2012.<sup>53</sup>

As stated in respect of the primary market *supra*, the underlying transaction should dictate the regulation thereof. The nature of the transaction dictates the market applicable and it is submitted that the principles of offer regulation should ideally manifest through legislation in order to regulate the transaction for the public order. Only legislation aimed at offer regulation which takes cognisance of the type of market and transaction and aligns itself with the principles of offer regulation will

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<sup>50</sup> LAWSA (1995) paragraph 226.

<sup>51</sup> Cilliers *et al* (2000) *Corporate Law* 262.

<sup>52</sup> LAWSA (1995) paragraph 225. See also *In Re Copal Varnish Co Ltd* [1917] (2) Ch D 349; [1916-1917] All ER Rep 914 [1917] 2 Ch 349 915. The contract for a share transfer occurs in the secondary market and is a contract of purchase and sale.

<sup>53</sup> Delport “Offers” 2011 *THRHR* 281. The informal market is regulated by the Companies Act and the common law, whereas the formal market is regulated by the FMA.

muster efficacy requirements. This must be reflected in legislation per the delineating parameters of the definitions applicable to transactional relativity of the subject matter sought to be regulated.

It is submitted and will be shown that the 2008 Act fails to heed the market and transactional differences which are required for effective offer regulation. The Legislature did not apply transactional awareness as well as the principles of offer regulation in drafting the 2008 Act. The potential for abuse in the secondary informal market is wide in scope.

## 1.2. Summary

It has been established that offer regulation has followed an evolutionary path which crystallised in the principles of offer regulation.<sup>54</sup> It is thus submitted that the principles of offer regulation should address the underlying transaction to be regulated. In the event that one of these two factors to offer regulation falls short, effective offer regulation is compromised. In order to address the transaction, the regulatory principles as meted out in legislation ought to address the markets separately.

Due to transactional relativity in terms of primary market sales, it is essential that underwriting constructions are provided for in the Companies Act and that the delineating parameters of offer regulation are sufficiently set out in respect of the regulatory model.

Based on the deficiencies in the common law, which will be further expounded on in the discussion which follows, it will show that

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<sup>54</sup> See chapter 4 *supra*.

legislation which regulates primary market transactions ought to provide for an invitation.

Regulatory confusion in terms of differentiation between the markets and the underlying transactions was caused by the provisions of the 1926 Act<sup>55</sup> which applied to both sets of separate transactions.<sup>56</sup> The Van Wyk de Vries Commission recommended that the provisions be in different chapters in the 1973 Act.<sup>57</sup> This model was inverted in Chapter 4. In order to contrast the two sets of legislation so as to highlight the problems with the step back to the 1926 approach, a review of offers in terms of the 1973 Act will follow below in order to contextualise the subject matter.

## **2. Offers in terms of the 1973 Act**

### **2.1. Primary market offer**

The 1973 Act defined<sup>58</sup> an offer in section 142 as:

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

The definition distinguished between a contract for subscription in the primary market and a contract of purchase and sale.<sup>59</sup> Chapter VI of the 1973 Act was intended to operate in relation to the raising of capital by a

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<sup>55</sup> Companies Act 46 of 1926.

<sup>56</sup> Delpont "Offers" 2011 *THRHR supra*

<sup>57</sup> *Ibid.* Section 141 of the 1973 Act was placed in chapter V while the primary market regulation was in the new Chapter VI (sections 142 *et al*). The confusion was due to the same terms used in different contexts.

<sup>58</sup> Section 142(1) of the 1973 Act.

<sup>59</sup> Delpont "Offers" 2011 *THRHR* 283.

public company, by means of an approach to the public, which is a primary market transaction and not akin to the secondary market transaction envisaged in section 141 of Chapter V.<sup>60</sup>

To this extent, the delineation in terms of Chapter VI at section 142 contained a specific set of definitions applicable to the primary market transactions to be regulated therein,<sup>61</sup> as the definitions in section 142 commences with the words: “*In this Chapter (VI)*” therefore the definitions can not be used for the secondary market provision of section 141 in Chapter V.<sup>62</sup>

Although “offer” as defined included an invitation<sup>63</sup> to subscribe for or purchase shares, this fundamentally differs from the secondary market transaction envisaged in section 141.<sup>64</sup> In the context of Chapter VI, purchase did not mean the purchase of issued shares acquired by the offeror or his principal, but the acquisition of shares in a new issue.<sup>65</sup> The aim of Chapter VI was the protection of investors by prohibiting offers to the public by a company, unless there was compliance with the provisions obligating truthful disclosure of prescribed information in a prospectus.<sup>66</sup>

The divide between the types of regulation between the markets, fundamentally resides in the type of transaction and the regulation thereof.

It is submitted that it follows that the divide between regulation in terms

<sup>60</sup> Kunst JA, Delpont PA and Vorster Q (2011) *Meskin Henochsberg on the Companies Act 5<sup>th</sup> ed 3 v* (loose-leaf) Durban: LexisNexis 258 (hereinafter referred to as Henochsberg on the 1973 Act).

<sup>61</sup> Henochsberg on the 1973 Act *ibid.*

<sup>62</sup> Delpont “Offers” 2011 *THRHR* 283.

<sup>63</sup> Section 141(10) of the 1973 Act.

<sup>64</sup> Henochsberg on the 1973 Act *supra.*

<sup>65</sup> *Ibid.*

<sup>66</sup> Blackman *et al* (2002) *Commentary* 6-2.

of Chapter V, section 141 and Chapter VI transactions is to avoid confusion and thus the possibility of assailing the more stringent Chapter VI, for section 141 in Chapter V. In the absence of confusion, legal clarity is obtained ensuring efficient compliance to regulatory principles. The main regulatory provisions in Chapter VI were firstly, section 143 which restricted offers to the public other than in accordance with the provisions of the 1973 Act, prohibiting offers of shares to the public of a company or external company unless exempted by section 144 (offers not being offers to the public.) The second main regulatory provision was section 145 which provided for no offer for subscription (once qualified under section 143 as a transaction under purview of regulation in terms of Chapter VI), without a prospectus. The third main regulatory provision was section 146 which provided under similar circumstances as section 145, for no offer without a prospectus, once qualified as a regulated offer, with the difference that the offer would be for sale and not for subscription and it had to be read with the definition of an offer in section 142. It has been shown that the definition of an offer in the 1973 Act distinguished between a contract for subscription in the primary market and a contract of purchase and sale which denotes an “underwriting” strategy.<sup>67</sup>

Section 142(1) defined an “offer” in relation to shares, as to mean an offer made in any way, including by provisional allotment or allocation, for the *subscription for or sale* of any shares, and included an *invitation to*

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<sup>67</sup> Although an offer as defined included an invitation to subscribe for or purchase shares, this fundamentally differed from the secondary market transaction envisaged in section 141. In the context of Chapter VI, “purchase” did not mean the purchase of issued shares acquired by the offeror or his principal, but the acquisition of shares in a new issue.



subscribe for or purchase shares.<sup>68</sup> In line with this definition in the 1973 Act, section 146 provided for underwriting constructions as provided for in South African law, and should not be considered as a sale similar to the secondary market transaction envisaged to have been regulated by section 141.

## 2.2. Primary market sale

It is now established that in the primary market, the offer must be intended for the conclusion of a contract for subscription (the acquisition of unissued shares).<sup>69</sup> Primary market sales in the context of Chapter VI regulation referred to section 146. The 1973 Act envisaged two situations, firstly, where a company allots shares to an issuing house, bank or mining house with a view to such intermediary subsequently making a public offer.<sup>70</sup> This underlying assumption of the role of the intermediary in floating the shares of the company constituted one of the main differences between the purview of section 146 as primary market sale and that of section 141 as secondary market sale. Secondly, it was envisaged where a company allotted and issued shares, not with the object of those shares being offered to the public for sale, but the shareholder concerned in co-operation with the company later offers them for sale to the public, and his offer for sale is accompanied by the stated intention of the company to

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<sup>68</sup> Own accentuation.

<sup>69</sup> See Delpont “Offers” 2011 *THRHR* 281 as well as Loss (1988) *Fundamentals* 85. The reason why it is a contract for subscription and not a contract for purchase and sale (as would be relevant in the secondary market), is because of the fact that the security, as an incorporeal, is not yet in existence before the issue thereof and can therefore not be sold. The company does not offer the shares for subscription; it issues an invitation to investors, who then make offers to the company. The company then accepts the offers to the extent that securities are available and allotment and issue follows.

<sup>70</sup> *LAWSA* (1995) paragraphs 218-220. The offeror is thus the intermediary who is running the risk of facing the failure of the public offer, but who is usually compensated by a commission or a price differential.

apply for the listing of those shares.<sup>71</sup> In the spirit of the evolvement of offer regulation, the applicable principles thereto had to be adjusted in order to accommodate changing strategies in protecting investors by mandatory disclosure provisions.<sup>72</sup> Based on this it may be recognised that underwriting transactions are those where the securities are obtained with a view to distribute them.

Primary market sales in the context of Chapter VI were regulated by section 146. Section 146(2) provided a presumption in terms of underwriting constructions and the secondary market sale. Such an offer for sale had to be accompanied by a full prospectus if the shares have been allotted with a view to them being offered to the public<sup>73</sup> within 18 months of the initial allotment. The same applied if a listing was eminent on an exchange as it is patent that under the circumstances listed it was a primary market transaction and not a secondary market trade. The prospectus requirement could not be assailed by pretending that an issue had not been made with a view to offering it to the public due to the presumption in section 146(2) that an issue is deemed to have been allotted with a view to being offered to the public of the offer for sale is made within 18 months of the allotment.<sup>74</sup> This would equally apply in respect of section 146(2) where typically under an underwriting construction, the offer would be accompanied by a prospectus under

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<sup>71</sup> Section 146(1)(b) of the 1973 Act. Here the shareholder is in co-operation with the company.

<sup>72</sup> *Ibid.*

<sup>73</sup> Section 146(1)(a).

<sup>74</sup> Cilliers *et al* (2000) *Corporate Law* 258.

Chapter VI. Under the 2008 Act the presumption is not available nor is an equivalent of section 146.

It has previously been recommended that section 146 of the 1973 Act be deleted and replaced by a definition of an underwriter, following the US model.<sup>75</sup> This is due to the fact that it was recognised that the differentiation between a primary market subscription and sale was unnecessary as the underlying construction denoted underwriting and also due to the possible interpretational problems in differentiating between the concepts of subscription and sale. Eventually the envisaged problems manifested in the *Gold Fields Ltd v Harmony Gold Mining Co Ltd* case.<sup>76</sup> The recommended definition referred to an underwriter as any person which obtains securities with the aim to distribute it to the public, whether a contractual relationship between the company and the underwriter exists or not.<sup>77</sup> The definition had to contain a presumption similar to section 146(2), denoting that in the case of any distribution prior to the expiry of 24 months such a person would be regarded as an underwriter.<sup>78</sup> Based on this it may be recognised that underwriting transactions are those where the securities are obtained with a view to distribute them. It follows that where such an outside party keeps the shares as an investment, past the 18 months under the 1973 Act, it would have been able to sell the shares as legitimate secondary market transactions. However, where the third party (usually) obtained the securities with a view to distribute or sell them to

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<sup>75</sup> In this respect see Delpont *Die verkryging van kapitaal* (1987) 800.

<sup>76</sup> *Gold Fields Ltd and Another v Harmony Gold Mining Co. Ltd and Others* 2005 (2) SA 506 (SCA) (hereinafter referred to as the *Gold Fields* case); see Delpont PA “Offer to the Public: Even More Disharmony” (2005) 17 *SA Merc LJ* 388 in respect of the confusion.

<sup>77</sup> *Ibid.*

<sup>78</sup> *Ibid.*

the public, section 146 of the 1973 Act would have brought the transaction within regulatory purview. If it is not a public transaction then Chapter VI would not have applied. It is for this reason that a primary market sale forms part of the nomenclature in terms of the delineating definitions. The artificial differentiation in the definition of an offer, between a sale and a subscription, would be negated if underwriting constructions were provided for as outlined above. It follows that such a provision would include a presumption of primary market distribution.

### 2.3. Secondary market and secondary market sale

Section 141 of Chapter V in the 1973 Act regulated secondary market transactions, i.e., sale of shares.<sup>79</sup> The section placed a restriction on the offering of shares for sale to the public without a statement.<sup>80</sup> An offer of shares to the public either orally, or in writing, was prohibited to be issued, distributed or published where the denoted material in its form and context were calculated to be understood as an offer, unless accompanied by a registered written statement which complied with the requirements of section 141(5).<sup>81</sup>

Specifically excluding the application of the section to primary market transactions was subsection (2)(e) which dictated that the provisions of subsection (1) did not apply where the offer is accompanied by a prospectus registered under Chapter VI of the 1973 Act.

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<sup>79</sup> Section 80*bis* under the 1926 Act.

<sup>80</sup> Henochsberg on the 1973 Act 252.

<sup>81</sup> Section 141(1) of the 1973 Act.

The prohibition extended to an offer or invitation whether made orally or in writing (including any newspaper advertisement, or any electronic advertisement) and to the distribution or publication of any material which in its form and context is calculated to be understood as an offer or invitation. It also extended to debenture stock or debenture bonds or any other security of a company.<sup>82</sup>

It follows that the field of application differs from Chapter VI transactions, being aimed at the unscrupulous selling to the public of issued shares of a company.<sup>83</sup> The essence is the requirement of disclosure of the information material to any intending purchaser's decision as whether or not to enter into the transaction, safeguarding the true market value of the shares and all matters affecting it.<sup>84</sup>

The investor who acquired shares in the primary market, by whatever means, may want to sell the shares and this transaction is reserved for the secondary market, the transaction having no direct relevance for the company.<sup>85</sup> The primary market and secondary markets operate in strict

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<sup>82</sup> Henochsberg on the 1973 Act 254.

<sup>83</sup> Also known as share hawking. The statement to include *inter alios* the dates on which and the price at which the shares offered were originally issued by the company, and were acquired by the person making the offer or by his principal, giving the reasons for the difference between such prices and the prices at which the shares are being offered (section 141(5)(i)). The sentence directly below subsection (k) appears to be superfluous in context as it can only be the shares issued by the company (Henochnsberg on the 1973 Act *ibid*). See also *S v Rossouw* 1969 (4) SA 504 (NC) 508-9 and *Vlakspruit Landgoed (Edms) Bpk v J Mentz (Edms) Bpk* 1977 (1) SA 780 (T).

<sup>84</sup> Henochsberg on the 1973 Act 255.

<sup>85</sup> Delpont "Offers" 2011 *THRHR* 281. Due to the principles 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 *Gomes-Sebastiao v Quarry Cats (Pty) Ltd* (A5015/2010) [2010] ZAGPJHC 103 (10 Nov 2010).

numerical order as per the nomenclature and it is physically and legally impossible for the secondary market to exist prior to the primary market.<sup>86</sup>

The reasoning for the importance of this distinction is that in the primary market the company must disclose by way of a prospectus and the extent of the disclosure is substantial.<sup>87</sup> In the secondary market, 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.<sup>88</sup>

The contextual difference is to be found in the context of information available to effectively disclose in meeting the principles of offer regulation. The less comprehensive system which was in place in terms of section 141 enabled both offer regulation as well as compliance thereto by a seller who did not necessarily have all the information available which was needed for a prospectus. The system therefore was less onerous than that of primary market regulation. Due to the confusion between the provisions of offer for subscription and for sale in the primary market and offer for sale in the secondary market (two sets of sale transactions with different context to each) confusion reigned in applying the provisions applicable in the 1926 Act.<sup>89</sup> Due to this, the Van Wyk de Vries Commission recommended that the provisions be in different chapters in the 1973 Act.<sup>90</sup>

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<sup>86</sup> Delpont “Offers” 2011 *THRHR* 281.

<sup>87</sup> *Ibid.*

<sup>88</sup> *Ibid.*

<sup>89</sup> *Ibid.*

<sup>90</sup> *Ibid.*

Based on an overview of the contingent history<sup>91</sup> it is clear that section 101 is an historic remnant clinging to its applicability in a modern regulatory regime.<sup>92</sup> As stated *supra*, section 101 of the 2008 Act is the predecessor of section 141 of the 1973 Act. Section 141 was preceded by section 80*bis* of the 1926 Act. Section 80*bis* was inserted into our law by the Companies Amendment Act 23 of 1939 in recommendation of the Lansdown Commission.<sup>93</sup> Section 80*bis* was derived from section 356 of the English Companies Act of 1929, which was inserted on recommendation of the Greene Commission to prohibit the hawking of shares and to ensure a minimum requirement of disclosure. The Greene Commission considered offers for sale. The structure of offering for sale through an intermediary had in many cases been adopted to circumvent the strict requirements of the law pertaining to prospectuses, with the result that the public had been deprived of the intended protection. The recommendation had been accepted and section 38 of the 1929 English Companies Act rendered the provisions of the stated Act relating to primary market offer regulation by means of a prospectus, applicable also in the case of offers for sale for the purchase of shares or debentures which a company had allotted or agreed to allot “with a view to all or any of those shares or debentures being offered for sale to the public.” In South Africa the Lansdown Commission pointed out that primary market

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<sup>91</sup> Delpont *Die verkryging van kapitaal* (1987) Chapter 12.

<sup>92</sup> The extent of investor protection based on the information to be disclosed is questionable. It was argued *ibid* that the trading of shares in the secondary market be limited to approved dealers or intermediaries. This excludes the concept of public and disclosure as is relevant in the system currently in place in the UK. Self-regulating with governmental purview of traders or intermediaries and an obligation on the latter to ensure that offers comply with the required provisions will ensure a more effective system (*ibid*).

<sup>93</sup> Lansdown Commission *supra*. See also Delpont *Die verkryging van kapitaal* (1987) 677.

offer regulation by means of mandatory merit disclosure requirements might lead to an increase in the practice of allotting securities to another company or individual for offer to the public in order to evade primary market regulation. A recommendation was made for the inclusion of the equivalent of section 38 of the English Companies Act of 1929, qualifying certain sales as primary market transactions. In these circumstances, a prospectus, was required, clearly differentiating between section 141 secondary market regulation and Chapter VI primary market regulation in respect of primary market sales (by means of an underwriter) even though reference is made to a contract of sale transaction. The differentiation does not exist in the distinction in designation between offer for subscription or offer for sale, but rather in the nature of the designated underlying transaction and regulatory principles to be complied with which were ultimately reflected in the 1973 Act.<sup>94</sup>

Section 356 was replaced by section 12 of the Prevention of Fraud (Investments) Act of 1939 after a short run on the statute books. This Act (the PFIA) followed from recommendations from the Bodkin Commission<sup>95</sup> and Anderson Commission.<sup>96</sup> The 1939 Act was replaced by the 1983 Act with same title. It was the aim of the latter Act to regulate

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<sup>94</sup> *Ibid.*

<sup>95</sup> Great Britain & Bodkin AH (1937) *Share-Pushing: Report of the Departmental Committee Appointed by the Board of Trade 1936-37* London: H M Stationery Off. See also Delpont *Die verkryging van kapitaal* (1987) 681.

<sup>96</sup> Great Britain, Board of trade Committee on Fixed trusts, Sir Alan Garrett Anderson (1936) *Fixed Trusts: Report of the Departmental Committee Appointed by the Board of Trade* London: HMSO. See also Delpont *Die verkryging van kapitaal* (1987) 681.



the secondary market by means of registered or exempt traders or intermediaries instead of the predecessor of section 101.<sup>97</sup>

The PFIA of 1958 regulated the secondary market of securities by means of registered or exempted traders. No person may have distributed documents or cause to distribute circulars which contained an invitation to conclude an agreement or to make an offer to conclude an agreement in order to obtain securities, to alienate, to subscribe or underwrite, or to conclude an agreement with the aim of obtaining a profit from the proceeds of the securities or from the difference in the price of the securities.<sup>98</sup> These provisions if contravened constituted criminal offences. The only persons who could conduct the business with reference to dealing in securities had to be licensed or exempt traders. Primary market transactions were excluded as the issuance of a prospectus on application form of shares together with a prospectus did not denote trading in shares in terms of the PFIA section 2(2)(b) and (d). Where a person wished to trade in securities they had to apply for a license in terms of section 3 and 4 of the PFIA. The Financial Services Bill, following Gower provided for the replacement of the 1958 Act.<sup>99</sup> The Financial Service Bill provided for the Financial Services Act which gave rise to the Financial Services Authority, the pro-active regulatory in the UK, which ultimately gave rise to the dispensation currently in force in the UK under the Financial Services Markets Act of 2002 and the Financial Conduct Authority. Where the PFIA relied on governmental regulation, the Financial Services

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<sup>97</sup> *Ibid.*

<sup>98</sup> See sections 14(1)(a)(i) and 13(1)(a),(b) and (c) of the PFIA.

<sup>99</sup> Delpont *Die verkryging van kapitaal* (1987) Chapter 12.

Act provided for regulation inside a statutory framework. The result was that no person could trade if not part of an investment firm or investment business unless exempted or authorized to do so per section 326 of the Financial Services Act. This has been carried forward in the United Kingdom's Financial Services Markets Act of 2002.

It follows that secondary market transactions of unlisted shares had to be in accordance with a licensed or exempt dealer. In general, the provisions of section 101 have to be complied with concerning offers extended to the public for the sale of securities, unless it is a trade in the formal securities market under which it is then excluded and regulated by the Financial Markets Act of 2012. It was recommended by Delpont that the trading of shares in the informal market be limited to approved traders or intermediaries whereby a couple of deficiencies could be excluded.<sup>100</sup> The concept of “public” as expounded in *Gold Fields Ltd* perpetuated the problems occasioned in the interpretation of the *Rossouw*<sup>101</sup> cases which added to the recommendations in the Van Wyk de Vries Report. In the 2008 Act, these problems are extended to impact on the liability and enforceability of Chapter 4 regulation of offers. Delpont opined that the secondary market offer to the public and the information required to be submitted was insufficient for an investor to make an informed choice. The information might also be difficult to obtain or impossible due to the fact that it is exclusively within the control of the company. It is submitted that these difficulties still exist. Following the system currently in place in

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<sup>100</sup> Delpont *Die verkryging van kapitaal* (1987) 695.

<sup>101</sup> *S v Rossouw* 1968 (4) SA 380 (T), *S v Rossouw* 1969 (4) SA 504 (NC), *S v Rossouw* 1971 (3) SA 222 (T), (the *Rossouw* cases).

the United Kingdom will have the benefit that all trading will be done by licensed or authorized persons and the requirements for disclosure are excluded. The intermediaries are dependent upon public opinion in successfully conducting their business and this will ensure above board trading.<sup>102</sup> The most important deduction to be made is that South Africa is still stuck with provisions replaced in 1939 in the United Kingdom. The short synopsis of the history above shows constant involvement in the United Kingdom.

These developments had to be considered prior to merging the regulatory provisions of section 101 (the regulatory predecessor in part, to section 141 of the 1973 Act), with and into Chapter 4, as it is evident that although regulation is required in respect of the secondary informal market, the existing provisions are outdated and cumbersome. The comparative study in Chapter 6 will allude to a probable resolution.

### **3. Offer regulation in terms of new dispensation**

It has been established that Chapter 4 regulates public offerings of company securities on the capital markets.<sup>103</sup> No person may offer any securities to the public otherwise than in accordance with the provisions of the 2008 Act.<sup>104</sup> An initial public offering, offer, offer to the public, primary offering and secondary offering are defined. These definitions will be expounded on below in order to contextualise same against the common law of the underlying transactions in amplifying the effect of the provisions in

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<sup>102</sup> *Ibid.*

<sup>103</sup> Heading to Chapter 4 in the 2008 Companies Act read with Chapter 4.

<sup>104</sup> Section 99.

Chapter 4, taking cognisance of the fact that capital markets are divided into the primary market and the secondary markets.<sup>105</sup>

Chapter 4 of the 2008 Act combines the regulation under section 141 of the 1973 Act together with the principles of Chapter VI under that Act. As shown the ambit, application, and history of section 141 and Chapter VI of the 1973 Act differs substantially from each other and equates to the division of the two regulatory regimes and underlying principles thereto. The interaction between the primary market and the secondary market is in the sense that the secondary market transaction with its written statement in terms of section 101(6) can be used to circumvent the full registered prospectus requirement of the primary market transaction.<sup>106</sup> To this extent, the delineating definitions are important as regulatory purview may also be excluded *in toto*.

### 3.1. Primary market

Section 99 refers, as far as is relevant:

99(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-

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<sup>105</sup> Delport "Offers" 2011 *THRHR* 280.

<sup>106</sup> *Ibid* 282. Delport opines that the 2008 Act resurrected the problems of Act 46 of 1926.

- (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.

Based on the definition, all initial public offerings will be primary offerings, but not all primary offerings will be initial public offerings.<sup>107</sup>

A primary offer(ing) is defined in section 95(1)(i) 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 -
  - (i) within a group of companies of which the first company is a member; or
  - (ii) with which the first company proposes to be amalgamated or to merge.

Therefore it is understood from a PO that it means an offer to the public, made by or on behalf of a company, of securities to be issued by that company, or another company within a group of companies with which the first company proposes to merge, or into which the first company proposes to be amalgamated.<sup>108</sup>

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<sup>107</sup> Delport (2011) *Manual* 44.

<sup>108</sup> Section 95(1)(h).

The initial public offer(ing) is defined in section 95(1)(e) 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.

Therefore an IPO is an offering to the public of any securities of a company if no securities of that company have previously been the subject of an offer to the public, or if all of the securities previously the subject of a public offer have been re-acquired by the company.<sup>109</sup>

An offer is defined as:

- (a) “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.

“Acquisition” is not defined and should include both an issue as well as sale, unless clearly indicated otherwise, as in the definition of primary offering. The use of the words “with respect to” instead of “for” would indicate that acquisition refers to the offeror as well as the addressee. In accordance with the definition of an offer, barter<sup>110</sup> is included. However, an invitation to make an offer is excluded. Problems relating to this are

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<sup>109</sup> Section 95(1)(e).

<sup>110</sup> Exchange for something other than money (Delpont (2011) *Manual* 44).

discussed in the subsection *infra* dealing with invitations and advertisements.

An offer to the public includes an offer of securities to be issued by a company, its subsidiary or a third party company, to any section of the public,<sup>111</sup> but does not include an offer made as contemplated in section 96 or a secondary offer through an exchange.<sup>112</sup> This definition does not include “an offer to the public” but merely adds categories that would be included in the common law definition.<sup>113</sup> An offer relating to securities in terms of the 2008 Act means an offer made in any way, by any person and with respect to the acquisition of any securities in a company for consideration.<sup>114</sup> The words “in any way” includes any offer, whether oral or in writing and also electronic.<sup>115</sup> Only a company may offer securities to the public.<sup>116</sup> An offer in relation to securities denotes an offer made in any way, which includes any offer whether oral or in writing and also electronic.<sup>117</sup> This offer, as made, is further defined as made by any

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<sup>111</sup> Including clients of the person issuing the prospectus, holders of a class of property or in any other matter. The prospectus requirement is tautologous as an offer in any event requires a prospectus, see Delpont (2011) *Manual* 45.

<sup>112</sup> Section 95(1)(h).

<sup>113</sup> Delpont (2011) *Manual supra*. The definition is wide due to the term “in any other manner” having the effect that all offers would have required a prospectus. It is accepted not everybody requires a prospectus because they may have the information or can acquire it readily. Section 96 therefore provides for certain persons not to be considered “public” even though they may be considered to be so. It falls outside the scope of this work to delve into detail into section 96.

<sup>114</sup> Section 95(1)(g).

<sup>115</sup> Delpont (2011) *Manual* 44. Also note the section hereunder for advertisements regarding this anomaly.

<sup>116</sup> Section 99(1). “Company” is defined in section 95(1)(a), and includes a foreign company, incorporated outside South Africa, which will make enforcement problematic (Delpont (2011) *Manual* 43).

<sup>117</sup> Where the offer is for debt instruments, the “security document” must contain the information as required by section 43(1)(b). No provision is made if the offer is not in writing (Delpont (2011) *Manual* 43).

person with respect to the acquisition of any securities in a company for consideration.<sup>118</sup>

If the offer is for “debt instruments,” the “security document” must contain the information as required by section 43(1)(b). No provision is made if the offer for debt instruments is not in writing.

Section 95(2) reads:

For the purposes of this Chapter, a person is to be regarded, by or in respect of a company, as being a member of the company or a purchaser of goods from the company.

This definition is superfluous and confusing and was transferred from section 141 of the 1973 Act, which had a different definition due to the difference in the ambit of regulation.<sup>119</sup>

The primary market is the first distribution.<sup>120</sup> It has been established that the primary market is in the first instance regulated by the Companies Act and lastly, to an extent, by the common law, insofar as not excluded by the provisions of Chapter 4.<sup>121</sup>

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<sup>118</sup> Acquisition is not defined, and should include both an issue as well as sale unless clearly indicated otherwise, as in the definition of primary offering. The use of the words “with respect to: instead of “for” would indicate that the acquisition refers to the offeror as well as the addressee (Delpont (2011) *Manual supra*).

<sup>119</sup> Delpont (2011) *Manual ibid*.

<sup>120</sup> *Ibid*. Distribution is here in context of the common law, to indicate that the shares are made available to investors of those shares and not in terms of the definition in terms of section 1 of the 2008 Companies Act. In this distribution, the eventual investor is a party to the contract, which ever form it takes on, and the company is the other party.

<sup>121</sup> *Ibid*. The common principle is that the ultimate two parties to the contracts are the company who acquires the consideration for shares (directly or indirectly) and the (eventual) investor who acquires the shares (directly or indirectly). It follows that in time this is the primary market by virtue of the nature of the transaction and mechanism as there will not be scope for secondary transactions without this initiating step.



The main regulatory provisions, apart from section 95 which delineate the scope of application of Chapter 4, are section 99 which provides the general restriction on offers to the public including the disclosure requirement once an offer qualifies under section 95 as falling under regulatory purview, and section 101 which provides for secondary offers whilst section 96 contains the statutory exemptions to the application of Chapter 4 regulation.<sup>122</sup>

Section 95(1)(g) defines an “offer” as, in relation to securities, an offer made in any way by any person with respect to the acquisition, for consideration, of any securities in a company. In addition thereto, the concepts of an initial public offering (IPO) as well as a public offering (PO) are provided for in sections 95(1)(e) and (i). An IPO, a new concept in our law, is defined as an offer to the public of any securities of a company if no securities of that company have previously been the subject of an offer to the public; or all of the latter securities have been re-acquired by the company. A PO is defined as 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. In addition thereto, a secondary offering is defined as 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.<sup>123</sup> It follows that an offer in terms of section 95(1)(g) must be aimed at bringing a particular contract into existence.<sup>124</sup> The difference between the PO and the IPO which may determine regulation

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<sup>122</sup> For purposes of this discussion, the liability provisions are excluded.

<sup>123</sup> Section 95(1)(m).

<sup>124</sup> Delpont “About Offers to the Public” 2011 *THRHR* 669.

in the secondary market is that in the case of an IPO it is an offer of securities and not an offer of securities to be issued as is the case in a PO. Therefore an IPO can be in respect of any “acquisition for consideration” as defined in “offer” but the PO applies only in respect of issued securities. It follows that the ambit of these transactional definitions is uncertain but it is opined that all IPOs will be POs but not all POs will be IPOs.<sup>125</sup>

### 3.1.1. Imported PO and IPO concepts

Regarding primary offerings, it is to be discerned between the imported concepts of primary offering and initial public offering. A primary offering may not be made to the public (excluding an IPO) of any listed securities of a company, unless that offer is in accordance with the requirements of the exchange, or make a primary offer of unlisted securities of a company, unless the offer is accompanied by a prospectus that satisfies the requirements of section 100.<sup>126</sup> Primary offering further means an offer to the public made by or on behalf of a company, of securities to be issued by that company, or another company within a group of companies of which the first company is a member, or with which the first company proposes to merge, or into which the first company proposes to be amalgamated.<sup>127</sup>

An offer to the public includes an offer of securities to be issued by a company, its subsidiary or a third company to any section of the public,

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<sup>125</sup> *Ibid.*

<sup>126</sup> Section 99(3)(a) and (Delpont (2011) *Manual* 44.) All IPOs will be primary offerings, but not all primary offerings will be IPOs.

<sup>127</sup> Section 95(1)(h).

whether or not selected as security holders of the company concerned, as clients of the person issuing the prospectus concerned,<sup>128</sup> as the holders of a particular class of property, or in any other manner, but does not include an offer made in any of the circumstances contemplated in section 96, or a secondary offer through the exchange.<sup>129</sup> This definition does not include “an offer to the public” but merely adds categories that would be included in the common law definition. The effect is that the *Gold Fields Ltd case*,<sup>130</sup> in which a non-public category was erroneously created under the words of the 1973 Act, would now be incorrect. The definition in section 95(2) is superfluous and confusing and was transferred from the 1973 Act, which had a different definition due to the difference in the ambit of regulation.<sup>131</sup>

There is also a clear overlap between the IPO, which is a new concept in our law, and that of the secondary offering as regulated in section 101 due to the fact that although the latter is clearly defined as an offer for sale, the use of the word “offer” in the definition of an IPO is on the basis of the definition of an offer in terms of section 95(g), which is wide enough to include an offer for sale.

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<sup>128</sup> Delpont (2011) *Manual* 45. This phrase is tautologous as the offer to the public determines whether a prospectus must be issued.

<sup>129</sup> Section 95(1)(h).

<sup>130</sup> *Gold Fields supra*.

<sup>131</sup> Delpont (2011) *Manual* 45.

## 3.1.2. Resurrection of perplexity

The confusion is resurrected and perpetuated in terms of the current Chapter 4 regulatory regime due, *inter alia* to section 99(3) which ignores the distinction between the capital markets, and which has the net effect of making regulation confusing, opening up room for creative manoeuvring in terms of circumventing regulation as well as contributing to inefficiency.<sup>132</sup>

Whereas ignorance of the difference between the capital markets may be colloquially acceptable, it is not possible in law as the two capital markets remain separate from each other. The secondary market can only operate after the shares have been issued in the primary market. The primary market offer of listed securities is, therefore, physically and legally impossible. In respect of listed securities the time difference between the initial issue and the subsequent listing may be small, but, nonetheless, it remains.<sup>133</sup>

The difference in transactional relativity between the concepts of an offer as provided for in the 1973 Act and that of the 2008 Act has been discussed by Delpont in “*Offers*” and *the Companies Act 71 of 2008*.<sup>134</sup> Section 95(1)(g) differs fundamentally in respect of the underlying contractual principles as well as the evolvement of company law. It refers to an offer as being an offer for the acquisition, for consideration of

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<sup>132</sup> Section 99(3) provides that a person must not make a primary offer to the public of any listed securities of a company, other than in accordance with the requirements of the relevant exchange.

<sup>133</sup> Delpont “Offers” 2011 *THRHR* 285. See also Johannesburg Stock Exchange (JSE) (2014) “Listings Requirements” LexisNexis [www.jse.co.za/content/JSESpecificationsItems/Service%20Issue%2017.pdf](http://www.jse.co.za/content/JSESpecificationsItems/Service%20Issue%2017.pdf) (accessed on 29 June 2014) chapter 5.

<sup>134</sup> Delpont “Offers” 2011 *THRHR* 280.

securities. The difference is evident when compared to the definition in the 1973 Act. This definition now includes subscription and sale, not differentiating between primary market and secondary market transactions or underwriting constructions, to be read as all if three are applicable. It also does not consider the exposition of offer and invitation as an invitation is not provided for in Chapter 4. The invitation for subscription by the company will therefore not be an offer as defined in the 2008 Act or under the common law. The definition also implies that it is the investor making the offer and not the company making an invitation for the subscription to an offer. The PO and IPO is also excluded as the investor is not the party extending the offer of securities in terms of the PO and IPO as the determining definition is that of an offer. There is a vast difference between an invitation and an advertisement as provided for in section 98 read with section 1. Section 98 refers to an offer as defined and section 98 regulates the offer if it is made by advertisement and not if the advertisement is an invitation. Section 95(1)(m) refers to the secondary market offering and means: “...an offer for sale...requiring either a registered prospectus or a written statement.” The use of offer as defined is wide enough to create an overlap of regulation in respect of the markets, where the definition of an IPO is read with the secondary market offering for sale.<sup>135</sup> It follows that the definition of an offer in terms of section 95(1)(g) also will have to be revisited as to provide for an invitation and to denote a move towards the definition in the 1973 Act, *sans* the differentiation between a distribution and sale.

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<sup>135</sup> *Ibid.*

An ordinary contractual offer, such as provided for in section 95(1)(g) which defines an offer, does not in itself create rights and duties between offeror and offeree, mainly because the offeror is, in terms of the definition, the investor and is unable to make the offer due to the incorporeal subject matter of the securities in respect of a primary market distribution and allotment or sale. In terms of the law of contract, an offer gives rise to the *spes* of a future right, based on the acceptance of the obligations envisaged in the offer.<sup>136</sup> In terms of acceptance, same constitute a declaration of will which indicates assent to the proposal contained in the offer.<sup>137</sup> If the securities have been allotted with a view to offer them to the public it will be a primary market transaction and the regulatory principles in terms thereof under Chapter 4 ought to apply.<sup>138</sup> It is submitted that this ought to be the objective test: have the securities been allotted with a view to offer them to the public? The avoidance of this regulatory principle in terms of underwriting transactions has been made difficult in terms of the presumption under section 146(2) of the 1973 Act which provided for the deeming provision that an issue will be considered to have been allotted with a view to being offered to the public if the offer for sale is within 18 months of the allotment. It follows that where such an outside party keeps the shares as an investment, past the 18 months under the 1973 Act, it would have been able to sell the shares as legitimate secondary market transactions. However, where the third party

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<sup>136</sup> *Ibid* 45-6.

<sup>137</sup> *Ibid* 48.

<sup>138</sup> Section 146(1)(a) of the 1973 Act provided for these types of transactions. Section 146(1)(b) provided for simultaneous listings on an exchange (the JSE) as it is a primary market transaction in the first instance and not a mere trade in the secondary market.

(usually) obtained the securities with a view to distribute or sell them to the public, section 146 of the 1973 Act would have brought the transaction within regulatory purview. If it is not a public transaction then Chapter VI would not have applied.

### 3.1.3. Invitation

It is common cause that public offers in the primary market ought to include an invitation following the common law transactional relativity in respect of company law.<sup>139</sup> The contrary is that an offer will not constitute a contract if the common law in terms of the law of contract is followed. Furthermore, if the definition of an offer does not provide for an invitation to be included, the relativity towards the mechanism in extending an invitation or offer to the public for the subscription or sale of shares would be effectively negated. This is due to the incorporeal nature of shares to be allotted and subscribed in that the *merx* is not in existence as of yet. It is also common cause that the term sale, in terms of a primary market transaction, refers to an underwriter construction rather than a secondary market sale.<sup>140</sup> The procedure of subscribing requires an application usually described as an offer by the applicant to take up a number of securities by means of the completed application form accompanied by payment. This is followed by the acceptance of the offer by the company by the allotment to the subscriber of the security. Due to the immaterial

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<sup>139</sup> In this respect see Cilliers *et al* (2000) *Corporate Law* 257. An offer should be aimed at the conclusion of a particular type of contract and an invitation to do business is not a contract. However, section 142(2) of the 1973 Act defined an offer to include an invitation. The offer (or invitation) was aimed at concluding a contract for subscription or sale of shares. See also Van Wyk de Vries Commission Main Report 108; Delpont *Verkryging van Kapitaal* (1987) 304 and Delpont "Offers" 2011 *THRHR* 284. For this reason, the Van Wyk de Vries Commission recommended the inclusion of an invitation into the definition of an offer.

<sup>140</sup> *Ibid.*

nature of the securities which are not yet in issue, the contract is of subscription.<sup>141</sup> The application for and allotment and issue for shares commences with a contract to acquire shares from the company. This contract to acquire shares is not a contract of sale but a contract to subscribe for shares.<sup>142</sup> To subscribe means to enter into an agreement to take shares by a formal application or otherwise, under which there is liability to pay.<sup>143</sup> The contract *essentialia* entails the offer from the company for subscription; the application of the subscriber; and the allocation of shares to the subscriber. It is perfected when the subscriber pays for the shares and they are issued to the subscriber.<sup>144</sup> The subscription contract is the contract whereby the company creates shares.<sup>145</sup> The contract follows the basic principles of invitation, offer and acceptance.<sup>146</sup> The share as incorporeal which consists of rights against the company is not in existence before issue, it cannot therefore be sold in terms of a contract for purchase and sale. The company therefore invites offers from investors, which make an offer to the company for a number of shares. The company then allots the shares to the offeror. This is a unilateral internal act of the company and is in essence the acceptance of the offer.<sup>147</sup> The issue of the shares is the act which ends the transaction and ends in the issue of the shares to a specific person. It involves a set of

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<sup>141</sup> See fn 25 *supra*.

<sup>142</sup> See fn 26 *supra*.

<sup>143</sup> Refer to fn 27 *supra*.

<sup>144</sup> Refer to fn 28 *supra*.

<sup>145</sup> Section 35(4) and Delpport (2011) *Manual* 35.

<sup>146</sup> Nagel *et al* (2006) *Commercial Law* 42. See also Delpport (2011) *Manual* *ibid*.

<sup>147</sup> Delpport (2011) *Manual* 35.



proceedings which result in the applicant becoming a shareholder.<sup>148</sup> These precepts are ignored in terms of Chapter 4 and are not provided for. Following the precepts of the law of contract, a contract as an agreement creating rights and obligations consists of an invitation to consent to the creation of obligations between the parties, called an offer and an affirmative response called an acceptance.<sup>149</sup> To constitute an offer, a declaration of intent must set out the essential and material terms of the envisaged contract to such an extent that mere acceptance by the offeree will constitute an agreement, it follows that the company is unable to “offer.”

Where under the 1973 Act, the regulation of an invitation and an advertisement were separate,<sup>150</sup> it interacts negatively in the 2008 Act where the definition of an offer does not include an invitation, yet the regulation of an advertisement is provided for.

It is accepted in the law of contract, with exceptions which are not relevant, that “an offer is a declaration of the will of one party which is of such a nature, and in such form, that acceptance thereof will be sufficient

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<sup>148</sup> *Central Piggery case supra* as well as *Hurst v Vestcorp Ltd* (1988) 13 ACLR 17; (1988) 12 NSWLR 394 598.

<sup>149</sup> Van der Merwe *et al* (2007) *Contract: General Principles* 42.

<sup>150</sup> Section 157(1) of the 1973 Act confirmed that the definition of a prospectus in section 1 of that Act included an advertisement and held that save for compliance to qualifying criteria, every newspaper or other advertisement whatsoever, offering or calling attention to an offer or intended offer of shares of a company to the public is deemed to be a prospectus issued by the person responsible for publishing or disseminating the advertisement. All rules regarding the contents of a prospectus and the liability in respect of statements in or omissions from a prospectus or otherwise, applied to such advertisement. The 1973 Act therefore visited the full consequences of the failure to comply with the prospectus requirements on anyone advertising an offer of shares otherwise than by a proper registered prospectus (*LAWSA* (1995) paragraphs 152-153). Section 142(1) of the 1973 Act defined an offer to include an invitation. The two concepts were therefore different from each other and separated. The 1973 Act therefore excluded the “tombstone” prospectus or an advertisement drawing the attention to the prospectus as is enacted in the 2008 Act (section 98(1)).

to constitute an agreement.”<sup>151</sup> 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.<sup>152</sup>

For this reason, a company issuing shares uses an invitation instead of an offer, as it can then accept offers from investors for fewer shares than the investors offer to subscribe for, in order to avoid an over-subscription.<sup>153</sup>

The common law definition of an offer was not sufficiently wide enough to cover company law contracts for subscription and the definition of an offer in the 1973 Act included an invitation which would constitute an offer if all the requirements were met, thereby triggering offer regulation.<sup>154</sup>

In the 2008 Act, the definition of an offer does not expressly include an invitation. Therefore, if a company makes an invitation to subscribe for

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<sup>151</sup> Delpont “Offers” 2011 *THRHR* 284. See also Joubert (1987) *General principles of the law of contract* 37 and Van der Merwe *et al* (2007) *Contract: General Principles* 58. Basic contract law entails that an offer is aimed at the conclusion of a particular type of contract and that an invite to do business is not an offer. If the offer is for shares, legislation has been put in place (for example section 142(1) of the 1973 Act) to define an offer to include an invitation. The first requirement can therefore not be avoided by making an invitation instead of an offer where the offer or invitation is aimed at concluding a contract for subscription or sale of shares (Cilliers *et al* (2000) *Corporate Law* 257).

<sup>152</sup> Delpont “Offers” 2011 *THRHR* 284. See also Van der Merwe *et al* (2007) *Contract: General Principles* 58; Joubert (1987) *General principles of the law of contract* 39.

<sup>153</sup> Cilliers *et al* (2000) *Corporate Law* 247; Pennington (2001) *Company Law* 346. See for context Delpont “Offers” 2011 *THRHR* 284. If the company made the offer subject to the condition that acceptance by the addressee of the number of shares will be adjusted at 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).

<sup>154</sup> This was recognised by the Van Wyk de Vries Commission and an invitation was incorporated in the definition of an offer in section 142(1), (Van Wyk de Vries Commission Main Report 108). See also Delpont *Die verkryging van kapitaal* (1987) 304 as well as Delpont “Offers” 2011 *THRHR* 284.

shares, it is not an offer, either under the common law or in terms of Chapter 4 regulation.<sup>155</sup>

Furthermore, the definition of an 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 can be interpreted as the investor making the “offer.”<sup>156</sup> When applied to an investor, it follows that the investor is not able to offer any securities “by or on behalf of the company,” the invitation can obviously also not be either a “primary offering” or an “initial public offering.”<sup>157</sup>

The lack of inclusion of “invitation” in the definition of an offer, was perhaps sought to be addressed by section 98 and the definition of an “advertisement” in section 1. Section 98 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.”

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<sup>155</sup> Delport “Offers” 2011 *THRHR* *ibid.*

<sup>156</sup> *Ibid* (own accentuation).

<sup>157</sup> *Ibid.*

An advertisement in section 1 is defined as:

“advertisement” means 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 does not solve the interpretational difficulties regarding an “offer.” 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 and not by an invitation.<sup>158</sup>

Section 98 and 99 also overlap, the latter providing *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 written offer for shares must be 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 be defined as such.

The 2008 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

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<sup>158</sup> *Ibid.*

ambit of section 98 and the definition of an “advertisement,” the offer must be registered as a prospectus.<sup>159</sup>

Section 98(2) and (3) provide for the “tombstone advertisement,”<sup>160</sup> which if certain requirements are met, is intended to merely draw attention to the offer. If the requirements are not complied with, section 98(3)(b) provides that the “tombstone advertisement” is to “be regarded as having been intended to be a prospectus.” This provision flagrantly ignores the requirement that an offer must be accompanied by a registered prospectus and equates the offer to a prospectus. A prospectus is not defined in the 2008 Act.<sup>161</sup>

In terms of the 2008 Act, an offer also includes an advertisement that satisfies all of the requirements of the 2008 Act with respect to a registered prospectus and is also subject to “every provision of this Act relating to the making of a prospectus.”<sup>162</sup> The term “making of a prospectus” is an example of bad legislation. A prospectus can be prepared and submitted to be registered. The registered prospectus can accompany the offer.<sup>163</sup>

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<sup>159</sup> Delpont “Offers” 2011 *THRHR* 285.

<sup>160</sup> See also Loss (1988) *Fundamentals* 107.

<sup>161</sup> Delpont “Offers” 2011 *THRHR supra*. The confusion that existed under the 1973 Act as to whether a prospectus is the offer or the information that must accompany the offer, is perpetuated. As per Henochsberg on the 2008 Act 12(1): In the 1973 Act, the Act was ambiguous as to the exact nature of a prospectus. The definition in section 1(1) defined it, *inter alia*, as “any prospectus, notice, circular, advertisement or other invitation...*offering* any shares of a company to the public,” while in sections 145 and 146 it was referred to, not as the offer itself, but as the document that must accompany the offer: “No person shall make any offer to the public...unless it is accompanied by a prospectus...”.

<sup>162</sup> Section 98(1).

<sup>163</sup> Section 99(2).

It would appear that the prospectus as the offer, and the prospectus as the document that must accompany the offer, are confused.<sup>164</sup> The correct terminology would read “making an offer” as the term above can hardly imply the provisions of the 2008 Act relating to the preparation of the prospectus. It is submitted that the section be purposefully interpreted to convey the purpose of same.

A “registered prospectus” is defined in section 95(1)(m), but the word “prospectus” is not defined.<sup>165</sup> It is significant to note that, due to the express reference only to “prospectus,” the requirements for an advertisement do not apply to secondary offers in terms of section 101.<sup>166</sup>

It is clear that offer regulation is curtailed by the fact that Chapter 4 regulation enables an offer being made by means of an invitation without it being an offer. In the first instance, an invitation is not included. In the second instance, as the definition of an offer provides for the wording of “any person” it can be implied that it is the investor making the offer. This also falls short of the definitions of a primary offering as well as an initial public offering. Section 98 also does not provide an equitable solution as the wording expressly states that the regulation of the advertisement features “as an alternative to any other manner of making or presenting an offer,” with the operative word being an offer in section 98, and an offer can be argued to be excluded if by means of an invitation.

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<sup>164</sup> Delport (2011) *Manual* 47.

<sup>165</sup> *Ibid.* See also the subsection below relating to the prospectus.

<sup>166</sup> *Ibid.*

### 3.2. Secondary market

It is trite that the secondary market is informal and is distinguished from the formal regulated market.<sup>167</sup> It follows in time subsequent to primary transactions.<sup>168</sup> Essential to the division of the market is the type of transaction in the first instance and in the second instance, flowing from the type of transaction, the level of disclosure which flows therefrom.<sup>169</sup>

A secondary offer to the public must not be made unless the offer satisfies the requirements of section 101 of the Act.<sup>170</sup>

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.<sup>171</sup>

Section 96 which details certain public offers which will be considered as non-public offers, also applies to the secondary market, but given the difference in the type of contract, only certain exclusions will apply,

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<sup>167</sup> Delpont “Offers” 2011 *THRHR supra*. The informal is regulated by the common law and the Companies Act and the formal by the FMA.

<sup>168</sup> *Ibid*. The investor who acquired the shares in the primary market transaction, and who now sells the shares, trades on the secondary market. This type of transaction has no relevance of a direct nature for the company.

<sup>169</sup> Delpont “Offers” 2011 *THRHR* 282. In primary market transactions the company must disclose by way of a prospectus, and the extent of disclosure, in terms of sections 99 and 100 of the 2008 Act, whilst in the secondary market, it is not the company but the seller who must disclose and the extent is limited due to the fact that the seller does not have access to all the financial information. See section 101 of the 2008 Act.

<sup>170</sup> Section 99(3)(b). The whole of section 101 will be excluded if the securities are listed on an exchange, (section 101(1)). Non-compliance will not make the offer void or voidable. Apart from personal liability in terms of section 218(2), the transaction will only be void if a Court declares it void (section 218(1)).

<sup>171</sup> Section 95(1)(m). As a subsidiary in the secondary market a separate entity, the inclusion of same in the definition is obscure. The question begs to be asked as to whether the drafter of the Act was fully apprised of South African company law or not. The company not being a party to a secondary market transaction will also not have any influence on the trading of shares in its subsidiary (Delpont (2011) *Manual* 50).

similarly certain secondary market exclusions will also apply only to the primary market.<sup>172</sup>

And it is required in terms of 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).

Section 107 provides that four months after filing the prospectus for an offer, said time limit for allotment or acceptance expires.<sup>173</sup> The practical implication being that if a secondary offer is made within the four months, the prospectus must accompany the offer. After that, the written statement is required.<sup>174</sup>

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<sup>172</sup> *Ibid.* For example, seed capital in section 96(1)(g) in respect of secondary market exclusions and sophisticated investor in respect of the primary market.

<sup>173</sup> See the discussion on Prospectus below for commentary on the use of filing a prospectus *viz* registration of a prospectus, the latter being the correct term, although not used by the Act.

<sup>174</sup> Delport (2011) *Manual ibid.*



Section 101(2)(a) will also be excluded if the primary offering was not to the public and a prospectus was not required. Section 101(2)(b) will apply in respect of the secondary offering if to the public.<sup>175</sup>

The written statement must be filed for registration (juxtaposed to only filed, registration being the operative word) and the term for use expires within 3 months from date of registration.<sup>176</sup> The information required is set out in section 101(6), constituting a “prospectus lite,” the lesser disclosure requirements being obvious in terms of the underlying parties to the transaction.<sup>177</sup>

Unfortunately, investor protection and the public interest may be severely curtailed by the provisions under section 101. There is no requirement for the registration of changes. This entails any omissions or misrepresentations will only be actionable under the common law.<sup>178</sup> Section 101 provides for the regulation of secondary offers to the public. It does not apply to securities listed on an exchange or in respect of which an exchange has granted permission to deal.<sup>179</sup> A person making a secondary offering of the securities of a company (or its subsidiary) must ensure that the offer is accompanied by either the registered prospectus that accompanied the primary offering, together with any revisions

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<sup>175</sup> *Ibid.*

<sup>176</sup> Section 101(4).

<sup>177</sup> The requirement that the written statement must state: “...if any securities were issued by the company as partly paid-up shares under the Companies Act, 1973 (Act 61 of 1973), to what extent they are paid up,” as partly paid up shares were never possible under the 1973 Act (Delpont (2011) *Manual* 50). Another clear example of the Legislature not being *au fait* with South African company law principles.

<sup>178</sup> The written statement or prospectus must accompany the offer. If an oral offer is made, the documents must accompany such an offer. If the offer is made telephonically (albeit still oral) the delivery of the disclosure documenting will be difficult (Delpont (2011) *Manual* 50).

<sup>179</sup> Section 101(1)(a)(b).

required to address changes in any material matter, or a written statement that satisfies the requirements of section 101(4) and (6).<sup>180</sup>

Apart from the exemptions in section 96, section 101(3) exempts the executor or administrator of a deceased estate, or the trustee of an insolvent estate, or liquidator or trustee as per the Administration of Estates Act 66 of 1965 as well as for the purpose of a sale in execution, or by public auction or by a public tender.

In terms of the general prohibitory clause against offers to the public, section 99(3) provides that except with respect to securities that are the subject of an IPO, a secondary offer must not be made unless the offer satisfies the requirements of section 101.

Section 101 is the predecessor of section 141 in Chapter V of the 1973 Act. Section 141 was aimed at prohibiting the unscrupulous selling to the public of the issued shares of a company known as “share hawking.”<sup>181</sup> The effect of section 141 was to prohibit the making of an offer for shares for sale to the public, or making an invitation to the public to offer to purchase shares in terms of subsection (10), except in cases covered by the exemptions in subsection (2), or unless accompanied by a written

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<sup>180</sup> Section 101(2)(a)(b).

<sup>181</sup> Henochsberg on the 1973 Companies Act 254. It has already been stated that the field of application of section 141 is different from that of Chapter VI. Chapter VI controlled approaches to the public to raise capital for a public company by means of eliciting applications to subscribe for unissued shares (section 145(1)) or to purchase shares which have been, or have been agreed to be, allotted with a view to their being offered to the public or in respect of which it has been made known at or about the time of, and in connection with, an offer for their sale to the public, that an application for their listing on a stock exchange has been made or is intended (section 146(1) or to subscribe for unissued shares pursuant to a rights offer (section 146A read with section 142(1)). The prohibition extended to an offer or invitation with the subject matter being stock (section 1(1) “share” or a debenture or a unit, i.e., a right or interest by whatever name called in a share or stock or a debenture or debenture stock or a debenture bond or any other security of a company whether or not it constitutes a charge on its assets (section 1(1)) “debenture” *ibid.*

statement which contained the prescribed requirements and form as per subsections (4), (5) and (6) and lodged for registration with the Registrar.<sup>182</sup> The holder or owner of the shares of a company may wish to sell the property for personal gain and ought not to be precluded from seeking a purchaser among the public, yet the Legislature aimed to ensure candid disclosure concerning the true market value of the shares and all matters affecting it.<sup>183</sup>

Where the offer in terms of section 141(1) was to be accompanied by a prospectus registered under Chapter VI of the 1973 Act, section 141(2)(e) provided an exemption to the restriction of offering shares for sale. At first glance it seems to be that subsection (e) found its way back into the 2008 Act per section 101(2)(a). It is however submitted that the ambit of the two provisions differs fundamentally. The former provided for where a person wished to sell his or his principal's shares. A prospectus was defined in the 1973 Act per section 1(1), and subsection (e) required a prospectus: "*...which complies with the requirements of the Act with regard to a prospectus... .*" It was only such a prospectus which was capable of being registered.<sup>184</sup> Section 146(2) provided a presumption in terms of underwriting constructions and the secondary market sale. Such

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<sup>182</sup> Where the shares are those of a public company, the lodgement of the written statement was required and expired after 3 months in terms of subsection (7). The prohibition applied to both private and public companies (subsection 10).

<sup>183</sup> Henochsberg on the 1973 Act 255. The prohibition extended to an offer or invitation whether made orally or in writing (including by newspaper advertisement, or any electronic advertisement) and to the distribution or publication of any material which in its form and context is calculated to be understood as an offer or invitation in terms of subsection (1). Section 141 required disclosure of information material to any intending purchaser's decision as to whether or not to purchase.

<sup>184</sup> Section 155(1). For requirements see section 148. See also Henochsberg on the 1973 Act 257. A registered prospectus would contain the information material to the purchaser's decision as to whether or not to purchase the shares.

an offer for sale had to be accompanied by a full prospectus if the shares have been allotted with a view to them being offered to the public.<sup>185</sup>

The same applied if a listing was eminent on an exchange as it is patent that under the circumstances listed it was a primary market transaction and not a secondary market trade. The prospectus requirement could not be assailed by pretending that an issue had not been made with a view to offering it to the public due to the presumption in section 146(2) that an issue is deemed to have been allotted with a view to being offered to the public if the offer for sale is made within 18 months of the allotment.<sup>186</sup> Section 141(2)(e) must be read with this presumption and applied in terms that the intention of the Legislature was to provide for disclosure under section 141(2)(e) by means of exempting secondary offers accompanied by a prospectus. This would equally apply in respect of section 146(2) where typically, under an underwriting construction, the offer would be accompanied by a prospectus under Chapter VI. Under the 2008 Act the presumption is not available.

It will seem that section 101(2) lends a choice to the seller by means of the word “either.” Therefore, either the written statement (prospectus lite) can be used, or in terms of subsection (a), the registered prospectus that accompanied the primary offering of those securities, together with any revisions. Under section 141(2)(e), the registered prospectus could be used if still valid within the 3 month period (section 156). This exemption provided for sales within the 3 month period or where the seller prepared

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<sup>185</sup> Section 146(1)(a).

<sup>186</sup> Cilliers *et al* (2000) *Corporate Law* 258.

a prospectus in terms of section 148 and filed it for registration. It is submitted that there is no requirement under section 101(2)(a) to prepare a fresh prospectus. The subsection merely provides for the use of a prospectus if still valid or the recycling of a prospectus. In this regard, the prospectus becomes stale after four months after “filing.”<sup>187</sup> Also, section 99(8) provides that no document may be purported as a prospectus unless it is a registered prospectus. Section 99(11) provides that a prospectus may not be issued more than three months after the date of its registration and if a prospectus is so issued, it is regarded to be unregistered. Section 101(2)(a) is therefore in conflict with the listed provisions above. It may be that the Legislature attempted to revive section 141(2)(e) in a modern form, unfortunately there is no literature available behind the motives of the Legislature in the review process which covers Chapter 4 in detail. However the wording of section 101(2)(a) read with the rest of section 101 provides a choice to a seller as to which method of disclosure he or she wishes to use. Logically, if a secondary offer is made within four months the prospectus must accompany the offer, after that the written statement is required.<sup>188</sup> However, in terms of the legislation, the choice of an issuer is not prohibited.

In terms of the proviso concerning revisions required to address changes in any material matter since the date that the prospectus was registered in section 101(2)(a), it is submitted that section 100(11) applies to the

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<sup>187</sup> Section 107.

<sup>188</sup> Delpont (2011) *Manual* 50. This obviously only applies if there has been a prospectus. If the primary offering was not to the public, a prospectus would not be available and a written statement must be prepared. Section 101(2)(a) does not provide that a prospectus must be prepared by the seller, as the subsection only denotes the use of a prospectus or the recycling thereof.

proviso. Section 100(11) provides that as long as the IPO or other PO is open to the public any person responsible for the information in the prospectus must, when that person becomes aware of it, correct any error, report on any new matter and report on any change of a matter provided it is relevant or material to the investment decision. Due to the fact that it is only a person responsible for the prospectus that must comply to section 100(11) and that only such a person will in any event be cognisant of the relevant changes or errors, the proviso in section 101(2)(a) only relates to the requirement to submit a prospectus as well as the revisions thereto (where relevant) in terms of section 100(11). There is no requirement on the seller under a section 101 transaction to comply with section 100(11).

In terms of the exemptions, section 141(2) listed the applicable exemptions under that section. Section 101(3) lists the applicable exemptions under the section, to be read with the exemptions available under section 96 of Chapter 4. Section 96 will also apply in respect of the secondary market, but in light of the difference in the type of contract, only some of the exclusions will apply, for example section 96(1)(g) in respect of seed capital.<sup>189</sup> Additionally, exclusions in respect of the secondary market are suited only for the primary market, for example the sophisticated investor exemption under section 96(1)(b).<sup>190</sup> Section 101(3)(a)(ii) excludes the disclosure requirements in respect of a secondary offering under section 101(2) where the transaction is structured around a public auction or public tender. A sale of securities by

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<sup>189</sup> *Ibid.*

<sup>190</sup> *Ibid.*

public auction is an offer for sale of them to the public. Section 101(2) can be circumvented by means of an advertisement that the seller is offering specified securities for sale by public auction or tender, i.e., in the manner and in the terms in which anything is usually advertised for sale. The scope for abuse is patent, notwithstanding the presumed recognition by the Legislature that such transactions would be concluded on the basis of published conditions of sale which may contain some information envisaged by subsection (6).<sup>191</sup> It is submitted that there is no control in respect of whether full disclosure is made or not. *Caveat emptor* would seem to be the only real “control” in respect of a buyer’s interests.

It has been established that the definition of an offer in terms of section 95(1)(g) does not provide expressly for an invitation. The effect is that where an invitation is made by a company, it is not an offer either under the common law or in terms of the Act. The subsection further provides for an offer by any person with respect to the acquisition of securities in a company, denoting that it is the investor making the offer and not the company. This excludes the ambit of section 95(1)(e) and (i). Section 98 fails to address this issue as the operative word in section 98 is still “offer” as defined in section 95(1)(g) and section 98 must be read with the definition of an advertisement in section 1. Section 98 therefore only regulates the content of the offer if made by way of advertisement.<sup>192</sup>

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<sup>191</sup> Henochsberg on the 2008 Act 386.

<sup>192</sup> Delpont “Offers” 2011 *THRHR* 284-5. Section 98 overlaps with section 99 which provides for *inter alia* the prohibition against making a primary offer to the public unless the offer is accompanied by a registered prospectus. A written offer must be accompanied by a prospectus in terms of section 99. If section 98 is applied, the offer must comply with the requirements of a registered prospectus and be registered as such. As the Act does not require the offer to be in writing, a verbal offer can be

Section 99(3) provides that *sans* an IPO, a primary offer to the public of listed securities is prohibited, as well as unlisted securities unless the offer is accompanied by a registered prospectus; as well as a secondary offer to the public of any securities unless the offer satisfies the requirements of section 101. This section ignores the distinction between the primary and secondary markets in respect of an offer and makes for confusing application of the regulatory principles.<sup>193</sup> Delpont motivates the overlap between the IPO concept and the secondary offering in section 101 in that the latter is defined as an offer for sale, the definition of an offer is wide enough to include an offer for sale, leading to confusion and legal arbitrage.<sup>194</sup> Apart from that, that is even if a transaction will come under the purview of Chapter 4 as it is clear that primary market transactions can be structured as to avoid the ambit of the definition of an offer and section 101(3)(a)(ii) provides an ideal premise to avoid secondary market regulation.

It follows that the scope of application of section 101 regulation (intended to prohibit the hawking of shares) was broadened by the inclusion of the section into Chapter 4 and the application of section 95(1)(h). The ambit of an offer to the public includes the public at large as well as any section thereof, excluding exempted offers contemplated in section 96 and secondary offers through an exchange.<sup>195</sup> Under the 1973 Act, the intention of the person making this offer was established on objective

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accompanied by a prospectus. If however the verbal offer is an advertisement in terms of section 98, the offer must be registered as a prospectus. The requirement is that the offer must be accompanied by a prospectus, not that the offer is a prospectus as the latter is not defined in the Act.

<sup>193</sup> *Ibid* 285. See also the JSE Listing Requirements Chapter 5.

<sup>194</sup> *Ibid*.

<sup>195</sup> Section 95(1)(h)(i) and (ii).



basis from fact depending on the circumstances of each case.<sup>196</sup> The intent was decisive, in other words, whether the securities were purchased in order to distribute them at a profit among the public at large or to dispose of them in the context of a private negotiation. The distinction drawn in *Vlakspruit Landgoed (Edms) Bpk v J Mentz (Edms) Bpk*<sup>197</sup> applied in this determination. The distinction sought to be drawn was to differentiate between an intention to traffic in the securities as such and an intention by means of a sale of the securities to place the assets of the company under new control. This distinction will however not apply as the concept of a public offer is clearly defined and applicable to section 101. The result is that all secondary market offers in the informal market will have to comply with section 101 unless excluded there under or under section 96.<sup>198</sup> In respect of section 96 and public offers, section 95(1)(h) provides at (i) that a public offer includes an offer of securities to be issued by a company. The use of the wording: “to be issued” is troublesome as it clearly only provides for primary market transactions and effectively excludes section 101 transactions from the section 96 exemptions based on section 96(1) which provides that an offer: “*is not an offer to the public if....*”

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<sup>196</sup> Henochsberg on the 2008 Act 385. See also the *Rossouw* cases *supra*.

<sup>197</sup> *Vlakspruit Landgoed v J Mentz supra*.

<sup>198</sup> Henochsberg on the 2008 Act 385.

### 3.2.1. Continuous disclosure requirement

Section 100(11) provides for a continuous disclosure requirement in respect of the prospectus insofar as a primary offering or initial public offering is concerned. This requirement is of no assistance to the investor in the secondary market as the continuous disclosure requirement only includes the primary market. Therefore, where an event is triggered for the correction of any error, reporting on new matter or change in the prospectus, provided it is still within the four months of its registration, and the offer is a secondary offer, there is no provision to register these events or bring them to the attention of the investor.

### 3.2.2. *Nomine Officio* omission

There is no logic behind the exclusion of the requirements for disclosure in terms of a prospectus or a written statement where a person is acting in the capacity of an executor or administrator of a deceased estate, or a trustee of an insolvent estate or a liquidator or trustee referred to in the Administration of Estates Act 66 of 1965, or for the purposes of a sale in execution, or by public auction or by public tender.<sup>199</sup> The underlying transaction stays the same, in that it is only the seller as a party who is replaced *nomine officio*. Disclosure will still be possible regardless of this. The potential of abuse was clearly evident from the 1973 Act and these exclusions are ill-considered.

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<sup>199</sup> Delport (2011) *Manual* 50.

## 3.3. Holding and subsidiary relationship

The traditional common law view has been that a holding and subsidiary company each possess their own legal personality, rights, assets and liabilities.<sup>200</sup> The basis of the legal relationship between the holding company and its subsidiary is trite as per the judgement in *Salomon v Salomon*.<sup>201</sup>

It follows that in the absence of fraud, the holding company is a separate legal *persona* from the subsidiary, possessing its own interests, rights, assets and liabilities. By the same token, the subsidiary will also be a legal *persona*.<sup>202</sup>

Control in terms of management between the holding company and subsidiary does not denote an agency relationship. For this reason, the subsidiary as an effect of its separate legal *persona*, must institute actions and enforce its own rights.<sup>203</sup> Similarly the subsidiary cannot institute action to enforce the rights of its holding company.<sup>204</sup>

A company is a subsidiary of another juristic person if in terms of section 3(1):

(1) A company is-

<sup>200</sup> Cilliers *et al* (2000) *Corporate Law* 432. See also *The Albazero* [1975] 3 ALL ER 21 (CA) 28. The traditional common law approach has been subjected to pressures in order to give effect to the realities of simultaneous control in groups. This however only pertains to the submission of group annual financial statements based on the concept of the larger economic unit of companies which constitutes a group forming a single accounting entity. The holding company and subsidiaries therefore do not lose their separate legal personalities.

<sup>201</sup> *Salomon v Salomon supra*.

<sup>202</sup> Cilliers *et al* (2000) *Corporate Law* 432.

<sup>203</sup> *Ibid*. See also *Foss v Harbottle* (1843) 2 Hare 461; 67 ER 189; *Bell v Lever Bros Ltd* [1932] AC 161 (HL).

<sup>204</sup> Cilliers *et al* (2000) *Corporate Law* *ibid*. See also *Lindgren and Others v L & P Estates Co Ltd* [1968] 1 All ER 917 572.

- (a) a subsidiary of another juristic person if that juristic person, one or more other subsidiaries of that juristic person, or one or more nominees of that juristic person or any of its subsidiaries, alone or in any combination-
  - (i) is or are directly or indirectly able to exercise, or control the exercise of, a majority of the general voting rights associated with issued securities of that company, whether pursuant to a shareholder agreement or otherwise; or
  - (ii) has or have the right to appoint or elect, or control the appointment or election of, directors of that company who control a majority of the votes at a meeting of the board; or
- (b) a wholly-owned subsidiary of another juristic person if all of the general voting rights associated with issued securities of the company are held or controlled, alone or in any combination, by persons contemplated in paragraph (a).

A holding company in relation to a subsidiary means a juristic person that controls that subsidiary as a result of the circumstances contemplated in sections 2(2)(a) or 3(1)(a).

Section 2 reads as follows:

- (2) For the purpose of subsection (1), a person controls a juristic person, or its business, if-
- (a) in the case of a juristic person that is a company-
    - (i) that juristic person is a subsidiary of that first person, as determined in accordance with section 3(1)(a); or
    - (ii) that first person together with any related or inter-related person, is-
      - (aa) directly or indirectly able to exercise or control the exercise of a majority of the voting rights associated with securities of that company, whether pursuant to a shareholder agreement or otherwise; or
      - (bb) has the right to appoint or elect, or control the appointment or election of,

directors of that company who control a majority of the votes at a meeting of the board.

The definition of a primary offering *inter alia* is 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.

Section 2 is based on the holding company / subsidiary definition.<sup>205</sup> The definition of subsidiary refers to a juristic person, as a holding company but only a company as a subsidiary, which would exclude a trust or partnership or other juristic person.<sup>206</sup>

The offer made by or on behalf of the company, of securities to be issued by that company, is in accordance with the common law definition, of an issue of shares. The subsequent part of the definition of the issue by another company within a group of companies of which the first company is a member, is confusing.<sup>207</sup>

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<sup>205</sup> Delport (2011) *Manual* 105. It is however, possible to exert control outside the definition of holding company / subsidiary, although the exclusion of membership requirement as in the 1973 Act reduces the alternatives.

<sup>206</sup> *Ibid.* See also section 2.

<sup>207</sup> The problem arises when it is applied to the definition of primary offer(ing) and offer by or on behalf of a subsidiary. If the offer is made by (not on behalf of) a subsidiary company and it is to the public, a prospectus must be issued because it is a separate legal entity. Delport opines that it is trite and it is agreed – separate regulation is unnecessary. The only question would be whether the offer is public or not.

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).”<sup>208</sup>

When applied to the definition of a primary offer(ing) and an offer by or on behalf of a subsidiary, confusion comes to the fore.<sup>209</sup> The provision of holding / subsidiary relationships in section 2(1)(a) or 3(1)(a) also provides for other forms of juristic persons such as trusts.<sup>210</sup> The offer however can only be in respect of companies.<sup>211</sup>

If the offer is made of shares of the subsidiary, and it is to the public, a prospectus is required. The control relationship does not add to or subtract from this situation.<sup>212</sup> The nature of the offer does not change the nature of the subsidiary. The extended application of a primary offering is further obscured when subsection (ii) is reviewed, which provides for amalgamation or merger, as this company is more remote than the subsidiary.<sup>213</sup>

The net effect is that if the primary offering is made not by the particular subsidiary or target company, but on its behalf, it will not be a primary

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<sup>208</sup> Delport “Offers” 2011 *THRHR* 285. Definition of a holding company in section 1.

<sup>209</sup> *Ibid.*

<sup>210</sup> *Ibid.* Section 1: “juristic person” includes- (a) a foreign company; and (b) a trust, irrespective of whether or not it was established within or outside the Republic.

<sup>211</sup> *Ibid* 286 referring to section 99 and the definition of company in section 1 as well as section 95(1)(a).

<sup>212</sup> Delport (2011) *Manual* 109.

<sup>213</sup> Delport “Offers” 2011 *THRHR* 285.

offering.<sup>214</sup> Chapter 4 regulation will be sidestepped. Amendment of the 2008 Act is recommended in order to remedy this anomaly.

#### 3.4. Rights offers and non-renounceable offers

A rights offer is defined in section 95(1)(l) as an offer with or without a right to renounce in favour of other persons, made to any holders of a company's securities, for subscription of any securities of that company, or any other company within the same group of companies.<sup>215</sup>

Section 96(1)(d) provides that an offer is not an offer to the public if it is a rights offer that satisfies the requirements and an exchange has granted or has agreed to grant a listing for the securities that are the subject of the offer; and the rights offer complies with any relevant requirements of that exchange at the time the offer is made.

Non-renounceable offers are regulated in section 96(1)(c) which provides that an offer is not an offer to the public if it is a non-renounceable offer made only to existing holders of the company's securities or persons related to existing holders of the company's securities.<sup>216</sup>

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<sup>214</sup> *Ibid.*

<sup>215</sup> A rights offer is renounceable and an offer for subscription to the members or debenture holders of a company for the shares of that or any other company, where the JSE has granted a listing for those shares. As the shares concerned are or are to be listed, and the disclosure of adequate information will be required by the JSE, no additional disclosure will in essence be required. In making a rights offer, the company has to issue to the offerees a letter of allotment (in essence an offer) accompanied by the documents required and approved by the JSE in terms of its Listing Requirements, where the rights are to be listed (Cilliers *et al* (2000) *Corporate Law* 261).

<sup>216</sup> A rights offer is not regarded as an offer to the public due to the presumption that the shareholders have information about the company. The offer will be made by allotment to subscribe for the shares. The shares have already been allotted by the company and the acceptance of the offer will result in the shares being issued to the shareholder. This letter of allotment can (and in the case of the JSE), must be transferable (Cilliers *et al* (2000) *Corporate Law* 260).



Both types of offers are excluded from being public offers in terms of section 96. This will be discussed in detail in Part B *infra*. The determination of how non-renounceable offers will relate to rights offers is problematic as the definition of the latter now also includes non-renounceable offers, whilst much stricter and uncertain rules apply to the documents that accompany rights offers.<sup>217</sup>

### 3.5. Offers and capital market transactional interaction

Security offers, for reasons which follow, will prove to be exceptionally troublesome in terms of interpretation as well as enforcement of offer regulatory provisions and principles.

Provisions have been copied from the 1973 Companies Act<sup>218</sup> without amending terminology to better accord with the 2008 Act which also fails to provide for the consequences to the changes.<sup>219</sup>

Due to the already outlined differences in philosophy between the 2008 Act and the 1973 Act, it will not be possible to utilise the 1973 Act to make comparisons between the two as the combination of primary and secondary market regulation was not successful caused, *inter alia*, by the confusion between the prospectus and the written statement in respect of

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<sup>217</sup> Section 95(1)(f) read with section 99(4), (Sutherland “Company Law” 2012 *Stellenbosch Law Review* 169).

<sup>218</sup> Grafting on provisions of Chapter VI and merging it with section 141 secondary market regulation to Chapter 4 with the additional import of foreign concepts which are not supported by our common law.

<sup>219</sup> Sutherland “Company Law” 2012 *Stellenbosch Law Review* 168. See also Delpont (2011) *Manual* 43. The system currently in operation in terms of Chapter 4 regulation has been retained from the 1973 Act, except that the primary and secondary markets are now regulated in the same Chapter.

content, non-compliance and liability.<sup>220</sup> The statutory application of the common law is complicated by the grafting on of foreign concepts thereto into the regulatory regime pertaining to offers. This practice will no doubt complicate the application of the 2008 Act as well as curtail effective investor protection.

The definition of an offer in the 1973 Act distinguished between a contract for subscription and a contract for purchase and sale, the latter referring only to underwriting constructions.

The definition of an offer in the 2008 Act refers only to “acquisition, for consideration.” This definition includes subscription as well as sale, with the latter patently applicable to the primary market (if there is a primary market underwriting transaction) or to the secondary market in terms of section 101.<sup>221</sup>

To the extent that the distinction between the primary and secondary markets is ignored in respect of offers, regulation will be curtailed. As per section 99(3)(a)(i), a primary offer to the public of listed securities of a company is prohibited, other than in accordance with the requirements of the exchange. As the primary and secondary markets are separate markets, the execution of 99(3)(a)(i) is impossible in law.<sup>222</sup>

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<sup>220</sup> Delpont (2011) *Manual* 43 as well as Delpont “Offers” 2011 *THRHR* 283. The only aspect that remains to 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 2008 Companies Act.

<sup>221</sup> *Ibid* Delpont “Offers” 2011 *THRHR*.

<sup>222</sup> *Ibid* 285. The secondary market, whether formal or informal can only operate after the shares have been issued in the primary market. The “primary market offer” of “listed securities” is a theoretical, 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.

The secondary market transaction, requiring less disclosure can be used in the current regulatory dispensation to curtail prospectus requirements as there is an interaction between these two markets made possible by the definitions of the 2008 Act.<sup>223</sup>

There is an overlap between the “initial public offering” and the secondary offer(ing).<sup>224</sup> A secondary offer(ing), although defined as an “offer for sale,” the use of “offer” in the definition of a IPO is, on the basis of the definition of an offer in section 95(g), wide enough to include an offer for sale.<sup>225</sup>

The subject of the offer in the primary market of new unissued shares is not clear. A “primary offer(ing),” *inter alia*, is defined as: “*an offer...made by or on behalf of a company, of securities to be issued by that company, or by another company, within a group of companies of which the first company is a member.*”<sup>226</sup> Suffice it to state that it appears from the 2008 Act that a juristic person other than a company may make a public offer.

It is submitted that the confusion be mended by giving preference to the regulatory principles of investor protection and the public good by

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<sup>223</sup> *Ibid* 286. The written statement in terms of section 101(6) can be used to circumvent the full registered prospectus requirement of the primary market transaction and will be discussed in the following subsection concerning “public.”

<sup>224</sup> *Ibid*. IPO is a new concept in our law.

<sup>225</sup> *Ibid*. This will lead to arbitrage and confusion.

<sup>226</sup> *Ibid* 285. 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. A 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) as per section 1. (Sections 2(2)(a) and 3(1)(a) also provide for holding/subsidiary relationships in respect of other juristic persons like trusts (see definition of juristic persons in section 1) but the offer can only be in respect of companies in terms of section 99 and the definition of company in section 1 and 95(1)(a)).

negating the reading into of an offer made by any other juristic person other than a company, and that the principles of offer regulation take precedence.

#### 4. Chapter 4 liability

Where a written statement contains an untrue statement, it is an offence in terms of section 214(1)(d). Untrue statements in terms of the prospectus provisions will not attract statutory liability in terms of the prospectus provisions as the relevant provisions only refer to liability for untrue statements in a prospectus.<sup>227</sup> Liability will apply under the common law only for the delict of misrepresentation.<sup>228</sup> There is also no statutory criminal liability if a written statement is not issued where it is required, making it tempting to rather not issue a written statement than to issue one with an untrue statement. As per this subsection covering offers, the merger of primary and secondary market regulation, together with the confusion relating to the definition of an offer and the underlying transactions, the option to use a written statement is available even in the primary market. As per the above, the use or non-use of a written statement attracts as much liability as speeding on an unregulated part of the freeway.<sup>229</sup>

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<sup>227</sup> See section 104 and Delpont (2009) *Manual* 51.

<sup>228</sup> See Nagel *et al* (2006) *Commercial Law* 142. See also for context, Delpont (2011) *Manual* 51.

<sup>229</sup> The principles in *Vlakspruit Landgoed v J Mentz supra* 786 are presumed to continue to apply. These principles are that the intention of the Legislature with section 141 of the 1973 Act was to regulate the “hawking of shares” (as described in the short title of section 80*bis* of the Companies Act 46 of 1926, the predecessor of section 141 of the 1973 Act), and not to interfere with transactions where the intentions of the parties in the sale of the shares are to merely place the control of the assets of the company in different hands. If the securities are not shares, the principles will not apply (Delpont (2011) *Manual* 51).

## 4.1. Primary market

Section 95(6) provides that Chapter 4 liability provisions will not limit liability that a person may incur under the Act or in any other public regulation or the common law. Chapter 4 does not limit nor diminish any liability a person may incur under any provision of the Act contained in any other Chapter under it or under any other law or under the common law. In terms of section 2 of the Interpretation Act 33 of 1957, “law” includes any proclamation, ordinance, Act of Parliament or other enactment having the force of law. A prospectus is also included in the definition of a financial report, and the effect of this inclusion is that there is an additional liability over and above that provide for in sections 104 to 106 if the prospectus is false or misleading. Liability under the common law may be criminal or civil. An innocent party can claim rescission if the misrepresentation is material and/or damages from the director/s and /or experts and/or the company. Section 104 provides for liability for untrue statements in a prospectus. It provides as follows:

## 104. Liability for untrue statements in prospectus

- (1) If securities are offered to the public for subscription or sale pursuant to a prospectus, every -
  - (a) person who becomes a director between the issuing of the prospectus and the holding of the first general shareholders meeting at which directors are elected or appointed;

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- (b) person who has consented to be named in the prospectus as a director, or as having agreed to become a director either immediately or after an interval of time;
  - (c) promoter of the company; or
  - (d) person who -
    - (i) authorised the issue of the prospectus or, under this Act, is regarded as having authorised the issue of the prospectus; or
    - (ii) made that offer to the public,

is liable to compensate any person who acquired securities on the faith of the prospectus for any loss or damage the person may have sustained as a result of any untrue statement in the prospectus, or in any report or memorandum appearing on the face of it to be, issued with, or incorporated by reference in, the prospectus.

What is of concern is that section 104 only provides for liability for untrue statements in a prospectus, despite the securities being offered to the public for subscription or sale. This entails that secondary market offers will be excluded from section 104 liability. Section 101 which specifically deals with secondary offers and disclosure in terms thereof, either by way of a prospectus or a written statement, does not contain liability provisions for a written statement. It is thus submitted that a defendant would have to resort to the common law.

Sections 105 and 106 cover liability of experts and others and then responsibility for untrue statements in prospectuses generally, and also does not provide for secondary market transactions by means of the written statement. As Chapter 4 provides a choice to an issuer concerning the method of disclosure, the written statement can be used.

All prospectuses must include all material information relating to the securities being offered, including but not limited to the information specifically required in Part C of Chapter 4 of the regulations, and must also include a narrative statement setting out the extent to which and manner in which, the company has applied the King Report and Code and the reasons for any instance of not applying the recommended principles in the King Report and Code. “Material” is defined in section 1 of the Act, when used as an adjective; means significant in the circumstances of a particular matter, to a degree that is of consequence in determining the matter or might reasonably affect a person’s judgment or decision-making in the matter. This clearly differs from the substantive requirement in section 100 that the information that an investor may reasonably require must be provided in addition to the prescribed information. Prospectus liability for untrue statements follows the structure of the 1973 Act. Persons who authorise the issue of the prospectus are liable to pay compensation for any loss or damage sustained as a result of any untrue statement in the prospectus, or any report or memorandum appearing on the face of, issued with, or incorporated by reference into, the prospectus; by any person who acquired securities on the strength of the prospectus.

Section 77 provides for the liability of directors and prescribed officers. Specifically, it provides that a director of a company would be liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having signed, consented to, or authorised the publication of a prospectus or a written statement contemplated in section 101 that contained an untrue statement as defined in section 95. In terms of this, liability of the director is extended only towards the company. Although this section provides for the written statement as basis of establishing liability in the secondary market, only the company can use it and not investors. An investor would have to rely on section 104 or the common law. The problem with liability in terms of this subsection and the written statement is that it would seem that the director of the company is liable even if the director is not the seller of the securities. Henochsberg holds that it should be the opposite, that only if the director is the seller of the securities and there is an untrue statement in the written statement, will he or she be liable. Liability, in the sense of proper secondary market constructions, rests on the capacity of the seller and not the capacity as the director and it is not relevant under section 77. Liability towards the company is not possible as the company is not involved.<sup>230</sup>

#### 4.2. Secondary market

A secondary offer must not be made to the public unless the offer satisfies the requirements of section 101 of the Act. A secondary offering is

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<sup>230</sup> Henochsberg on the 2008 Act 386 and the discussions on liability and section 95, secondary offering.



defined in section 95(1)(m). Given the definition of an offer to the public in section 95(1)(h) which refers to securities being issued, it would appear that the section 96 exemptions do not apply to the secondary market, *sans* section 95(2). If a written statement contains an untrue statement, it is an offence in terms of section 214(1)(d). However, such an untrue statement will not attach statutory liability in terms of the prospectus provisions as the relevant provisos only refer to liability for untrue statements in a prospectus. Liability will therefore only be under common law for the delict of misrepresentations. There is however no statutory criminal liability if a written statement is required in terms of section 101 but it is not issued. It would therefore be better to not issue a statement under section 101 rather than issuing one which contains an untrue statement.

#### 4.3. Criminal enforcement provisions

Chapter 9 of the Act provides for offences and penalties under Part A thereof. Specifically, section 214(1)(d) makes it a criminal offence where a person is a party to the preparation, approval, dissemination or publication of a prospectus or a written statement that contains an untrue statement as defined and described in section 95.

Section 214(3) provides for an offence where a person fails to adhere to a compliance notice issued in terms of the Act, unless the Commission, the Panel or the exchange has requested a Court in terms of section 171(7)(a) for the imposition of an administrative fine.

Section 214(4) provides for the contravention of section 99(1), (2), (3), (4), (5), (8) or (9). Every person, as well as the director, if that person is a

company or prescribed officer of the company, who knowingly was a party to a contravention on the general restrictions on offers to the public as per the noted subsections, will be guilty of an offence and liable to any other person for any losses sustained as a consequence of that contravention. It is submitted that subsection (4)(b) extends civil liability for a contravention of section 99 and then in respect of the noted subsections. The penalties are as per section 216. Liability is extended in respect of directors and prescribed officers of the company that commit the offence, in the alternative due to the use of the word “or.” The words “every director or prescribed officer...is liable” has the effect that each person becomes liable in the alternative and liable for the whole of the loss or damage of the claimant concerned. In any case there may be a number of persons each individually liable, in full, for such loss for damage. The effect of the provisions is thus to create liability which will be joint and several.

Section 216 provides for penalties under the Act. Any person convicted of an offence in terms of the Act is liable in terms of a contravention of sections 213(1) and 214(1), to a fine or to imprisonment for a period not exceeding 10 years or both; or in any other case to a fine or a period of imprisonment not exceeding 12 months or both.

## 5. Proposed bridging of ambiguity through interpretation

It follows that a literal interpretation of Chapter 4 will amount to disorder. Juxtaposed against the textual or literal school of legislative interpretation is the contextual or purposeful school of interpretation.<sup>231</sup> The 2008 Act explicitly provides for a purposeful interpretation to be applied.<sup>232</sup> The question to be answered is the probability of the scope and application of applying the precepts of purposeful interpretation to Chapter 4 regulatory provisions.

The intention of the Legislature is inferred from the language of the statute read in its context:<sup>233</sup>

The context is not limited to the language of the rest of the statute, regarded as throwing light of a dictionary kind on the part to be interpreted. Often of more importance is the matter of the statute, its apparent scope and purpose, and, within limits, its background.<sup>234</sup>

In general, the law appears to be developing slowly to allow some regard to be had to the legislative history of unclear legislation.<sup>235</sup> The primary,

<sup>231</sup> Botha CJ (2005) *Statutory Interpretation: An Introduction for Students 4<sup>th</sup> ed* Lansdowne: Juta 25.

<sup>232</sup> Section 7.

<sup>233</sup> *Barkhuizen NO v Independent Communications Authority of South Africa and Another* [2001] JOL 8458 (E) 29.

<sup>234</sup> *McKelvey and Others v Deton Engineering (Pty) Ltd and Another* [1997] 3 All SA 569 (A) 575 c-d. See also *Kommissaris van Binnelandse Inkomste v Van Rooyen en Andere; Kommissaris van Binelandse Inkomste v Execom Mining and Exploration (Pty) Ltd en Andere* 1996 (1) SA 50 (NC) 58, 59 and 60.

<sup>235</sup> Devenish GE (1992) *Interpretation of Statutes* Cape Town: Juta 124. See also the separate concurring judgment of Mokgoro J in *Case and Another v Minister of Safety and Security and Others, Curtis v Minister of Safety and Security and Others* (CCT20/95, CCT21/95) [1996] ZACC 7; 1996 (3) SA 617; 1996 (5) BCLR 608 (9 May 1996); in BCLR 608 (CC) at paragraphs 12, and 18, at 624 – 5 (SA) and 591 (SACR); see also *S v Makwanyane and Another* 1995 (2) SACR 1 (CC); 1995 (6) BCLR 665 (CC) paragraphs 12 – 15 at 404 – 5 (SA) and 14 – 15 SACR.

and ordinarily most reliable source of interpreting the meaning of a statute, is the wording as used in their literal sense. However it is stated that a definite index of a mature and developed jurisprudence exists where a fortress is not made out of a dictionary. Rather the purpose or object to be accomplished by a statute is where sympathetic and imaginative discovery is the surest guide to the meaning of a provision.<sup>236</sup>

One of the recognised canons in constructing the meaning of a statute is that the Act as a whole must be considered when interpreting a section. Even where the language is unambiguous, the purpose of the Act and other wider contextual considerations are to be invoked, if needed, in aid of proper construction.<sup>237</sup> It will be mooted that in an attempt to interpret Chapter 4, a literal interpretation should be disregarded in favour of a purposive interpretation in order to provide for the purpose of offer regulation insofar possible. Where the spirit of offer regulation is inhibited by the ambiguity of the statute there will be no other choice for the Courts than to adopt a purposive approach in interpretation, again, insofar possible. It will be submitted in the following discussion that where the statute is not ambiguous, but materially flawed, purposive interpretation will fail.

### 5.1. Purposive interpretation

In reviewing purposive interpretation two aspects come to the fore: in the first instance, the mischief aimed to be cured, and, in the second instance,

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<sup>236</sup> *Gottschalk v Gough* [1996] 4 All SA 614 (C) 618i-j.

<sup>237</sup> *High School Carnarvon and Another v MEC for Education, Training Arts and Culture of the Northern Cape Provincial Government* [1999] 4 ALL SA 590 (NC) 601i-j.

the intent of the Legislature in the enactment of the provisions, i.e., the purpose of the provisions in addressing the mischief should be the intent of the Legislature. Once the mischief is identified and the intent of the Legislature is determined, the purpose of a provision will follow.

The two concepts may come across as tautologous, but the difference is that, in the first instance, a mischief, such as fraud in extending offers to the public and misuse of the corporate entity as *operis mobelis* for this criminal endeavour, manifests as the mischief. As the common law is unable to effectively protect investors and the public interest, it is the intent of the Legislature to address offer regulation by means of statutory enactment. The provisions of the legislation aim then to address the mischief. These aims are the purpose behind the legislation.

Without harm or the potential thereof, of mischief to the public interest, there will be no existence of intent to remedy such a problem, or will the purpose of the legislation which gives effect to the intent of the Legislature be discerned.

In the case of fraud, coupled with the socio-economic impact thereof on the markets, constitute a public interest as the driving force behind the evolution of offer regulation and the principles thereof. Flowing from these principles, the regulatory regimes aimed at offer regulation were enacted, commencing in the United Kingdom, with anti-fraud provisions and subsequent disclosure requirements, leading to what is known today as offer or securities regulation. The purpose of these enactments is to address the mischief in an efficient manner.

Where the enactments operate in the legal sphere and are enacted to address a mischief and to give purpose to regulatory principles, it very well may come to the fore that through evolution, the regulatory principles may prove to be ineffective or in conflict with each other. A secondary mischief thus manifests, and in addressing same through review and further amendments, the purpose of the regulatory principles also attracts a further secondary meaning evolving from the establishment of a regulatory regime, towards the betterment of the efficiency of such a regime. In essence an encompassing argument, as, in addressing the *Grundnorm* through purposeful legislation which may be assailed either through shrewd methods or *lacunae* in the regulatory dispensations, the reason of existence of the *Grundnorm* motivates its survival. Addressing the mischief becomes the purpose, and the purpose, if not effective will constitute a mischief, to be addressed by a further purpose. For example, the division of regulatory dispensations aimed at two separate markets in one regime gave rise in the 1926 Act to mischief addressed by the Van Wyk de Vries Commission Report and eventually provided for in the 1973 Act. The purpose behind the 1973 Act and offer regulation as manifested therein was aimed not at exclusively addressing the *Grundnorm* anymore but at a secondary mischief that was ambiguity and confusion as a result thereof which could have led to the circumvention of the *Grundnorm*.<sup>238</sup>

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<sup>238</sup> The *Grundnorm* manifests from the principles which lead to the primary mischief to be addressed. Subsequently, the purpose of the *Grundnorm* was to establish a regulatory regime in addressing the mischief. If the purpose does not serve the *Grundnorm*, a secondary mischief must be addressed, which sets a secondary purpose.

## 5.2. Ascertaining mischief

Reference is to be made to the judgment in the *Westinghouse*<sup>239</sup> case which considered the interpretation of a statute which is ambiguous so as to ascertain the mischief aimed at being prevented by such a statute, provided that there is a clear connection between the subject matter of the enquiry and recommendations in the report and the statutory provisions in question.<sup>240</sup>

The Court in *Westinghouse* held that it is permissible, in construing the legislation in question, to have regard to the underlying judicial report as to the mischief aimed at.<sup>241</sup> English authorities are listed in the case as having authoritatively held that in construing a statute where the words are not ambiguous, the Court may have regard to the report of a Royal Commission or Committee appointed by the Government which shortly preceded the passing of the statute in order to ascertain the mischief aimed at and the state of the law as it was then understood to be.<sup>242</sup> The Court held that it is entitled when construing the words of a statute which are not clear and unambiguous to refer to the report of a judicial commission of

<sup>239</sup> *Westinghouse Brake & Equipment (Pty) Ltd v Bilger Engineering (Pty) Ltd* 1986 (2) SA 555 (A).

<sup>240</sup> *Ibid* at the Headnote.

<sup>241</sup> *Ibid* 562.

<sup>242</sup> *Ibid*. See also *Black-Clawson International Ltd v Papierwerke Waldhof-Aschaffenburg AG* [1975] AC 591; [1975] 1 All ER 810; *R v Bloxham* [1983] 1 AC 109 115 as well as [1982] 1 ALL ER 582 and also *Eastman Photographic Materials Co Ltd v Comptroller General of Patents, Designs and Trademarks* [1898] AC 571 (HL); *Assam Railways and Trading CO Ltd v Commissioners of Inland Revenue* [1935] AC 445 (HL), and *Smith I et al* (1997) *Social Security & Pensions Halsbury's Laws of England 4<sup>th</sup> ed* Vol 44 (2) paragraph 901. In South Africa, *Hleka v Johannesburg City Council* 1949 (1) SA 842 (A) the SCA having referred to the *Eastman* case *supra* and the *Assam Railways* case *supra*, left the point open, but in *S v Mpetsha* 1985 (3) SA 702 (A) 712H – 713E, Galgut AJA, delivering a minority judgment (the majority judgment did not consider the point); held that it was permissible for the SCA, in construing the Internal Security Act 74 of 1982, to have regard to the report of the Commission of Enquiry into Security Legislation in order to ascertain the mischiefs aimed at. The *Black-Clawson International* case has been followed in Zimbabwe (*Hewlett v Minister of Finance and Another* 1982 (1) SA 490 (ZS) 496 – 7) and in Canada (*Re Urman* (1981) 128 DLR (3rd) 33 37 – 8).

enquiry whose investigations shortly preceded the passing of the statute in order to determine the mischief it sought to rectify, provided that there is a clear connection between the subject matter of the enquiry and the recommendations of the report, as well as of the statutory provisions in question.<sup>243</sup>

In *S v Nel*<sup>244</sup> the judgment in *Westinghouse* was applied and confirmed, with the proviso that such an enquiry will be entertained only if the legislation is ambiguous or contains obscure provisions. In *National Home Products*<sup>245</sup> the *Nel* judgment was confirmed.

In *Heydon's*<sup>246</sup> case the statutory provisions to be interpreted were contextualised with referenced to its precautionary nature. In an attempt to arrive at the real meaning the Court held that the law must be considered in determining the legal position at hand, by looking to prior to the enactment. Ascertaining mischief is a historical exercise at best and it has been developed and acknowledged in South African jurisprudence.<sup>247</sup>

### 5.3. Manifestation of purposeful interpretation

Contemporary Anglo-centric jurisprudence supports a context-based purposive approach which is practical at its core:

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<sup>243</sup> *Westinghouse v Bilger* 583.

<sup>244</sup> *S v Nel* 1987 (4) SA 276 (O). See also Botha (2005) *Statutory Interpretation* 101.

<sup>245</sup> *Vynide Ltd v National Home Products (Pty) Ltd; National Home Products (Pty) Ltd v Vynide Ltd and Others* 1988 (1) SA 60 (W). See also Botha (2005) *Statutory Interpretation* *ibid*.

<sup>246</sup> *Heydon's* case 3 Co Rep 7a 7b. See also Du Plessis LM (1986) *The Interpretation of Statutes* Durban: Butterworths 33.

<sup>247</sup> *Diepsloot Residents' and Landowners Association and Another v Administrator Transvaal* 1994 (3) SA 336 (A). See also the discussion in as per Botha (2005) *Statutory Interpretation* 103 discussing this judgment where the SCA held that the Court may look at the background as well as historical context in interpreting legislation.



This means judges fill in gaps in legislation, quite unashamedly and without hesitation. They ask simply: what is the sensible way of dealing with this situation so as to give effect to the presumed purpose of the legislation. They lay down the law accordingly.<sup>248</sup>

The purposive approach has been accepted by our Courts.<sup>249</sup> In the Constitutional Court it was held that the preferred approach is not to search for what is general and specific but to seek out the essential purposes and interests served by the provisions of a statute, whereby the use of a species of proportionality, a balance, ought to be struck between the interests and purpose on the one hand and the literal meaning on the other. By emphasising the way in which context can modify plain meaning, this type of interpretation conforms to overwhelming international practice.<sup>250</sup>

The general approach adopted is that Judges are to function in an unapologetically purposive fashion and to acknowledge without fear that they can and do “rectify” the text of a statute when the words used in a

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<sup>248</sup> *S v Mhlungu supra* at 916C-E. Membership of the European Union has had its effect on English Judges. Lord Denning explained the approach of European Judges in the following terms: “They adopt a method which they call in English by strange words – at any rate they were strange to me – the “schematic and teleological” method of interpretation. It is not really so alarming as it sounds. All it means is that the Judges do not go by the literal meaning of the words or by the grammatical structure of the sentence. They go by the design or purpose which lies behind it. When they come upon a situation which is to their minds within the spirit – but not the letter of the legislation, they solve the problem by looking at the design and purpose of the Legislature – at the effect it was sought to achieve. They then interpret the legislation so as to produce the desired effect. This means they fill in gaps, quite unashamedly, without hesitation. They ask simply: what is the sensible way of dealing with this situation so as to give effect to the presumed purpose of the legislation. They lay down the law accordingly. See also the remarks of Mohamed J in the same case at 872F – 876E and 889 D – F.

<sup>249</sup> *Barkhuizen NO supra* 31.

<sup>250</sup> *Barkhuizen NO ibid* quoting Sachs J in *S v Mhlungu and others* 1995 (3) SA 867 (CC) at 914H-916A.

particular formulation defeat or go against the general purpose of the statute. A contextual approach is therefore promoted where words and, in particular, general words cannot be read in isolation: their colour and content are to be derived from their context. This practice entails a purposive and mischief-orientated reading as opposed to a purely literal one.<sup>251</sup>

The Supreme Court of Appeal has held that even where the language is unambiguous the purpose of the Act and other wider contextual considerations may be invoked in aid of a proper construction and even the antecedents of an Act may be used if need be.<sup>252</sup>

Even if a South African Court comes to the conclusion that the language of a statute is clear and unambiguous (which it is respectfully submitted is not the case with Chapter 4), it is entitled to reject the purely literal meaning if it is apparent from the anomalies which flow therefrom that the literal meaning could not have been intended by the Legislature.<sup>253</sup>

<sup>251</sup> *S v Mhlungu* *ibid* at 917B-D. Sachs J acknowledges that the approach suggested is relatively new in South Africa, and involves a utilisation of proportionality that is little different from its normal employment in other countries, yet finds it helpful in the case of ambiguity (917F).

<sup>252</sup> *Secretary for Inland Revenue v Sturrock Sugar Farm (Pty) Ltd* 1965 (1) SA 897 (A) 903 as per Ogilvie Thompson JA. See also *Stopforth v Minister of Justice and Others*; *Veenendaal v Minister of Justice and Others* 2000 (1) SA 113 (SCA) 391 d-e where it was held that a purposive interpretation should be given to the TRC Act. The Zimbabwean Supreme Court in *Commissioner of Taxes v First Merchant Bank of Zimbabwe Ltd* 1998 (1) SA 27 (ZS) 30 I – 31 A that the interpretation of a provision of a statute should always be in contextual harmony with both the letter and the spirit of the whole body of law, statutory and common. Regard must be given not only to the pervasive presumption referred to but to the Act as a whole, to its preamble, general framework and antecedents. For it is rare that the true meaning of a provision can be ascertained simply by looking at the language used and nothing else. Also, the Ciskeian Full Bench consisting of White and Ebrahim JJ, in *Fredericks v MEC for Education and Training, Eastern Cape* 2002 (2) BCLR 113, also adopted the purposive approach in interpreting provisions of the Labour Relations Act, 66 of 1995. See also *Pete's Warehousing and Sales CC v Bowsink Investments CC* 2000 (3) SA 833 (E) 840B-C where the purposive approach in relation to contracts have been considered.

<sup>253</sup> Kellaway EA (1995) *Principles of Legal Interpretation of Statutes, Contracts and Wills* Durban: Butterworths 62.

The real intent of the Legislature is described as the protection of the public interest.<sup>254</sup> The Legislature cannot be presumed to act in an unreasonable or unjust manner as a result of the public interest goal of the Legislature, and it is being elected by the people to protect their interests. Words in legislation are to be construed upon that premise: reason enough why words are not restricted to their ordinary or literal meaning, but are extended to be flexible in order to include the most reasonable meaning which can be extracted from the purpose and object of what is sought to be accomplished by the statute.<sup>255</sup> In the case of *Barkhuizen NO v ICASA and another*,<sup>256</sup> the Court, insofar as purposive interpretation is concerned, utilised the premise of intent, in order to interpret the provisions of the statute concerned. The Court held that the purposive approach to the construction of a statute has become an accepted part of our law.<sup>257</sup> The Court quoted the judgment of Dickson J in the Canadian Charter case of *R v Big M Drug Mart Ltd*<sup>258</sup> as the *locus classicus* of purposive interpretation:

In *Hunter v Southam Inc.*...this Court expressed the view that the proper approach to the definition of rights and freedoms guaranteed by the Charter was a purposive one. The meaning of a right or freedom guaranteed by the Charter was to be ascertained by an analysis of the

<sup>254</sup> In close alignment with the principles of offer regulation.

<sup>255</sup> Sullivan R & Driedger EA (1994) *Driedger on the Construction of Statutes 3<sup>rd</sup> ed* Toronto: Butterworths 73-9. It follows that the purposive approach may lead to a more expansive interpretation of words, depending on the underlying purpose of the Act.

<sup>256</sup> *Barkhuizen NO supra*.

<sup>257</sup> *Ibid* 26.

<sup>258</sup> *R v Big M Drug Mart Ltd* [1985] 18 DLR (4th) 321.

purpose of such a guarantee: it was to be understood, in other words, in the light of the interests it was meant to protect. In my view this analysis is to be undertaken and the purpose of the right or freedom in question is to be sought by reference to the character and larger object of the Charter itself, to the language chosen to articulate the specific right or freedom, to the historical origins of the concept enshrined and, where applicable, to the meaning and purpose of the other specific rights and freedoms with which it is associated within the text of the Charter. The interpretation should be, as the judgment of *Southam* emphasises, a generous rather than a legalistic one, aimed at fulfilling the purpose of a guarantee and securing for individuals the full benefit of the Charter's protection. At the same time it is important not to overshoot the actual freedom of the right in question, but to recall that the Charter was not enacted in a vacuum, and must therefore...be placed in its proper linguistic, philosophical and historical context.<sup>259</sup>

The Court held in *Barkhuizen NO* that the approach of disregarding the purpose of legislation if the literal meaning of the words to be interpreted is reasonably clear, is outdated.<sup>260</sup> The Court quoted Driedger<sup>261</sup> as saying:

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<sup>259</sup> *Ibid* 359-60.

<sup>260</sup> *Barkhuizen NO supra* 28.

<sup>261</sup> Sullivan & Driedger (1994) *Construction of Statutes* 64. The Court in *Barkhuizen NO* remarks *obiter* that Sullivan & Driedger (1994) *Construction of Statutes* being an authoritative work is beyond question, referring to *Executive Council Western Cape Legislature and Others v President of the*

“In current practice, the purpose of legislation is taken into account in every case and at every stage of interpretation, including determination of the ordinary meaning.” The author then refers to *McBratney v McBratney*<sup>262</sup> and concludes as follows:

In this passage Duff CJ asserts two principles that govern judicial reliance of purpose in interpretation:

- i) Where the ordinary meaning of legislation is ambiguous or otherwise unclear, the interpretation that best accords with the purpose of the legislation should be adopted.
- ii) Where the ordinary meaning is clear, but an alternative interpretation is plausible and more in keeping with the purpose, the interpretation that best accords with the purpose of the legislation should be adopted.

The “golden rule” of statutory interpretation holds that absurdity is to be avoided, as well as interpretation which would lead to unreasonable outcomes in the general sense.<sup>263</sup>

Driedger<sup>264</sup> summarises the “golden rule” of interpretation by the following propositions:

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*Republic of South Africa and Others* 1995 (4) SA 877 (CC) 894, where the late Chaskalson P (as he then was) refers to said work.

<sup>262</sup> *McBratney v McBratney* (1919) 59 SCR 550 561.

<sup>263</sup> Du Plessis (1986) *Interpretation* 35.

<sup>264</sup> Sullivan & Driedger (1994) *Construction of Statutes* 85 and 86. See also *Barkhuizen NO supra* 28.

- i) It is presumed legislation is not intended to produce absurd consequences.
- ii) Absurdity is not limited to logical contradictions and internal incoherence; it includes violations of justice, reasonableness, common sense and other public standards. Also absurdity is not limited to what is shocking or unthinkable; it may include any consequences that are judged to be undesirable because they contradict values or principles that are considered important by the Courts.
- iii) Where the words of a legislative text allow for more than one interpretation, avoiding absurd consequences is a good reason to prefer one interpretation over the other. Even where the words are clear, the ordinary meaning may be rejected if it would lead to absurdity.
- iv) The more compelling the reasons for avoiding absurdity, the greater the departure from ordinary meaning may be tolerated. However the interpretation that is adopted should be plausible.

It is submitted that the “golden rule” may infer a purposive approach to Chapter 4 interpretation. However, the ambiguity is not contained in a fortress of a dictionary. The delineating definitions do not provide for the philosophical, common law and complete law constructions with the probability of problems in utilising this interpretive approach as the argument that Chapter 4 is not ambiguous but clear may hold true. It is

submitted that there is a difference between ambiguity and patent errors in legislation.

#### 5.4. Ascertaining purposeful interpretation

In the first instance the purpose of offer regulation can be ascertained from its evolution, as well as the principles of offer regulation.<sup>265</sup> In the second instance the further purpose underlying offer regulation in South Africa is to be denoted by the difference in capital market transactions and to provide for the consequences thereof, in an attempt, in the first instance, to remedy the mischief aimed to be addressed by the *Grundnorm* and, in the second instance, the mischief which underlies regulatory confusion and grey areas which lead to ineffectiveness. In the third instance, purpose is to be determined from section 7 of the 2008 Act. The operative discourse is the determination of purpose insofar as it is capable of being determined through interpretation of section 7. If not, a wider interpretation is to be applied *ex legis*. In ascertaining purpose, the mischief must be considered alongside the provisions and the provisions so interpreted as to address the qualm.

Our Constitutional Court has held that it is permissible in interpreting a statute to have regard to the purpose and background of the legislation in question.<sup>266</sup> Explanatory memoranda providing reasons for new Bills have

<sup>265</sup> Chapters 3 and 4 *supra*.

<sup>266</sup> Chaskalson P in *S v Makwanyane supra* at 13, quoting Schreiner J in *Jaga v Dönges NO and Another; Bhana v Dönges NO and Another* 1950 (4) SA 653 (A) 662 G – H: “Certainly no less important than the often repeated statement that the words and expressions used in a statute must be interpreted in the light of their context. But it may be useful to stress two points in relation to the application of this principle. The first is that “the context,” as here used, is not limited to the language of the rest of the statute regarded as throwing light of a dictionary kind on the part to be interpreted.

not been admitted as background material by Courts in the interpretation of statutes.<sup>267</sup> However, the Constitutional Court has held that it is permissible to take notice of the report of a judicial commission of enquiry for the limited purpose of ascertaining the mischief aimed at by the statutory enactment in question.<sup>268</sup>

In England the Courts have relaxed the exclusionary rule and have held that subject to the privileges of the House of Commons reference to parliamentary material should be permitted as an aid to the construction of legislation which is ambiguous or obscure or the literal meaning of which leads to an absurdity. Even in such cases, references in Court to parliamentary material should only be permitted where such material clearly discloses the mischief aimed at or the legislative intention behind the ambiguous or obscure words.<sup>269</sup>

#### 5.5. Application of purposeful interpretation to Chapter 4

Amidst the highlighted problems in this part covering offers the question is begged, *sans* amendments to Chapter 4, how, in the first instance, can a company interpret offer regulation in regard to giving effect to the philosophy of offer regulation thereby minimising and / or avoiding liability. Secondly, submissions are to be made which are aimed at

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Often of more importance is the matter of the statute, its apparent scope and purpose, and, within limits, its background.”

<sup>267</sup> *S v Makwanyane* *ibid* 14. This includes debates in Parliament, including statements made by Ministers responsible for the legislation. This will entail that the Guidelines will not be considered by our Courts in the interpretation of the 2008 Act.

<sup>268</sup> *S v Makwanyane* *ibid*, referring to *Attorney-General, Eastern Cape v Blom and Others* 1988 (4) SA 645 (A) 668H-669F; *Westinghouse v Bilger* *supra* 562C-563A.

<sup>269</sup> *Pepper v Hart* [1993] AC 593 42.



assisting a Court to interpret Chapter 4 in the eventuality of securities litigation.

Due consideration will be given to sections, 5, 6 and 7 of the 2008 Act, read with section 158 in order to form the basis of an interpretational framework aimed at Chapter 4 offer regulation interpretation.

Section 5 of the Act is headed: “General interpretation of the Act.” It deals with the interpretation of the Act and specifically states that the Act must be interpreted and applied in a manner that gives effect to the purposes of the Act as provided for in section 7.<sup>270</sup> Courts must therefore interpret the language of the Act to give effect to the purposes of the Act as stated in section 7. This statement already denotes an express purposeful interpretation. This view is reinforced by section 6(1), *inter alia*, referring to substantial compliance.<sup>271</sup>

Part B of the Act, section 7 reads as follows:<sup>272</sup>

#### 7. Purposes of Act

The purposes of this Act are to-

- (a) promote compliance with the Bill of Rights as provided for in the Constitution, in the application of company law;

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<sup>270</sup> Henochsberg on the 2008 Act 35-6.

<sup>271</sup> *Ibid* 36.

<sup>272</sup> The DTI published the Guidelines (instead of moving for the appointment of a Commission of Enquiry aimed at a review of the then company law). The Guidelines envisaged, ironically enough, a “clear facilitating, predictable and consistently enforced law.” It lists the vision as well as mission statements of the reform process (*in lieu* of a review process). The purposes of the Act as provided for in section 7 are in line with the guidelines in the Guidelines.

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- (b) promote the development of the South African economy by-
    - (i) encouraging entrepreneurship and enterprise efficiency
    - (ii) creating flexibility and simplicity in the formation and maintenance of companies; and
    - (iii) encouraging transparency and high standards of corporate governance as appropriate, given the significant role of enterprises within the social and economic life of the nation;
  - (c) promote innovation and investment in the South African markets;
  - (d) reaffirm the concept of the company as a means of achieving economic and social benefits;
  - (e) continue to provide for the creation and use of companies, in a manner that enhances the economic welfare of South Africa as a partner within the global economy;
  - (f) promote the development of companies within all sectors of the economy, and encourage active participation in economic organisation, management and productivity;

- (g) create optimum conditions for the aggregation of capital for productive purposes, and for the investment of that capital in enterprises and the spreading of economic risk;
- (h) provide for the formation, operation and accountability of non-profit companies in a manner designed to promote, support and enhance the capacity of such companies to perform their functions;
- (i) balance the rights and obligations of shareholders and directors within companies;
- (j) encourage the efficient and responsible management of companies;
- (k) provide for the efficient rescue and recovery of financially distressed companies, in a manner that balances the rights and interests of all relevant stakeholders; and
- (l) provide a predictable and effective environment for the efficient regulation of companies.

These principles are to be applied in determining any matter brought before a Court, the Commission, the Panel or the Companies Tribunal. The Courts must promote the spirit, purpose and objects of the Act and if any provision of the Act, or other document in terms of the Act, read in its context, can be reasonably construed to have more than one meaning, the

meaning that best promotes the spirit and purpose of the Act must be preferred, and will best improve the realisation and improvement of rights.<sup>273</sup> This approach is also referred to as the purposive approach in hermeneutics and in terms of section 7 is to be applied in the interpretation of the Act.<sup>274</sup>

In addition, in section 158(b)(i) it is held that if a provision of the Act, read in its context, can be reasonably construed to have more than one meaning, the meaning that best promotes the purposes of the Act must be preferred by the Courts.<sup>275</sup> This relevant section attempts to ensure that remedies are afforded in such a way so as to promote the purpose of the Act by providing that the Commission, the Panel, the Companies Tribunal and the Court, are required to promote the “spirit, purpose and objects” of the Act.<sup>276</sup>

The spirit and objects are not defined in the Act. The purposes are listed in section 7. In terms of Chapter 4 offer regulation, is the Guidelines, as well as the Memorandum on the Objects of the Companies Bill, 2008, is silent

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<sup>273</sup> Henochsberg on the 2008 Act 46(3). Read with sections 5(1) and 158(1)(b).

<sup>274</sup> See in regard to the purposive approach: *Swart v Beagles Run Investments 25 (Pty) Ltd (Four Creditors Intervening)* 2011 (5) SA 422 (GNP) 18, 42; *Welman v Marcelle Props 193 CC and Another* [2012] JOL 28714 (GSJ) 16, 25; *Employees of Solar Spectrum Trading 83 (Pty) Ltd v AFGRI Operations Ltd and Another In Re; AFGRI Operations Ltd v Solar Spectrum Trading 83 (Pty) Ltd* 6418/2011, 18624/2011, 66226/2011, 666226/2011, 66226A/11 [2012] ZAGPPHC 359 (16 May 2012); *Mouritzen v Greystones Enterprises (Pty) Ltd and Another* 2012 (5) SA 74 (KZD) 18; *Nedbank Ltd v Bestvest 153 (Pty) Ltd; Essa and Another v Bestvest 153 (Pty) Ltd and Others* 2012 (5) SA 497 (WCC) 21 *et seq* and *Peninsula Eye Clinic (Pty) Ltd v Newlands Surgical Clinic (Pty) Ltd and Others* 2012 (4) SA 484 (WCC).

<sup>275</sup> Henochsberg on the 2008 Act 46(4).

<sup>276</sup> *Ibid* 550.

in terms of general background in interpreting the spirit and objects thereof.<sup>277</sup>

Generally, the Guidelines lists the purpose of the company law overhaul process as being to develop a “clear, facilitating, predictable and consistently enforced law,” and to provide “a protective and fertile environment for economic activity.” The Memorandum on the Objects of the Companies Bill also set out specific goal statements, namely simplification, flexibility, corporate efficiency, transparency and predictable regulation.<sup>278</sup> It is patent that Chapter 4 falls short of these goals and purposes as per section 7. It is submitted that Chapter 4 should be purposefully interpreted to give effect to section 7(c) as well as (l). Not only is the Guidelines silent on the mischief and/or reasoning behind Chapter 4, it will also have little value in interpreting the intention of the Legislature.<sup>279</sup>

Further, it is also not possible to utilise the Guidelines or the Memorandum as both documents fail in specifics relating to offer regulation, going as far as blatantly ignoring the specifics whilst referring in broad sweeps to goals and purposes.<sup>280</sup> Rather, foreign concepts are introduced in an attempt to sweepingly address the Guidelines in terms of revising offer regulation in a cursory manner and to address simplification; flexibility; corporate efficiency; transparency and

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<sup>277</sup> In *Kalahari Resources (Pty) Ltd v Arcelormittal S.A. and Others* [2012] JOL 29174 (GSJ) paragraph 60, the Court acknowledged the purposive approach of the Act as per section 7. See also chapter 7 *infra* in its critique of the company law overhaul process and the Guidelines.

<sup>278</sup> Henochsberg on the 2008 Act 550.

<sup>279</sup> See fn 201 *supra*.

<sup>280</sup> See conclusion at chapter 7.

predictable regulation. It is submitted that the *modus operandi* only considered structural changes and never entertained substantive aspects of offer regulation.

It has been established that the intention of the Legislature with the company law overhaul process was, insofar as Chapter 4 is concerned in particular, not as much substantive as it was structural.<sup>281</sup> The changes to Chapter 4 were to give effect to the vision and mission of the Guidelines.<sup>282</sup> There was no review of the substantive law and foreign concepts, by means of definitions, were introduced in order to give effect to the Guidelines. Not only does this leave us with an offer regulatory dispensation which is ineffective due to the confusion caused by its ambiguity, it is submitted that the offer regulatory dispensation is also erroneous as it is in direct conflict with not only logic but also existing law. In applying section 7 it will seem that this is not to be the *status quo*. However section 7, in determining the purpose behind the substance of Chapter 4 (juxtaposed to the formal structure), will not offer any solace in purposeful interpretation. The purpose of Chapter 4 offer regulation will have to be determined from the principles of offer regulation as well as from previous substantive jurisprudence concerning offer regulation in South Africa, in an attempt to arrive at an equitable conclusion in interpreting the provisions regarding their purpose. As Chapter 4 regulation retained in essence the system in operation in terms of the 1973

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<sup>281</sup> See the development of the 2008 Companies Act at Chapter 2 *supra* as well as developmental flaws as discussed *supra*.

<sup>282</sup> Inferred deduction, based on the general mission statement listing simplification, flexibility, corporate efficiency transparency and predictable regulation (read with the vision statement of the Guidelines).

Act, except for placing secondary and primary capital market regulation in the same Chapter,<sup>283</sup> it is submitted that in the interpretation of Chapter 4 regulatory provisions which are not clear and unambiguous, reference may be made to preceding reports of a judicial commission of enquiry. In this instance, the Van Wyk de Vries Commission Report which considered the provisions of the 1926 Act and drafted the provisions of *inter alia* Chapter V and Chapter VI of the 1973 Act after considering each of the provisions together with causalities and eventualities in detail.

The nexus between the judgment in *Westinghouse* and the question as to whether the Van Wyk de Vries Commission Report may be used to interpret Chapter 4 will be based on the following:

- i) whether the wording in Chapter 4 can be described as being clear and unambiguous; (first tier)
- ii) the interpretation and application of the wording in the judgment denoting that the Report of the Commission shortly had to precede the legislation; (second tier)
- iii) the connection between the subject matter of the enquiry and the recommendations in the report and, on the other hand, the statutory provisions in question. (Third tier.)

It is submitted that items i) and iii) fall within the scope of the enquiry. It is further submitted that item ii) will also fall within the scope of the enquiry. The reason being the Van Wyk de Vries Commission Report

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<sup>283</sup> Delport (2011) *Manual* 43.

shortly preceded the 1974 Act with its offer regulatory principles in Chapter V and VI. The principles in place in terms of offer regulation as per the 1973 Act has been retained in essence in the 2008 Act, *sans* aforementioned inclusion of the two markets into one regulatory dispensation. Due to the fact that the Guidelines and process that lead to the 2008 Act, and specifically offer regulation in terms thereof, shed little to no light on offer regulation and the changes effected; it follows that the Van Wyk de Vries Commission Report will still be relevant. It is submitted that item ii) as a requirement features only to safeguard relevance and in doing so the use of the Van Wyk de Vries Commission Report will be acceptable.

The logical inference to be drawn is that the Legislature, in enacting the current Chapter 4 as highlighted above, did not consider the impact of the proposed changes otherwise it never would have drafted the Bill in the way it did. In interpreting Chapter 4, the precepts of the Van Wyk de Vries Commission Report, read with the principles of offer regulation, should be used insofar as possible to construe the mischief underlying the provisions as well as the purpose of the provisions.

#### **6. Concluding remarks**

Chapter 4 offer regulation as it stands is rife with confusion pertaining to its application in terms of the philosophy giving rise to the changes effected by the company law overhaul process, as well as in terms of the inadequately drafted definitions of the subject matter it seeks to regulate.



The net effects of unclear provisions will be two-fold. Firstly, the application of Chapter 4 regulation by companies is complicated and the risk of liability of non-compliance to non-specific regulatory provisions will contribute to undue hardship. Secondly, lack of clarity creates grey areas and these areas inhibit enforcement of regulatory principles making it easier to circumvent them. Bad law makes for bad judgments and it is only a matter of time before unscrupulous business practices in terms of capital acquisition start to take advantage of the principles lacking which will offer plenty of interpretational problems in a Court.

The challenge is to firstly address the compliance, as far as possible, for ethical businesses when making offers to the public and, secondly, to either provide for suitable arguments for review and amendment of Chapter 4 of the 2008 Companies Act, or to provide, as an alternative, a basis of interpretation which may guide a Court when confronted with the plethora of problems created by an over-zealous drafting process. Purposive interpretation may be an option. However it can only stretch that far until the counter-argument is raised, stating that the law is not ambiguous. It is currently the case in respect of Chapter 4 – where an argument can be made that the law is defective, yet unambiguous.

In terms of the South African disposition concerning aspects of Chapter 4 offer regulation, the reality of two separate markets has been identified together with the fact that the philosophy in South Africa has changed between the 1926 Act to the 1973 Act that these markets be separately regulated. Although the 1926 Act did not provide for explicit separate

regulation, it did differentiate between the two capital markets, applied conjunctively. The 1973 Act took it one step further; it differentiated between the two regimes and applied its regulation towards a separation model. The 2008 Act provides for differentiation like the 1926 Act only. The basis of regulation is disclosure and liability provisions. These are market dependant as per the legislation which provides for a differentiation between the markets yet not a lucid application of the regulatory provisions by separating the application of the regulatory provisions. It is submitted that a multi-staggered approach had to be followed in drafting the 2008 Bill. After conjoining the regulation of the markets, the impact of each and every definition applicable as well as section had to be considered in providing for the differentiation to go beyond the conjoining by means of merely providing for conjoined regulation but to provide for compliance of conjoined regulation to each and every section in Chapter 4 to the principles and common law as applicable. The problem resides in the basis of disclosure as regulatory mechanism and the fact that disclosure is market dependant. It is submitted that the genesis of enforcement failure concerning Chapter 4 regulation is with conjoined regulation of the two markets and the definitions applicable to same.

The subject matter of offer regulation is transactional in nature. The problems concerning conjoined provisions with different scope of application have been highlighted. Also the relevance of section 101 in our law has also been highlighted with the deduction that it has outlived its usefulness. Conjoined regulation is not a problem *per se*; it is where

there is an overlap in regulatory provisions which cause ambiguity, especially if the definitions fail to efficiently delineate regulation.

Ultimately the purpose of offer regulation in terms of Chapter 4 should be to ensure efficiency in respect of the enforcement of *ex ante* regulatory provisions in protecting the interests of investors.<sup>284</sup> Enforcement efficiency will advance the furtherance of the Grundnorm. Where this is not the case, the provisions fail, lacking legislative clarity and creating confusion, ergo chaos.

Interaction between the primary and secondary market is evident, in the sense that the secondary market, with less disclosure, may be used to circumvent offer regulation by means of a registered prospectus. This is evident from the overlap between an IPO and the secondary offer(ing).<sup>285</sup>

Although the latter is defined as an offer for sale, the use of offer in the definition of an IPO is on the basis of the definition of an offer in section 95(g) and wide enough to include an offer for sale. It would appear that the protection of the future shareholder / investor has been forsaken for the sake of introducing new concepts into South African company law without due consideration or review.

The inclusion in Chapter 4 of secondary market regulation which should have been aimed at the prevention of the unscrupulous sales of securities in the secondary market has created an overlap in regulation which, based

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<sup>284</sup> Sutherland “Company Law” 2012 *Stellenbosch Law Review* 161.

<sup>285</sup> Delpont “Offers” 2011 *THRHR* 286. Secondary offering regulated in terms of section 101. In terms of section 101(6) the more onerous prospectus requirements can be circumvented by utilising the written statement provided for.

on incomplete definitions in section 95 constitute a regulatory nightmare, especially when enforcement thereof *ex ante* or liability either criminally or by means of civil enforcement *ex post* needs to be enforced. The definitions, read with section 101 and the provisions for secondary market regulation creates an untenable regulatory regime. Section 101 has evolved from the regulation of share hawking to full blown secondary sale regulation which severely impacts the regulatory regime in the primary market. Chapter 4 offer regulation should be aimed at the regulation of distributions and primary market sales. It is submitted that the main causes of ambiguity in respect of Chapter 4 is the definitions in section 95 which must efficiently delineate the scope and application of Chapter 4. The definition of an offer must be revised in order to provide for the common law in respect of the underlying transaction. As Chapter 4 does not provide for underwriting constructions as section 146 did, apart from the apparent distinction in section 95(1)(h), and cognisant of the problems envisaged with said definition on its own as well as if read together with secondary market sale regulation, it would serve the regulatory regime well if section 95(1)(h) is revised to provide for an invitation and construction following the precepts of the 1973 Act's definition, *sans* the differentiation between a sale and a distribution (as to allow for a discontinuance of ambiguity). Chapter 4 should also include a definition of an underwriter with presumption which provides for underwriting transactions. The divorce of regulatory provisions is not recommended but rather the deletion of the "share hawking" provisions for other methods akin to those currently in force in the United Kingdom.

All the consequences of the changes where some sections have been copied from Chapter VI of the 1973 Act and tweaked for accommodation in the 1998 Act have not been covered by the Legislature or the drafters of said Act.<sup>286</sup>

The 2008 Act does not provide for the definition of an underwriter. The 1973 Act also did not, although it did provide for underwriting constructions in terms of section 146. A similar provision is not to be found in Chapter 4 apart from the reference to “sale” in section 95(1)(h) which could or could not denote a secondary market sale due to the ambiguity of the definitions in section 95 and the rest of Chapter 4.

It follows that the division of the primary and secondary markets is ignored. It is important to take cognisance of the fact that the primary and secondary markets operate strictly in numerical order as per the nomenclature. It is physically and legally impossible for the secondary market to exist before the primary market.<sup>287</sup> The reason why it is important that the markets do not overlap is that in the primary market disclosure is required by means of a prospectus and the extent of the disclosure is substantial.<sup>288</sup> In the secondary market the seller must disclose (juxtaposed to the company) and the extent is limited due to the fact that the seller does not have access to all the financial information.<sup>289</sup>

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<sup>286</sup> Sutherland “Company Law” 2012 *Stellenbosch Law Review* 168.

<sup>287</sup> Delpont “Offers” 2011 *THRHR* 281. This is true for the informal secondary market and even more so the formally regulated market (*Stock Exchange Inquiry Commission* (RP 47 of 1965) 4).

<sup>288</sup> Delpont “Offers” 2011 *THRHR* 282. Sections 145 and 146 of the 1973 Act and sections 99 and 100 of the 2008 Act.

<sup>289</sup> Section 141 of the 1973 Act and section 101 of the 2008 Act.

Due to the confusion created by the provisions that applied to the primary and secondary markets in the Companies Act of 1926, the Van Wyk de Vries Commission Supplementary Report<sup>290</sup> recommended that the provisions be in different chapters of the 1973 Act and section 141 was placed in Chapter V while the primary market was regulated in Chapter VI. The confusion was due to the same terminology being used in different contexts.<sup>291</sup>

It is submitted that Chapter 4 regulation entails, at its core, the definition of rights and obligations to be regulated.<sup>292</sup> A purposive approach therefore would be suited towards Chapter 4 interpretation. This will entail that the meaning of a provision in Chapter 4 is to be ascertained by analysing the purpose of such a provision in light of the interests it is aimed at protecting and the mischief it is to cure or prevent. This analysis would have to be undertaken in light of the ineffective and confusing provisions in Chapter 4. In doing so, the character and objects of offer regulation and disclosure as an aspect thereof, by articulating the rights and obligations and aligning them with the historical origins of the concept enshrined in offer regulation as developed in South Africa, must be taken into consideration in order to give meaning and purpose to the provisions in Chapter 4. The interpretational emphasis should be not legalistic but rather aimed at fulfilling the purpose in a proper linguistic, philosophical and historical context.

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<sup>290</sup> Van Wyk de Vries Supplementary Report *supra* 97.

<sup>291</sup> Delpont “Offers” 2011 *THRHR supra*.

<sup>292</sup> Investor protection and the public interest are not *per se* defined in terms of rights and freedoms to be guaranteed by a Charter of fundamental rights, such as human rights, applicable to the *R v Big M Drug Mart supra* judgment, but it does align itself closely to the judgment insofar as the regulation of transactions are concerned to protect the public interest and investors.

It is submitted that section 7 only applies to Chapter 4 insofar as the regulatory regime was structurally revised in order to give effect to section 7. The structural revision, *in lieu* of a substantive revision, has not been successful for evident reasons. Section 7 will be applied insofar it is relevant in constructing a purposive approach and the gist of section 7 lends itself to a purposive interpretation of Chapter 4.

It is also submitted that due to the silence of the Guidelines on offer regulation, the purposive interpretation of Chapter 4 would have to be in the context of the philosophy behind offer regulation as well as that of the Van Wyk de Vries Commission Report.

It is further submitted that the structure and provisions of Chapter 4, insofar as it has been retained in essence from the 1973 Act, lends itself to be construed in accordance with the Van Wyk de Vries Commission Report. In constructing a discourse for Chapter 4 interpretation, regard must be given to the division between the primary and secondary market as well as the underlying transactional implications at common law. Regard must be given to the primary market offer as well as primary market sale, in the first instance, and be sequestered from the secondary market sale. Furthermore, practical, regulatory provisions should be interpreted to provide protection to investors and to uphold the public interest. Unfortunately some provisions are drafted in such a manner that they are not ambiguous at all and can be assailed even with a purposive interpretation.

The need for amendment is evident. Whether the DTI will face its erroneous ways and initiate such a process is uncertain. In the interim Chapter 4 regulation should be attempted to be interpreted purposefully in order to avoid confusion, by applying where possible, the purposes of section 7 relying on effective regulation: thereby purposefully looking at the *Grundnorm* as well as the mischief which the Van Wyk de Vries Commission Report sought to address. However, due to the differences in philosophy, such an approach cannot be considered the ultimate solution.

The most important deduction to be made is that South Africa is still stuck with provisions replaced in 1939 in the United Kingdom. The short synopsis of the history above shows constant evolvement in the United Kingdom. These developments had to be considered prior to merging the provisions of section 101 into Chapter 4 as it is evident that although regulation is required in respect of the secondary informal market, the existing provisions are outdated and do not contribute towards the premise of complete law. Based on same, it is deduced that the delineating definitions in Chapter 4 read with the conjoined regulation in Chapter 4 of secondary market sales of unlisted securities adds to an overlap which contributes towards the substantive aspects of Chapter 4 failing at the *Grundnorm* as well as the requirements for complete law. It is submitted that same will contribute towards enforcement failure.



## CHAPTER 5

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### PART B: SECURITIES

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1. Introduction
2. Issuer
3. Legal nature of securities
  - 3.1. Nature of the contract
  - 3.2. Defining the concept of a security
4. Shares
  - 4.1. Definition of a share
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6. Debentures
  - 6.1. Definition of debenture and debt instrument
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  - 6.3. Qualifying a debenture
  - 6.4. Debt instruments as subject of offer regulation
  - 6.5. Specific issues relating to debt instruments
7. Concluding remarks

## 1. Introduction

A “security” as term is utilised abundantly in the 2008 Act.<sup>1</sup> The practical importance of the definition of a security is that if a financial instrument has the legal characteristic of being a “security,” the substantive requirements of securities regulation will apply to its issue and trading.<sup>2</sup>

Only securities may be offered to the public in terms of the Act.<sup>3</sup> Typically definitions of securities are open-ended and capable of applying to various novel financial transactions within their ambit.<sup>4</sup> This is in line with the principles underscoring offer regulation. In order to be applicable, an instrument is required to fall under the ambit of regulation. The major substantive requirement imposed is that of disclosure through a prospectus.<sup>5</sup> This is so that the offer can be evaluated by an interested party.

The term “security” as used in the 2008 Act, imports with it not only a new definition grafted into our company law but the application through the nature thereof will have to be clarified as well. Insofar as offer regulation is concerned it follows that Chapter 4 regulation aims to

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<sup>1</sup> Stein & Everingham (2011) *Unlocked* 150.

<sup>2</sup> Yalden *et al* (2008) *Business Organizations* 398. The relevant statutes governing securities offerings are the 2008 Companies Act; the Collective Investment Schemes Control Act 45 of 2002; the Financial Advisory and Intermediary Services Act 37 of 2002; the Financial Markets Act 19 of 2012 and the Banks Act 94 of 1990 (hereinafter referred to as the Banks Act). See Getting the Deal Through: “Securities Finance in 18 Jurisdictions Worldwide”- Supplement on South Africa, Davids E & Yuill D, Bowman & Gilfillan Inc <http://www.bowman.co.za/FileBrowser/ArticleDocuments/Getting-the-Deal-Through-Securities-Finance-2014.pdf> (accessed on 16 March 2014) 118.

<sup>3</sup> Section 99(1).

<sup>4</sup> *Ibid* Yalden *et al* (2008) *Business Organizations*.

<sup>5</sup> At any time securities are offered, the substantive requirements of securities law are in principle engaged, although there are exceptions. More about the exceptions will follow under Part C of this chapter. Yalden *et al* (2008) *Business Organizations* 388. Further regulatory provisions entail extended liability.

provide for the regulation of public offerings of securities. The purported policies applicable to the 2008 Act and then per implication, Chapter 4, have already been established, as not in line with the principles of offer regulation, but rather that of section 7.<sup>6</sup>

In the 1973 Act, a share was defined in section 1 so as to include a debenture, the latter regulated in terms of sections 116 to 131, the former in terms of sections 74 to 115, both as instruments of obtaining capital,<sup>7</sup> and included in chapter V of the 1973 Act. Offer regulation in terms of Chapter VI of the 1973 Act made mention only of an offer of shares (including debentures). Debentures were defined in section 1 as including debenture stock, debenture bonds and any other securities of a company, whether or not constituting a charge on its assets.

The definition in the 1973 Act was not so much an attempt to define, as it was to include the instrument in the Act.<sup>8</sup> The meaning of debenture is imprecise but means any document, however it may be described and whatever form it may take, which creates or acknowledges indebtedness in the company to another for money advanced or to be advanced on loan.<sup>9</sup>

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<sup>6</sup> The closest section 7 comes to the principles of regulation is that it provides for the encouragement of efficiency and encourages transparency and high standards through corporate governance, promotes investment and innovation, provides for the optimisation of conditions to aggregate capital for productive purposes and investment and to provide for a predictable and effective regulatory environment. Commendable aims, if only it did not fail at the practical level of drafting and implementing the new regime. The rise to the new regime has already been covered, together with the practical problems related to an overview and drafting process based on policy and the import of foreign concepts rather than a complete review of substantive law together with proposed changes thereof.

<sup>7</sup> Delpont *Die verkryging van kapitaal* (1987) chapters 3 and 4, generally.

<sup>8</sup> Henochsberg on the 1973 Act general note on section 116 at 224.

<sup>9</sup> *Ibid* with quoted sources.

The expression “securities of a company” in the definition of “debenture” in section 1(1) of the 1973 Act was denoted to mean, in the context, documents embodying obligations of the company to repay moneys advanced or to be advanced on loan, which are secured by property, whether owned by the company or by another.<sup>10</sup> It is submitted that this contextual nature of a debenture should be read into the current regime when interpreting the nature of a security.

It follows that a security offering tautologically denotes the concept of a security.<sup>11</sup> This links with the capitalisation of profit companies under Part D of the 2008 Act.<sup>12</sup>

It is trite that corporate ventures are financed, *inter alia*, through the issue by the company of securities (usually in the form of shares) or by debt. This funding is obtained from investors, in the form of shares or by loans made to the company.<sup>13</sup> The offer to conclude one of the contracts in respect of an offer to the public must be in respect of securities as the second determinant.<sup>14</sup>

In analysing the framework of securities regulation and its interaction with the raising of capital, one has to consider the purposes served by this body of law.<sup>15</sup> The disclosure of information is a regulatory strategy consistent

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<sup>10</sup> Henochsberg on the 1973 Act *ibid*. See also *Singer v Williams (Inspector of Taxes)* [1921] 1 AC 41, 49, 57-8 (HL).

<sup>11</sup> Delpont (2011) *Manual* 43.

<sup>12</sup> This definition is much wider than previously used (*ibid* 29).

<sup>13</sup> Cassim *et al* (2002) *Contemporary Company Law* 213. See also Cilliers *et al* (2000) *Corporate Law* paragraph 16.01.

<sup>14</sup> Delpont “About Offers to the Public” 2011 *THRHR* 669.

<sup>15</sup> Yalden *et al* (2008) *Business Organizations* 389.

with the goals of investor protection and market efficiency.<sup>16</sup> Disclosure requirements imposed on offerors and directed towards offerees are the major form of regulation imposed by securities law.<sup>17</sup>

The primary functions of a securities regulator are the protection of investors and the promotion of stability and the integrity of the financial markets.<sup>18</sup> The development of financial markets was caused by the expansion of markets and investment funds, financial innovation,<sup>19</sup> and increased global fund flows towards international markets.<sup>20</sup> This in turn led to diversification,<sup>21</sup> conglomeration,<sup>22</sup> and globalisation.<sup>23</sup> It is stated that such developments call for a holistic or integrated approach in supervision and regulation.<sup>24</sup>

Securities regulators are required to pay attention to the effects of transactions or securities related activities on both investor protection and the efficiency of capital markets<sup>25</sup> *in toto*.<sup>26</sup> It will therefore be necessary to review not only what is meant by the term securities but also to review

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<sup>16</sup> *Ibid.*

<sup>17</sup> *Ibid.*

<sup>18</sup> Nel Commission Report at chapter 5. Securities regulation became stagnated and less effective *inter alia* due to the proliferation of regulators; the rapid development of financial products and financial markets and growth of big conglomerates.

<sup>19</sup> Credit securitisation, growth of derivatives and technological advances, as well as a global community and world marketplace.

<sup>20</sup> Nel Commission Report *supra*.

<sup>21</sup> One institution offering a range of financial services.

<sup>22</sup> Financial business merging into a group.

<sup>23</sup> Nel Commission Report *supra*.

<sup>24</sup> *Ibid.* Chapter 8 of the Act details the regulatory agencies and administration of the Act. Part A details the first regulatory agency; the Companies and Intellectual Property Commission. Part B enacts the Companies Tribunal; with part C detailing the Takeover Regulation Panel. Lastly, the Financial Reporting Standards Council is featured in part D. For purposes of this chapter, only the Companies and Intellectual Property Commission is discussed as regulator of the Act concerning offers to the public, is discussed.

<sup>25</sup> In the secondary market, the prospectus requirements, as regulated, will have an overspill effect in that the prospectus used in the primary market is utilised in the secondary market as well. See chapter 5 for the discussion on raising of capital and the offer as well as chapter 6 for the discussion on prospectus requirements.

<sup>26</sup> Yalden *et al* (2008) *Business Organizations* 389.

the subject matter underlying the concept of a security, as being the *merx* of the public contract. This is due to the fact that an offering of securities will act as second determinant aimed at the activation of offer regulatory provisions.

## 2. Issuer

The definition of a security will be dealt with in 3.2 below, suffice it to state at this juncture that the definition in the 2008 Act relates to any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company.<sup>27</sup> The definition implicates the offer of securities to be in respect of an issuer.<sup>28</sup> Section 99(1) provides that a person must not offer to the public any securities of any person unless that second person is (a) a company and (b), in the case of a foreign company, certain documents, such as the equivalent of its MOI and information about its directors (not officers), must have been filed within 90 business days prior to the offer being made public.<sup>29</sup>

The term “company” is defined in section 95(1)(a) as including the term as per section 130 and includes a foreign company.

A foreign company, *inter alia* is an entity outside the borders of the Republic of South Africa<sup>31</sup> and therefore a *Peregrinus* of the Courts and subsequent jurisdiction thereof.

<sup>27</sup> Section 1.

<sup>28</sup> Delpont “About Offers to the Public” 2011 *THRHR* 669-70. This is an attempt to cover the *lacunae* in the 1973 Act in respect of offers into South Africa by foreign companies.

<sup>29</sup> *Ibid* 670. This means that securities are a necessary implication in respect of an issuer, which is now defined in an attempt to cover the *lacunae* in the 1973 act in respect of offers into South Africa by foreign companies.

<sup>30</sup> A juristic person incorporated in terms of the 2008 Act, a domesticated company, or a juristic person in terms of the 1973 Act, the Close Corporations Act of 1984, recognised in terms of the 1973 Act as a company or deregistered in terms of the 1973 Act and re-registered in terms of the current Act.

This inclusion will no doubt contribute to substantial problems in terms of enforcement, and thereby possibly circumventing the principles of regulation. Under the 1973 Act, Chapter VI provided for the inclusion of an external company, defined in section 1 of that Act as a foreign company which *inter alia* had established a place of business in the Republic.<sup>32</sup>

The 2008 Act provides for the registration of external companies and a registered office.<sup>33</sup> The office must be registered subsequent to registration as an external company.<sup>34</sup> In terms of effective service of process and subsequent execution, if applicable, depends on whether a Court has jurisdiction.<sup>35</sup>

The conjunctive “and” implies that a foreign company is a category of the genus of “company,” otherwise the disjunctive “or” would be used. However, the definition of “company” does not include a foreign

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<sup>31</sup> Section 1.

<sup>32</sup> This also includes the acquisition of capital. It is therefore clear that the 1973 provision sufficiently provided for the creation of an *Incola* of our Courts, establishing jurisdiction over the external company in terms of enforcement. Whether or not the draftsmen of the 2008 Act foresaw this problem or not is not evident. It is submitted that in an attempt to simplify the company laws of South Africa, an omission occurred in the practical application of company laws which are much more than the black letters on a piece of paper. See *Ex Parte NBSA Centre Ltd supra*. See also Delport (2011) *Manual* 38-42 regarding the discussion of securities.

<sup>33</sup> Section 23. An external company must register as an external company with the CIPC within 20 days from commencing business in the Republic and also maintain at least one registered office. The definition in section 1 of an external company denotes a foreign company incorporated in a foreign jurisdiction where it meets legislative or definitional requirements comparable to the 2008 Act and which is then recognised in terms of the 2008 Act on registration, Henochsberg on the 2008 Act 103. Maintaining an office is apparently less onerous than the establishment of a place of business. This does not mean the setting up of a wholly owned subsidiary company, registered under the 2008 Act or its predecessors. Henochsberg on the 2008 Act 103. This thin requirement can be traced back to the purposes of section 7 under the auspices of simplifying the incorporation process. Henochsberg on the 2008 Act 64 referring to paragraph 1.2 of the Guidelines and section 7(b)(ii).

<sup>34</sup> Section 23(3)(b). Until registration, there is no registered office (Henochsberg on the 2008 Act at 103; see also *BP & JM Investments (Pty) Ltd v Hardroad (Pty) Ltd* 1978 (2) SA 481 (T) 458 which differs from an *obiter* in *BP & JP Investments (Pty) Ltd v Hardroad (Pty) Ltd* 1977 (3) SA 753 (W) 579).

<sup>35</sup> See the discussion of section 23 in Henochsberg on the 2008 Act 104 under the heading “Court process.”

company. A “foreign company” is defined in section 1 as an entity incorporated outside the Republic irrespective of whether it is for profit or non-profit or whether it carries on business within the Republic. If it does carry on business inside South Africa, it becomes an external company and section 23 applies. Section 23 has a presumption in respect of “conducting business,” but not “carrying on [of] business.”<sup>36</sup>

The due effect is that all external companies are foreign companies, but not all foreign companies are, as per section 23, external companies. A company incorporated in Delaware will therefore have to comply with the Act if it offers securities in South Africa, irrespective of whether it is an external company or not. This in itself causes certain difficulties, because if a company does not comply with the Act it commits an offence and is liable for losses sustained by a person as a result of the contravention (offence) (section 214(4)).<sup>37</sup>

Extraterritorial criminal enforcement will be difficult and enforcement of a damages claim will be impossible. In terms of the offer of “securities” other than one of those defined in section 1 of the Act will apply, (of which there are many obvious examples under foreign laws), and the Act will not be applicable as the second determinant is absent due to creative transactional structuring.<sup>38</sup>

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<sup>36</sup> Delpont “About Offers to the Public” 2011 *THRHR* 670.

<sup>37</sup> *Ibid.*

<sup>38</sup> *Ibid.*



### 3. Legal nature of securities

Blackman discusses the already mentioned case of *Singer v Williams*<sup>39</sup> in deriving at a meaning of the word “securities” in the 1973 Act. The Guidelines to the company law review process which gave rise to the 2008 Act is silent on the subject, although the use of the term is abundant in the 2008 Act. In the case of *Singer* it was accepted, while the word security has no legal definition and may mean different things in different contexts and may be given a particular definition in a statute, that the normal meaning of the word “securities” is a debt or claim to the payment of which is in some way secured:

The security would generally consist of a right to resort to some fund or property for payment; but I am not prepared to say that other forms of security (such as a personal guarantee) are excluded. No doubt the meaning of the word may be enlarged by an interpretation clause contained in a statute...or the context may show...that the word is used to denote, in addition to securities in the ordinary sense, other instruments such as stock and shares. But in the absence of any such aid to interpretation, I think it clear that the word “securities” must be construed in the sense above defined, and accordingly does not include shares or stock in a company.<sup>40</sup>

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<sup>39</sup> Blackman *et al* (2002) *Commentary* 5-328. See also *Singer v Williams supra*.

<sup>40</sup> *Singer v Williams ibid* as per Viscount Cave at 49.

Lord Shaw in the same case said that the term involves the idea of the relation of a creditor with debtor, the creditor having a security over property, concern, assets, goods or other things, which, so to speak, are put in pledge by the debtor to the creditor.<sup>41</sup> Lord Wrenbury<sup>42</sup> said that a security is a possession such that the grantee or holder of the security holds against the grantor a right to resort to some property or some fund for the satisfaction of some demand, after whose satisfaction the balance of the property or fund belongs to the grantor. Thus, specifically excluding a share from the description.

It follows that statutorily, the term “security” includes shares. This may be due to the regulatory nature underpinning shares as well as debentures (the two, by nature, are required to be regulated together insofar as offers to the public are concerned). The drafters (no doubt under the influence of foreign nomenclature) aimed to include shares and use the all-encompassing definition throughout the 2008 Act.

### 3.1. Nature of the contract

Following non-statutory contract law for the contract of sale all that is necessary is agreement on the thing to be sold and the price to be paid which in turn gives rise to rights and obligations.<sup>43</sup> As noted under

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<sup>41</sup> *Ibid* 58.

<sup>42</sup> *Ibid* 59.

<sup>43</sup> Kerr AJ (2004) *The Law of Sale and Lease 3<sup>rd</sup> ed* Durban: LexisNexis Butterworths 3; Havenga P *et al* (2010) *General Principles of Commercial Law 7<sup>th</sup> ed* Claremont South Africa: Juta 8, 13; De Wet JC & Van Wyk AH (1978) *Die Suid-Afrikaanse Kontraktereg en Handelsreg 4de uitg* Durban: Butterworths (1978) 313. See also *Kennedy v Botes* [1979] 3 All SA 66 (AD); 1979 (3) SA 836 (A) 845F-846A, and also Kerr AJ & Glover G (2010) *Sale The Law of South Africa 2<sup>nd</sup> ed* Volume 24 paragraph 1 (hereinafter referred to as *LAWSA* (2010)) with authorities quoted, referencing Grotius *Inleiding* 3 14 1; Van Leeuwen *Cens For* 1 4 19 1; *RHR* 4 17 1; Huber *HR* 3 2 2' Voet *Commentarius* 18 1 1; Pothier *Sale* preliminary article and par 3; Van der Linden *Koopmans Handboek* 1 15 8. van Leeuwen *Cens For* 1 4 19 1; Voet; Pothier *Sale* par 3 and Van der Linden write as if they intend to

Chapter 3, although the law of sale has been traditionally shaped by the common law and *stare decisis*, the evolution of certain sales moved towards greater statutory regulation of consumer contracts.

Depending on which market the *merx* is traded, the incorporeal movable property, subject to the concept of security, will either not yet have come into existence, and will be subjected to the condition that it come into existence as is the case with a primary market transaction, or it will be in existence, as is the case with secondary market transactions.

For the purposes of offer regulation, the subject matter of securities needs to be considered. Underlying which is the nature of the contract to which the company and the investor are the parties. The *essentialia* of the contract have been discussed in Part A *supra* as part of the discussion of the offer. For the purposes of the *res vendita* or *merx* related to the *essentialia*, the subject matter, as expounded below, identifies same when considering securities.<sup>44</sup>

The Nel Commission considered security regulation and financial products in an attempt to highlight the best way to achieve the protection of the public as well as the financial markets, through effective regulations, by investigating the financial product which sought to be regulated.<sup>45</sup> Insofar as securities are concerned, the debate is ongoing as to whether it is possible to isolate and identify the common characteristics which apply to products such as securities and thereby obviate the

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convey that there are three separate essentials. Instead of price, thing and consensus, the better view - see Grotius; Huber and Pothier - is to infer consensus reached on the thing and price.

<sup>44</sup> See LAWSA (2010) paragraph 1.

<sup>45</sup> Nel Commission Report chapter 6.

necessity for an enumeration.<sup>46</sup> Experience in the United States, where the pro-active regulator battle with creative designers of financial gimmicks, illustrates the difficulties encountered by regulators and Courts to find an adequate and workable definition of a “security.”<sup>47</sup>

In the United States since 1970, the regulatory agencies and the Courts have been inundated with irregular investment devices which had to be considered against the statutory definitions to determine whether the devices are securities.<sup>48</sup>

It is important at this juncture to note that in the event that an instrument does not qualify as per the existing legislation and definitions as a security, the regulatory principles will not apply to a scheme which will negate the philosophy of offer regulation and the application thereof.

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<sup>46</sup> Long J (2011) *Blue Sky Law -Vol 12 Securities Law Series* New York: Thomson Reuters 1 – 19. As per the Nel Commission Report (*ibid*) the generic definition has not yet been successful. Definition by enumeration is the method used worldwide. The advantages of this type of definition are that it is usually easier to decide whether a particular financial product falls within the definition, reduces disputes, and it is also easy to add a new and innovative product to the list.

<sup>47</sup> Professor Long attributes this to the fact that there has been no adequate definition of a security since securities regulation first came into being. The first Securities Act did not even contain a definition of a security, but merely assumed that the word had a common meaning. Subsequent state acts added rudimentary enumerative definitions. The Illinois Securities Act of 1919 provided the first enumerative definition: "...the word securities shall include stocks, bonds, debentures, notes, participation certificates, certificate of shares or interest, pre-organisational certificates and subscription, certificates evidencing shares in trust estates or associations and profit-sharing certificates." This definition foreshadowed the approach that other Legislatures were to follow. First, the definition would contain a series of items having rather fixed, generally recognised meanings such as stocks, bonds, and debentures. The specific terms were followed by a series of general terms having no fixed legal meaning, such as profit-sharing certificates and evidences of indebtedness, which were included in an attempt to cover unusual securities. Where irregular investment forms appeared, the Legislatures simply added additional general terms in the hopes of plugging the gaps. The Securities Act of 1933, however, tended to act as a catalyst in this process of definition by enumeration. Most of the existing state definitions were examined and was combined into the single enumerative definition found in section 2 (1) of the 1933 Act (Nel Commission Report chapter 6).

<sup>48</sup> These opportunities range from the more legitimate condominium and resort membership often afforded and commodity options or coins and bullion and forward delivery contracts. Lack of an adequate definition has not been a serious problem: much of securities regulation in the United States focused, by and large, on offerings emanating from established regular forms of securities, such as stock, bonds, and debentures, where there is little question that the instruments come within the regulatory purview of the Securities Acts. However, there have been certain times when for one reason or another capital markets breakdown. When this occurs, a flock of irregular financing gimmicks - some legitimate, others extremely fraudulent – appeared on the scene.

The Nel Commission Report indicated that, as a result of the rapidly growing market in exotic forms of financial derivative products and the dematerialization of traditional securities, there is a need for an extended definition.<sup>49</sup> It is submitted that the Nel Commission aimed for clarity and effectiveness in curbing abuse. During the past few decades, trading in derivatives has become one of the fastest growing industries. In addition to the growth in its trading, new derivatives are continuously being added.<sup>50</sup>

In the extensive review conducted by the Van Wyk de Vries Commission, the object, *inter alia*, was to simplify legislation relating to shares and share capital.<sup>51</sup>

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<sup>49</sup> Nel Commission Report chapter 6. The importance of course is not only in finding a definition that covers all probable instruments but also a definition that is practical and workable in the South African offer regulation context.

<sup>50</sup> *Ibid.* The growing importance of the trade in derivatives contracts is underscored by the quoted publication by the Office for Futures and Options Research at the University of Illinois (OFUR). OFUR underscores the importance of derivative contracts by stating that a constant new stream of financial services are coming to the market, each often more exotic and complicated than the last. The financial services industry, which includes commodity derivatives exchanges, brokerage houses and banks providing price risk reduction services (ageing services), is one of the fastest growing industries. Due to sheer survival, these companies show a rapid productive innovation. For commodity derivatives, the risk of failure is considerable. Derivative products may be created based on debt securities that represent an interest in a pool of residential home mortgages. One derivative product may provide that the purchaser receives only the interest payments made on the mortgages while another product may specify that the purchaser receives neither principal payment. These derivative products, which reacted differently to movements in interest rates, may have specific appeal to different investment strategies employed by investment managers. A derivative is defined as a contractual relationship established by two or more parties where payment is based on or derived from some agreed upon benchmark such as interest rates, stock indexes, foreign currency and the like and whether payment is in currency, securities or a physical commodity. An option represents the right, but not the obligation to buy or sell a security or other asset during a given time for a specific price (the strike price). An option to buy is known as a call, and an option to sell is called a put. An investor can purchase options (the right to buy or sell the security in question) or sell (right) options. It follows that there is an obligation to sell a security to, or buy a security from, the party that choose the option. For a full discussion on *inter alia* covered and naked options, forward contracts, futures, stripped mortgage backed securities, interest on the securities structured notes, swaps, bankruptcy futures, and the like, see chapter 6 of the Nel Commission Report.

<sup>51</sup> Van Wyk de Vries Commission Main Report at Chapter IX “Shares and Share Capital.”

### 3.2. Defining the concept of a security

Securities are defined in section 1 (after amendment by Act 3 of 2011). It means any shares, debentures or other instruments, irrespective of the form or title, issued or authorised to be issued by a profit company. This definition is exhaustive and not inclusive, with the result that anything that does not fall within this definition cannot be offered to the public through a public offer.<sup>52</sup>

It is not clear as to the exact subject matter of “other instruments” which are included. In an attempt to allude to these instruments, reference may be made to the Financial Markets Act of 2012.<sup>53</sup>

Securities under the FMA are much the same as under the SSA and are defined as any debt, equity or hybrid instruments that grant the holder some form of economic and/or voting rights and interests.<sup>54</sup>

Securities under the FMA are defined as:

- (a) listed or unlisted:
  - (i) shares, depository receipts and other equivalent equities in public companies, other than shares in a share block company as defined in the Share Blocks Control Act, 1980;

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<sup>52</sup> Delpont “About Offers to the Public” 2011 *THRHR* 669.

<sup>53</sup> The Financial Markets Act 19 of 2012 (FMA) was assented to by the President on 30 January 2013 and came into force on 3 June 2013 in terms of Government Gazette number 36485 of 31 May 2013. The FMA replaces the Securities Services Act 36 of 2004 in its entirety.

<sup>54</sup> DLA Cliffe Dekker Hofmeyr (2014) “Corporate and Commercial Alert” <http://www.cliffedekkerhofmeyr.com/en/news/publications/2014/corporate/corporate-and-commercial-alert-6-august.html> (accessed on 6 August 2014).

- (ii) debentures and bonds issued by public companies, public state owned enterprises, the South African Reserve Bank and the Government of the Republic of South Africa;
  - (iii) derivative instruments;
  - (iv) notes;
  - (v) participatory interests in a collective investment scheme as defined in the Collective Investment Schemes Control Act, 2002, and units or any other form of participation in a foreign collective investment scheme approved by the Registrar of Collective Investment Schemes; and
  - (vi) instruments based on an index;
- (b) units or any other form of participation in a collective investment scheme licensed or registered in a country other than the Republic;
  - (c) the securities contemplated in paragraphs (a) (i) to (vi) and (b) that are listed on an external exchange;
  - (d) an instrument similar to one or more of the securities contemplated in paragraphs (a) to (c) prescribed by the registrar to be a security for the purposes of the FMA; and
  - (e) rights in the securities referred to in paragraphs (a) to (d).

The term excludes money market securities except for the purposes of Chapter IV of the FMA, the share capital of the SARB and any security prescribed by the registrar as an excluded security.<sup>55</sup>

The exhaustive definition may include all possible financial instruments offered under the definition of a security insofar the definition is concerned, following the reasoning in *Singer v Williams*. The definition also does not isolate and identify the common characteristics applicable to products as securities rather opting to define the instrument along with its purpose: issued or authorised to be issued by a profit company.

The definition of shares, debentures or other instruments, irrespective of their form or title, provides for a parallel interpretation of any offered instrument (which may have the characteristics of a share or debenture issued or authorised to be issued by a profit company). It follows from the above that a security denotes a wider meaning than the term shares.<sup>56</sup>

The difficulty with definitions covering offer regulatory concepts, such as securities, shares and debt instruments, is the three-dimensional nature thereof and the application thereof in underlying transactions as applied to the common law as well as crystallised principles which underscore the practicalities of such definitions. In part A of this chapter, these difficulties have been alluded to as applied to public offers and they will not be repeated here, save for highlighting the concept of security and the application thereof not only to the common law but also against offer regulatory principles.

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<sup>55</sup> *Ibid.*

<sup>56</sup> Davis *et al* (2009) *Business Structures* 65.



#### 4. Shares

Part D of Chapter 2, consists of sections 35 to 48 and details the capitalisation of companies. Sections 35 to 42 govern shares specifically. In order to gauge the rights granted by a company to an investor from whom it is receiving capital and the obligations attached thereto, it is necessary to discern the nature of a share prior to defining it.<sup>57</sup>

##### 4.1. Definition of a share

Section 35 aims to regulate, according to the short title, the legal nature of company shares and the requirement to have shareholders. A share should be distinguished from securities.<sup>58</sup> The ambit differs in terms of the regulation as envisaged in the 2008 Act, depending on the instrument.

There is no simple definition of the nature of a share and the nature of a share in concept serves various functions.<sup>59</sup>

When the nature of a share is considered it should be noted that a share, issued by a company, is a form of moveable property.<sup>60</sup> A share does not have an indicator of value.<sup>61</sup>

In the 2008 Act, a share is defined as one of the *units* into which the *proprietary interest* in a profit company is vested.<sup>62</sup> This differs from the

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<sup>57</sup> Yalden *et al* (2008) *Business Organizations* 306.

<sup>58</sup> Securities include shares, but are more widely defined and also includes debentures or other instruments, irrespective of the formal title, issued or authorised to be issued by a private company.

<sup>59</sup> Hahlo & Pretorius (1999) *Hahlo's* 150.

<sup>60</sup> Section 35(1). See also Cassim *et al* (2002) *Contemporary Company Law* 215. Therefore and as per section 35(1) transferable in any manner provided for by or recognised by the 2008 Act or other legislation (ignoring the common law).

<sup>61</sup> Cassim *et al* (2002) *Contemporary Company Law* *ibid.* Under the 1973 Act it was possible to have shares with no label of value, known as no par value shares and also shares with a label of value known as par or nominal value shares.

<sup>62</sup> Section 1 of the Act (own emphasis).

definition of a share as per the 1973 Act, which held that a share was a share in the share capital of the company.<sup>63</sup>

The share ultimately held in a company denotes a proprietary interest.<sup>64</sup> This interest is separate from a proprietary right to the assets of the company. Hence the definition of a share in section 1 refers to a share as: “one of the units into which the proprietary interest in a profit company is divided.”<sup>65</sup>

The legal nature of this proprietary interest is further expounded in Chapter 2, Part D of the Act where it is stated that a share issued by a company is movable property, transferable in any manner provided for or recognised by the 2008 Act or other legislation.<sup>66</sup>

The term share is newly defined in the 2008 Act.<sup>67</sup> Neither a *unit* nor *proprietary* interest is defined in the Act.<sup>68</sup> The ordinary dictionary meaning of a “unit” is defined as a *proportionate component* and that of a “proprietary interest” being *a right or title to the property concerned*, which *in casu* will be the profit company and not its underlying assets.<sup>69</sup>

It is submitted that the proportionate component of the proprietary interest to the property concerned does not refer to the assets of the company, but

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<sup>63</sup> Hahlo & Pretorius (1999) *Hahlo's* 150.

<sup>64</sup> Cassim *et al* (2002) *Contemporary Company Law* 213. A share does not constitute a right to the separate estate of the company (as separate legal entity capable of owning assets in its own name.)

<sup>65</sup> *Ibid*. See also the discussion of the nature of a share in Cilliers *et al* (2000) *Corporate Law* paragraph 14.10.

<sup>66</sup> Section 35. It will also not have a nominal or par value as per section 35(2). For transitional arrangements for existing par value shares see item 6 of schedule 5 and regulation 31 (Delpont (2011) *Manual* 29.)

<sup>67</sup> Stein & Everingham (2011) *Unlocked* 150.

<sup>68</sup> *Ibid* 193.

<sup>69</sup> *Ibid* .

rather to an interest *in* the company. A share denotes a share or participatory right in the share capital of the company, being a share in the proprietary interest of the company and not its assets. In *Short v Treasury Commissioners*<sup>70</sup> in this regard it was held that shareholders are not part owners of the company. The company is separate from the totality of the shareholders.<sup>71</sup>

It follows that the shareholders and the company are distinct from each other by way of contract in that the shareholders provide capital to the undertaking and the undertaking, as separate legal entity, in terms of the MOI grants certain rights towards the shareholders, at its core, a *spes* of a favourable return on the investment.

Regarding transferability, no mention is made of the MOI and its effect on the transfer of shares. Only the 2008 Act or other legislation applies, also excluding the common law. The provisions of section 35 also apply only to shares and not to securities. The definition of a share is much wider than was previously the case, securities including a share but a share not including a security. In respect of securities, authorised but unissued securities are included, while in respect of shares, only issued shares are included. As per section 35(1) securities are not included and, therefore, debentures are excluded.<sup>72</sup>

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<sup>70</sup> *Short v Treasury Commissioners* (1948) 1 KB 116 (CA) at 122 and confirmed in (1948) AC 534 (HL).

<sup>71</sup> Hahlo & Pretorius (1999) *Hahlo's* 150.

<sup>72</sup> Delpont (2011) *Manual* 29.

4.2. Subject matter of security transaction: *Shares*

The proprietary interest denotes a fractional part of the share capital, conferring on the holder of a share rights to the proportionate parts of the assets of the corporation by means of dividend or distribution of assets in the event of a winding up, being a separate right of property. The capital, being the property of the company, the share, being the property of the shareholder.<sup>73</sup>

In *Borland's Trustee v Steel Brothers & Co Ltd*<sup>74</sup> a share was described as the interest of a shareholder in the company, measured by a sum of money, for the purpose of liability firstly and, secondly, of interest as well as a series of covenants entered into by all the shareholders.<sup>75</sup> The mention of the interest of a shareholder being able to be measured in money has been rejected.<sup>76</sup> However, for purposes of liability, the judgment emphasizes that shareholders as members may be under obligation to the company as well as having rights against it.<sup>77</sup>

The interest of a shareholder in the company, its assets and dividends, is derived from a bundle of personal rights.<sup>78</sup> Therefore, as a result of the nominal value of shares, a share is a residual claim to the net cash flow of

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<sup>73</sup> *Bradbury v English Sewing Cotton Co Ltd* [1923] AC 744 746. See also Cassim *et al* (2002) *Contemporary Company Law* 213.

<sup>74</sup> *Borland's Trustee v Steel Brothers & Co Ltd* (1901) 1 Ch 279. See also Hahlo & Pretorius (1999) *Hahlo's* 150.

<sup>75</sup> Approved in *Liquidators, Union Share Agency v Haton* 1927 AD 240 at 250-1 by Innis CJ. See also Hahlo & Pretorius (1999) *Hahlo's* 149.

<sup>76</sup> Davies (1997) *Gower and Davies' Principles* 30. The requirement of a nominal value is described as being meaningless and possibly misleading apart from determining the minimum liability.

<sup>77</sup> Hahlo & Pretorius (1999) *Hahlo's* 149.

<sup>78</sup> *Standard Bank of South Africa Ltd and Another v Ocean Commodities Inc and Others* 1983 (1) SA 276 (A). This interest is understood to compose financial as well as non-financial rights and duties as per Davis *et al* (2009) *Business Structures* 66. See also Hahlo & Pretorius (1999) *Hahlo's ibid.*

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a company.<sup>79</sup> Shareholders are therefore residual claimants and risk bearers.<sup>80</sup> This meaning of a share was further expounded in *Commissioner of Inland Revenue v Crossman*:<sup>81</sup>

A share...is the interest of a person in a company, that interest being composed of rights and obligations which are defined in the Companies Act and by the memorandum and articles of association....

As per *Borland's Trustee*, the contract constituted by the articles of association (now the MOI), will define the nature of the rights attached to the share.<sup>82</sup>

In practical application of the definition relating to the underlying transaction relating to an offer as well as a sale of a share is to be found in the nature of the proprietary interest to be obtained as well as the value thereof.

The transaction denotes an interest in a company, consisting of complex personal rights in an incorporeal moveable entity capable of being negated or otherwise disposed of. The interest is not consumable like money, although a monetary value is attached to it. By means of analogy the interest cannot be likened to a debt. The value of a share may fluctuate for

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<sup>79</sup> Fama EF & Jensen MC "Agency Problems and Residual Claims" (1983) 26 *Journal of Law and Economics* 327. For application, see Hahlo & Pretorius (1999) *Hahlo's* 150.

<sup>80</sup> *Ibid.*

<sup>81</sup> *Commissioners of Inland Revenue v Crossman and Others; Commissioner of Inland Revenue v Mann and Others* [1936] 1 All ER 762 (HL) 787.

<sup>82</sup> Hahlo & Pretorius (1999) *Hahlo's supra.*

a number of reasons and it may also be affected by all manner of eventualities which befall the company.<sup>83</sup>

In return for the offer for subscription of shares or the sale transaction, the conclusion of both types of contracts transfers a bundle of intangible property rights to the shareholder from the company, in return for the contribution of monetary value. These shares are said to allocate:

- (a) income rights, i.e., rights of participation in the form of dividends;
- (b) risk of loss, by means of priority rights in relation to capital; and
- (c) power of control, principally through voting rights.<sup>84</sup>

A share constitutes by its nature, as expounded on above, a *ius in personam* as right of action whereupon the extent and nature of the liability attaching to the ownership depends on statute.<sup>85</sup> Conversely the

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<sup>83</sup> *Cooper v Boyes NO and Another* 1994 (4) SA 521 (C) 535. See also *Standard Bank of South Africa Ltd and Another v Ocean Commodities supra* at 288 where it was held that a share in a company consists of a bundle or conglomerate of personal rights entitling the holder thereof to a certain interest in the company, its assets and dividends.

<sup>84</sup> Fidelis O "Takeovers, Share Exchanges and the Meaning of Loss" (1996) 111 *Law Quarterly Review* 424 426-7. According to the author, the definition and allocation of these rights is an integral part of shares. Shares are classified according to income, capital and control rights. By reason of ownership of a share, a shareholder becomes the owner of an intangible property right in a company made up of income, capital and voting rights, all determined by the terms of the issue of the share, the company's MOI, the general law and applicable statutes of the jurisdiction, or incorporation of the company. Shares being the units into which the shareholders rights of participation in the company's cash flow, management and on a return of capital, are divided. See also Cassim *et al* (2002) *Contemporary Company Law* 214.

<sup>85</sup> *Liquidators Union Share Agency Appellants v Hatton Respondent* 1927 AD 240 250. See also *Randfontein Estates Ltd v The Master* 1909 TS 978 981-2 (followed in *De Leef Family Trust and Others v Commissioner for Inland Revenue* 1993 (3) SA 345 (A) 356 where the Court held that shares are rights of action (*jura in personam*) entitling their owner to a certain interest in the company, its assets and its dividends. Conversely it is submitted that same attracts a cause of action if the value to this complex set of rights is misrepresented.) See also Cassim *et al* (2002) *Contemporary Company Law* 214.

transaction of subscription or sale of a share underlies a cause of action akin to those under the common law as well as the statutory corporate law provisions. The share represents the legal relationship existing between the company and the shareholder. As a party to this legal relationship, rights accrue to the shareholder to dividends, as well as the right to participate in a distribution on liquidation. Furthermore, duties accrue, mainly to honour the MOI.<sup>86</sup>

The nature of the movable property rights denoted to a share underpins its transferability. In this regard section 35(1) states that a share is transferable in a manner provided for or recognised by the 2008 Act or other legislation. The problem with this definition has been alluded to above. The importance of this section is that proprietary rights applicable to movable property vests onto shares except as amended for by legislation.<sup>87</sup>

As personal rights denoted by a share,<sup>88</sup> ownership thereof passes by way of cession, with consensus being sufficient to establish cession.<sup>89</sup>

Regarding transfer, the meaning thereof is wide, consisting not of a single

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<sup>86</sup> Cilliers *et al* (2000) *Corporate Law* paragraph 14.10.

<sup>87</sup> Delpont (2011) *Manual* 38.

<sup>88</sup> *Standard Bank of South Africa Ltd v Ocean Commodities Inc* 1983 (1) SA 276 (A) held that a share represents a bundle of personal rights entitling the holder thereof to certain interests in the company, its assets and dividends.

<sup>89</sup> Cession takes place by means of an agreement of cession (agreement to transfer) concurrently with, or preceded by a *iusta causa*, which can be an obligatory agreement (*Botha v Fick supra*). If the MOI or any other agreement between the shareholders provides that the disposition of shares (or securities) is subject to a right of first refusal, this obligation is a *pactum de non cedendo* and is inherent in the shares. Purported transfer (cession) of the share in conflict with this obligation would be void, even in respect of bona fide third parties. See *Smuts v Booyens; Markplaas (Edms) Bpk en 'n Ander v Booyens* [2001] 3 All SA 536 (A). See also Delpont (2011) *Manual* 39.

act but a series of steps, namely an agreement to transfer, the execution of a deed of transfer and lastly the registration of the transfer.<sup>90</sup>

Although a share is defined in legislation, it is the nature of the share that is not simple to define.<sup>91</sup> The essence of a share seems to have crystallised as being a representation of an interest in a company, consisting of complex personal rights, which may, as incorporeal moveable property, be negotiated or otherwise disposed of.<sup>92</sup> It is not consumable as is money, although a monetary value can be attached to it.<sup>93</sup> It is also not a debt, as a debt may give rise to a claim even though the debt and claim may lead to an award of money awarded to the claimant in respect of the debt.<sup>94</sup>

In support of the notion above, it is discussed that, as property, shares are directly related to and co-existent with the assets of the company and that their legal nature depends on the nature of those assets. Whilst the share was legally perceived as equitable interest in a company and its assets, the shareholders, as equitable co-owners of those assets, were necessarily identified with their companies (and therefore not with the assets of the companies).<sup>95</sup>

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<sup>90</sup> *Inland Property Development Corporation (Pty) Ltd v Cilliers* 1973 (3) SA 245 (A). Passing of ownership is therefore an element in the transfer chain, but transfer of the shares is not a requirement for the passing of ownership. Therefore, if shares are transferred in ownership from A to B, but the transfer is not registered, B is the beneficial (true) owner of the shares (and rights in the shares), while A is the registered shareholder (or nominee or agent of B) where some of the rights can be ceded as well, e.g., the voting right or dividend right. See also Delport (2011) *Manual* 39.

<sup>91</sup> *Cooper v Boyes* *NO supra*; Hahlo & Pretorius (1999) *Hahlo's* 149.

<sup>92</sup> *Ibid.*

<sup>93</sup> *Ibid.*

<sup>94</sup> *Ibid.*

<sup>95</sup> Ireland P, Crigg-Spall I & Kelly D "The Conceptual Foundations of Modern Company Law" (1987) 14 *Journal of Law and Society* 149 152. See also Hahlo & Pretorius (1999) *Hahlo's* 150.



Shareholders have four primary rights, comprising financial and non-financial rights. The rights, *inter alia*, are the right to vote, the right to information, the right to share in profits that have been distributed, and the right to share in the net surplus capital of the company on its winding up.<sup>96</sup> In the MOI, the company may confer different rights.<sup>97</sup>

As corporate investment it is a complex form of personal property. The concept of a share connotes a common, divided, participation interest in the business of the corporation.<sup>98</sup> Even when a corporation is dissolved and the assets thereof liquidated, shareholders do not have any right to receive a distribution of those specific assets but only a proportionate distribution of the value of said assets.<sup>99</sup> However, this distribution refers, only to such value as remains after the debts and related liabilities has been extinguished.<sup>100</sup>

The investment or subscription may have been made by the shareholder directly or not.<sup>101</sup> It may have been acquired not from the issuing company but from another shareholder.<sup>102</sup> It is deduced that a shareholder may be entitled to certain rights relating to such matters as voting for

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<sup>96</sup> Davis *et al* (2009) *Business Structures* 67.

<sup>97</sup> *Ibid.* Particularly in regard to the payment of dividends or distributions and the return of capital on a winding-up. The shares may be divided into different classes, like preference shares and the variations thereon, such as convertible preference shares, redeemable preference shares and even deferred shares (or founder's shares).

<sup>98</sup> Nicholls (2005) *Corporate Law* 354 – 56.

<sup>99</sup> *Ibid.*

<sup>100</sup> *Ibid.*

<sup>101</sup> *Ibid.*

<sup>102</sup> *Ibid.*

directors and voting in general as well as the receipt of dividends, and the receipt of a portion of the capital when the company is wound up.<sup>103</sup>

Section 35 sets out the legal nature of company shares as discussed above. A share should be distinguished from securities. Securities include shares but are wider in their definition and also include debentures or other instruments, irrespective of their title.<sup>104</sup>

Equal rights and privileges do not necessarily attach to all shares.<sup>105</sup> Some shares have preferential rights either as to capital or as to dividends or both, subject to section 37.<sup>106</sup> A share may have special privileges regarding voting or in other respects.<sup>107</sup> They may be preferent and ordinary or shares with more classes, each with its own special rights and incidents attached to it.<sup>108</sup>

The most important of duties of a shareholder will be contained in the MOI and will, primarily be to comply with the MOI.<sup>109</sup>

Lastly, the rights attached to a share only come into existence if they are capable of being exercised against the company.<sup>110</sup> This common law principle is confirmed in section 35(4), in that a share only comes into

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<sup>103</sup> See also *Letseng Diamonds Ltd v JCI Ltd and Others: Trinity Asset Management (Pty) Ltd and Others v Investec Bank Ltd and Others* 2007 (5) SA 564 (W) paragraph 17, confirming such rights. (This case was dismissed on appeal on different grounds in *Trinity Asset Management (Pty) Ltd and Others v Investec Bank Ltd and Others* 2009 (4) SA 89 (SCA) as per Henochsberg on the 2008 Act 157.)

<sup>104</sup> Henochsberg on the 2008 Act *ibid.*

<sup>105</sup> *Ibid.*

<sup>106</sup> *Ibid.*

<sup>107</sup> *Ibid.*

<sup>108</sup> *Ibid.*

<sup>109</sup> Davis *et al* (2009) *Business Structures* 66.

<sup>110</sup> Henochsberg on the 2008 Act 161.

existence upon issue.<sup>111</sup> Being a form of personal property, especially listed shares, they can be actively traded on a securities exchange.<sup>112</sup>

The gist of this analysis underscores the subject matter of the rights attached to the offer, discussed in part A of this chapter. The immaterial, movable nature of the proprietary interest to which a nominal value is attached, creates the opportunity for misrepresentation as to the value attached to it. A share and the rights it represent do not materialise in a material form such as a motor vehicle, where the value can be easily ascertainable, if only by means of test driving it, looking at it and feeling it. Facts, figures and promises underlie the transactional nature of the offer, to wit the requirement of offer regulation.

#### 4.3. Transfer of shares

Transfer is not made subject to the provisions in the memorandum of incorporation, which could have the effect that restrictions in the document may not have an effect on third parties and that any such restrictions cannot invalidate the transfer. Restrictions, as required by the Act, for example as in section 8(1)(b)(ii), could be recognised by the Act but whether any restrictions, for example in the case of a public company will fall under this category is uncertain. Presumably because the MOI is recognised (in other words required) by the Act, in the provision that the memorandum of incorporation comply with section 15 and, it is

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<sup>111</sup> *Ibid.*

<sup>112</sup> Davis *et al* (2009) *Business Structures* 66

submitted, a shareholders agreement comply with section 15(7), could be seen as recognition by the Act as well.<sup>113</sup>

In regard to shares which were transferred in the full and technical sense, which is not a single act but consists of a series of steps, namely an agreement to transfer, the execution of the deed of transfer and, finally the registration of the transfer.<sup>114</sup>

### 5. **Contrasting share and debenture holders**

A shareholder participates in the profits of the company available for distribution in the form of dividends which first must be declared. A debenture holder receives interest at a predetermined rate payable at fixed intervals, irrespective of whether the company earns sufficient profits and is paid out of capital.<sup>115</sup> These differences will be expounded on in the discussion in respect of each capitalisation instrument, *infra*.

### 6. **Debentures**

Debt instruments (or debentures) are included under the definition of securities and, as such, under Chapter 4 offer regulation.<sup>116</sup> The offer of shares, debt instruments or other options, akin to the definition of a security, is a commercial decision by the company: as is the option of the investor as to which type of security to invest in (if a choice is available.)<sup>117</sup>

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<sup>113</sup> Henochsberg on the 2008 Act: general note on section 55 at 159, with quoted authorities.

<sup>114</sup> *Ibid.*

<sup>115</sup> Cilliers *et al* (2000) *Corporate Law* paragraph 14.41.

<sup>116</sup> Section 1, definition of *securities* read with Chapter 4, section 95.

<sup>117</sup> Yalden *et al* (2008) *Business Organizations supra*.

Companies can be financed by way of a debt instrument *in lieu* of a share.<sup>118</sup> As such it is important that it be considered as an instrument underlying an offer to be regulated under Chapter 4. The issue by a company of any security other than a share is an issue of a debt instrument.<sup>119</sup>

Debentures, already alluded to, manifest as a type of security other than a share. Instead of obtaining a share in the company by means of the proprietary interest it would seem that the holder of a debenture obtains a claim and interest right against the company.

When a company opts to borrow money it may either enter into a negotiated loan agreement with a banking institution or other lender or it may sell corporate securities such as bonds or debentures.<sup>120</sup> These are the two most important, if not prevalent, methods of raising capital.<sup>121</sup> The company may wish to raise debt capital in the capital markets rather than borrow money from a lender, such as a banking institution.<sup>122</sup> Just as is the case in the issue of shares, debt securities may be issued.<sup>123</sup> Companies can therefore finance their business ventures through debt instead of equity alone.<sup>124</sup>

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<sup>118</sup> Cassim *et al* (2002) *Contemporary Company Law* 230.

<sup>119</sup> *Ibid* 231.

<sup>120</sup> Yalden *et al* (2008) *Business Organizations* 350-1. See also Delpont *Die verkryging van kapitaal* (1987) chapter 2.

<sup>121</sup> Yalden *et al* (2008) *Business Organizations* 75.

<sup>122</sup> *Ibid*.

<sup>123</sup> *Ibid*.

<sup>124</sup> *Ibid*.

An advantage in electing debt instruments over loans is that vast amounts of capital may be borrowed without the need to identify a single lender.<sup>125</sup> Furthermore, the issuing company is getting direct access to investors rather than engaging a financial intermediary such as a banking institution.<sup>126</sup> As a direct result more attractive interest rates are available.<sup>127</sup>

The nature of a debenture, the various rights attached thereto<sup>128</sup> and the methods of securing a debenture<sup>129</sup> remain the same, due to the common law as well as other statutes<sup>130</sup> which cater for approximating formalities, as detailed below.

#### 6.1. Definition of debenture and debt instrument

The issue of debentures is a method of raising capital through the extension of obligations. The holder is a creditor of the company for the amount of the loan and interest whose rights are defined by the terms of issue read with the provisions of the 2008 Act. The definition of securities and the concept of an offer of securities which operates as determinant of a public offer, which will not constitute an offer if the “security” concept is not part of the offer, opens up an interpretational difficulty. The

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<sup>125</sup> *Ibid.*

<sup>126</sup> *Ibid.*

<sup>127</sup> *Ibid.* The financing of public companies differs from that of private companies as private companies are precluded from inviting members of the public to subscribe for their shares or securities, whereas public companies often have their shares and debentures listed on a securities exchange.

<sup>128</sup> Rights of redemption or conversion.

<sup>129</sup> For example by mortgage or notarial bond.

<sup>130</sup> For example the Deeds Registries Act.

definition of securities, other than shares, creates interpretational problems in the context of the referring definition being exhaustive.<sup>131</sup>

There is no clear legal distinction between debt securities, debt instruments and debentures.<sup>132</sup> It is submitted that the operation of the common law debenture applies to the newly defined debt instrument as the field of application remains the same.

It has been held that the pliable nature of a debenture consists of an instrument encompassing various kinds and classes.<sup>133</sup> Also, as a result of the foregoing, a precise legal argument lacking as a debenture is not, either in law or commerce, a strictly technical term: it is a mercantile term which is well adapted in commerce.<sup>134</sup>

In essence, a debenture represents a right to receive periodic payments of interest and the return of principal on specific dates and in accordance with related contractual terms of issue.<sup>135</sup>

Although a debenture takes on different forms, in essence it is a document issued by a company acknowledging that it is indebted to the debenture holder in the amount stated therein.<sup>136</sup>

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<sup>131</sup> Delport “About Offers to the Public” 2011 *THRHR* 669.

<sup>132</sup> Yalden *et al* (2008) *Business Organizations supra*.

<sup>133</sup> *Edmonds v Blaina Furnaces Co* [1887] 36 Ch D 215; see also Cassim *et al* (2002) *Contemporary Company Law* 232.

<sup>134</sup> *Levy v Abercorris Slate & Slab Co* (1887) 37 Ch D 260 264; see also Cassim *et al* (2002) *Contemporary Company Law ibid*.

<sup>135</sup> Yalden *et al* (2008) *Business Organizations supra*.

<sup>136</sup> *Coetzee v Rand Sporting Club* 1918 WLD 74. See also Davis *et al* (2009) *Business Structures* 75.

Part D of Chapter 2 of the 2008 Act contains provisions for the issue of securities other than shares.<sup>137</sup> The Act does not define a debenture.<sup>138</sup> Rather a broader definition for a debt instrument is provided.<sup>139</sup>

Debt instruments are governed by section 43 of the 2008 Act. Section 43(1)(a) provides for the purposes of section 43:

**43. Securities other than shares**

(1) In this section-

(a) “debt instrument”-

(i) includes any securities other than the shares of a company, irrespective of whether or not issued in terms of a security document, such as a trust deed; but

(ii) does not include promissory notes and loans, whether constituting an encumbrance on the assets of the company or not; and

(b) “security document” includes any document by which a debt instrument is offered or proposed to be offered, embodying the terms and conditions of the debt instrument including, but not limited to, a trust deed or certificate.

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<sup>137</sup> Section 43. As with the 1973 Act, the interrelationship with the Banks Act in respect of deposits and the regulation of property syndication schemes has been ignored. Especially the latter, now regulated in terms of the Consumer Protection Act 68 of 2008, should have been included in the definition of securities, as there is no logical explanation for the separate regulation (Delpont (2011) *Manual* 41).

<sup>138</sup> Stein & Everingham (2011) *Unlocked* 169.

<sup>139</sup> *Ibid.* The former lengthy and detailed provisions on debentures have been eliminated by the Act, recognising debt instruments of a company as contracts and that the form and terms of these contracts are better suited to be situation-specific negotiated and drafted by the parties.



The short title of section 43 is “securities other than shares,” but the section only refers to debt instruments and appearing to apply only to such instruments.

The definition of a debt instrument includes any securities other than shares of a company, irrespective of whether or not they are issued in terms of a security document.<sup>140</sup>

Due to the definition of a debt instrument being defined to include any securities of the company other than shares and excluding, amongst others, loans<sup>141</sup> a debt instrument can be construed as being “...[shares] *debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company.*”<sup>142</sup>

A debt instrument includes a security other than a share that has equity participation or voting rights or both.<sup>143</sup> A debt instrument however does not include promissory notes and loans, whether constituting an encumbrance on the assets of the company or not.<sup>144</sup>

A debt instrument is defined that it “*includes....*” This indicates that not only instruments of which debt is a constituent will be a debt instrument.

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<sup>140</sup> Section 43.

<sup>141</sup> Henochsberg on the 2008 Act 181. See also definitions of shares and securities and also the general note in Henochsberg on the 2008 Act at the discussion of section 35.

<sup>142</sup> *Ibid.* All others like letters of allotment could, then be as the “all” in the definition of “securities” qualified as not only debentures.

<sup>143</sup> Section 43(3).

<sup>144</sup> Section 43(1)(a). Secured or unsecured loans and promissory notes are therefore not debt instruments.

All debentures are therefore debt instruments, but not all debt instruments are debentures.<sup>145</sup>

The meaning offered of a debenture is imprecise, but it has been interpreted to mean any document, however it may be described and whatever form it would take, which creates or acknowledges indebtedness in the company to another for moneys advanced or to be advanced to the company.<sup>146</sup> Section 43(1)(a)(ii) excludes “promissory notes and loans, whether constituting an encumbrance on the assets of the company or not” from the definition of a “debt instrument.”<sup>147</sup>

Section 43 further defines a security document as to include any document by which a debt instrument is offered or proposed to be offered, embodying the terms and conditions of the debt instrument including, but not limited to, a trust deed or certificate.<sup>148</sup>

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<sup>145</sup> Henochsberg on the 2008 Act 181. Debentures have a nominal value, being the capital of the loan to the company repayable on redemption; but the terms of issue may provide for payment and also offer premium on redemption.

<sup>146</sup> *Ibid* with authorities quoted.

<sup>147</sup> *Ibid*. The exclusion of loans is problematic as a debenture, with referring to the underlying contract or the documented evidence is that contract, as some type of loan as element as a *causa* for the debt as seen in the common-law definitions. If a loan is excluded, it is, with this back, uncertain why the words “encumbrance on the assets of the company or not” have been included, because if a loan is excluded, and where this is then secured by encumbering the assets or not, it becomes irrelevant. See also section 87 of the Bills of Exchange Act 341 of 1964 for the definition of a promissory note, the exclusion of which is logical. Coincidentally, GAAP Standards IAS 32 (AC 125) and IAS 39 (AC 133) deal exclusively with financial instruments, the former with disclosure and presentation and the latter with recognition and measurement of such instruments. A financial instrument is defined as a financial asset, a financial liability or an equity instrument. A financial liability is defined as a contractual obligation to: (1) deliver cash (for example, to creditors and loans payable) or another financial asset (for example, loan repayable in government stocks) to another enterprise; or (2) exchange financial instruments with another enterprise under conditions that are potentially unfavourable. Liabilities imposed by statutory requirements, such as income tax, are not financial liabilities, since they are not contractual in nature. Since debentures clearly fall within the definition of a financial liability, the accounting treatment for debentures is covered by these GAAP standards. Extensive disclosure is required (Henochnsberg on the 2008 Act 182).

<sup>148</sup> Section 43(4).

Debt instruments are, therefore, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued, by a profit company.<sup>149</sup> All other instruments, like letters of allotment, could then be debt instruments as the “or” in the definition of securities qualifies not only debentures.<sup>150</sup>

A debt instrument therefore includes a security, other than the shares of a company, irrespective of whether they are issued in terms of a security document such as a trust deed.<sup>151</sup>

The board of the company may authorise the company to issue debt instruments, unless the memorandum of incorporation provides otherwise, and must also determine whether the instrument is secured or unsecured.<sup>152</sup> The concept that the board authorises the company (and not *vice versa* as the former is an organ/agent for the latter) may be due to the provisions of section 66.<sup>153</sup> Section 43(2) provides that the board of the company may authorise the company to issue debt instruments. A debt instrument is defined in section 43(1) to include, *inter-alia*, securities other than shares but to exclude loans. It is not clear as to the intent of the Legislature as to what is meant with the exclusion of loans as debt

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<sup>149</sup> Henochsberg on the 2008 Act general note of section 43 at 181.

<sup>150</sup> *Ibid* Henochsberg on the 2008 Act.

<sup>151</sup> Delport (2011) *Manual* 41.

<sup>152</sup> Henochsberg on the 2008 Act *supra*.

<sup>153</sup> Henochsberg on the 2008 Act *ibid*. Section 66 deals with the board, directors and prescribed officers. The business and affairs of the company must be managed by or under the direction of its board, which has the authority to exercise all of the powers and perform any of the functions of the company, except to the extent that the 2008 Act or the memorandum of incorporation of the company provides otherwise. A positive obligation is placed on the directors to manage the company (see subsection 76ff as well as the notes in Henochsberg on the 2008 Act *ibid* relating to directors’ duties.) This is different from the 1973 act where the directors were functionaries (organ or agents) of the company. There is also a case to be made that section 66 merely regulates the division or allocation of responsibilities between directors and shareholders see the notes on “business” and “affairs” in Henochsberg on the 2008 Act 248.

instruments<sup>154</sup> which are by nature loans to the company. The direct result of this is that a company can issue debentures (or debt) as long as the debt is not in the form of loans. The *causa* for the debt, other than a loan, limits section 43 as far as company finance is concerned.

The definition of debentures has always been problematic and the new definition does not bring any certainty. To apply the distinction in *New South Wales Corporate Affairs Commission v David Jones*<sup>155</sup> that the word debenture should be interpreted as the written acknowledgement of debt rather than the underlying transaction does not solve the problem. The scope for confusion is patent.

#### 6.2. Subject matter of security transaction: *Debt instruments*

Although the scope of a debt instrument has been limited by means of legislation, it may be worthwhile to briefly review the subject matter of security transactions insofar as debt instruments are concerned.

In this context debt instruments are taken as being a synonym for a debenture although the Act is silent on that part. It is submitted that for the purposes of interpretation the latter should be construed to include the former, insofar as practically possible.

In *Coetzee v Rand Sporting Club*<sup>156</sup> Ward J quoted Bowen LJ in *English and Scottish Mercantile Investment Co v Brunton*<sup>157</sup> holding that there are

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<sup>154</sup> Presumably also debentures (Delpont “About Offers to the Public” 2011 *THRHR* 670).

<sup>155</sup> *Corporate Affairs Commission v David Jones Finance Ltd* [1975] 2 NSWLR 710 714. See also *English and Scottish Mercantile Investment Company v Brunton* [1892] 2 QB 700 and *Coetzee v Rand Sporting Club supra*. See also Delpont “About Offers to the Public” 2011 *THRHR* *ibid*.

<sup>156</sup> *Coetzee v Rand Sporting Club* *ibid*. Also see Hahlo & Pretorius (1999) *Hahlo’s* 171.

three different forms of debenture. The first a simple acknowledgement of debt. Secondly, an instrument acknowledging debt and charging the property of the company with repayment and, lastly, an instrument acknowledging debt and charging the property with repayment and further restricting the company from giving any prior charge. The word debenture, according to the judgment of Ward J implies an acknowledgement of debt, derived from *debentur*.<sup>158</sup>

Debentures have a nominal value, being the capital of the loan to the company repayable on redemption, but the terms of issue may provide for payment also of a premium on redemption.<sup>159</sup> It may be issued on discount and may embody an option for the holder to convert the debenture into fully paid (ordinary) shares.<sup>160</sup>

As to issue, allotment, prospectus and transfer of debentures, this form of security is in most respects, subject to the same rules as shares.<sup>161</sup> It follows from the nature of a debenture, juxtaposed to that of a share, that a debenture holder is a creditor and not a member of a company.<sup>162</sup> Interest on debentures is payable even if no profit is earned.<sup>163</sup> Debentures will become redeemable at a specified time or at the commencement of the winding up of the company, whichever occurs first.<sup>164</sup>

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<sup>157</sup> *English and Scottish Mercantile Investment Company v Brunton supra* 712; Hahlo & Pretorius (1999) *Hahlo's ibid*.

<sup>158</sup> *Debentur (mihi)*: owing to me, *debere* (to own) *Dictionary.com* (accessed on 28 August 2013).

<sup>159</sup> Henochsberg on the 2008 Companies Act *supra*.

<sup>160</sup> *Ibid*.

<sup>161</sup> Hahlo & Pretorius (1999) *Hahlo's* 170.

<sup>162</sup> *Ibid*.

<sup>163</sup> *Ibid*.

<sup>164</sup> *Ibid*.

Debentures are part of the other loan funds of a company and form part of the external equities of the company to which a company may turn for the funds for its undertakings.<sup>165</sup>

In theory this undertaking will allow the company to attain its profitability goals which eventually will lead to the investment of a debenture holder being honoured. A debenture usually denotes a long-term loan fund.<sup>166</sup>

As noted above, the definition of a debt instrument is in absence of a statutory defined definition and is to be deduced from qualifying the transaction. A brief review of established case law will assist in this. Cassim<sup>167</sup> makes a full referral to the relevant case law which shows that there is no precise definition of a debenture.<sup>168</sup> It is submitted that the nature of a debenture as a pliable alternative to a share underscores the difficulty with its definition.

As with a security various transactional schemes as applied to this alternative to a share make it difficult to find an all-encompassing definition. Rather than attempting to fit it into a definition, it is submitted that a qualitative test would be more suitable.

The 2008 Act provides that the Board of a company may authorise the company to issue debt instruments “except to the extent provided by that [sic] the company’s MOI.”<sup>169</sup> This concept is dubious as it is usually the

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<sup>165</sup> Cilliers *et al* (2000) *Corporate Law* paragraph 14.36.

<sup>166</sup> *Ibid* paragraph 14.37.

<sup>167</sup> Cassim *et al* (2002) *Contemporary Company Law* paragraph 7.9.

<sup>168</sup> *Ibid* 231 and fn 90. In *British India Steam Navigation Co v Inland Revenue Commissioner* 1881 7 QBD 165 171-2 the Court held that the word debenture has no defined signification in the present state of the English language. It was also noted that the correct meaning of a debenture is unknown.

<sup>169</sup> Section 43(2), (Delpont (2011) *Manual* 41).

company that is the principal, giving authority to the Board which acts as the company's agents.<sup>170</sup> No reasoning to due effect is evident and it is clear that legislative amendment must be effected to correct this anomaly.

Holders of debt instruments can be given special privileges regarding attendance and voting at general meetings and the appointment of directors, allotment of securities, redemption by the company, or substitution of the debt instruments or shares of the company, provided that the securities to be allotted or substituted in terms of any such privilege are authorised by or in terms of the company's MOI, unless otherwise provided for by the MOI.<sup>171</sup>

The provision that a debt instrument includes securities other than shares but excludes loans,<sup>172</sup> may have the effect, insofar as offer regulation is concerned, an instrument operating as a debt instrument (and offering a loan) will be excluded or argued to be excluded from the ambit of offer regulation, as it is a loan. The undue effect of this may curtail the principles of offer regulation. It may be that the drafters of the 2008 Act in their attempt to simplify and clarify company legislation meant to exclude bonds from banks to the company or other incidental debt not akin to the common law debenture. There is, however, no clarity in this regard.<sup>173</sup>

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<sup>170</sup> *Ibid.*

<sup>171</sup> *Ibid.* Shares and securities are used here as synonyms with the necessary qualification, as per section 43(3). The rights, etc., of shareholders are not addressed.

<sup>172</sup> Section 43(1).

<sup>173</sup> The 1973 Act defined in section 1, debenture as to include debenture stock, debenture bonds and any other securities of a company, whether constituting a charge on the assets of a company or not. Blackman describes this statutory definition as not a definition, but rather an assumption that the term debenture has an ordinary meaning and that it is extended or confirmed to have extended that meaning to include the various instruments, whether a charge on the assets of a company or not (Blackman *et al* (2002) *Commentary* 5.326, general discussion on section 116 of the 1973 Act).

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### 6.3. Qualifying a debenture

The qualification will denote a review of what a debenture in essence constitutes in the first instance and, secondly, what it does not constitute.

At its core a debenture is a written acknowledgment of indebtedness, irrespective of its form, executed by the company.<sup>174</sup> As a result, the debenture holder becomes a particular kind of creditor of the company for the amount of the loan and interest, whose rights are defined by the terms of the issue read with the provisions of the Act.<sup>175</sup>

A debenture is not a share.<sup>176</sup> Also, every document which creates or acknowledges a debt of a company is not necessarily a debenture, the term does not include a negotiable instrument and various other documents whereby a company acknowledges to pay a sum of money, for example, a mortgage bond.<sup>177</sup>

Blackman, in discussing section 116 of the 1973 Act, states that not every document creating or acknowledging a debt of a company is a debenture, the term not being used when referring to negotiable instruments and other documents in which a company agreed to pay a sum of money, for example, a specific mortgage of land, etcetera. Therefore, the possibility exists that the drafters of the 2008 Act (albeit without justification or reasoning, as little of their motive is available concerning section 43)

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<sup>174</sup> Cassim *et al* (2002) *Contemporary Company Law* 232-2 with quoted cases.

<sup>175</sup> *Ibid* with quoted and referenced case law. The terms of issue of debentures are usually that they are repayable or redeemable at a fixed future date, or between specified dates, at their nominal value, unless the terms of the issue stipulate that a premium is payable on redemption in addition to the nominal value.

<sup>176</sup> By virtue of the definition and legal nature of a share versus a debt instrument. With a share, a proprietary interest is obtained in essence. With a debt instrument no proprietary interest is obtained, rather a *spes* on the advanced capital together with interest.

<sup>177</sup> Cassim *et al* (2002) *Contemporary Company Law supra*.



aimed to adapt the common law meaning of a debenture (debt instrument) as being excluded from a “loan.” It however falls onto its own back, as already stated above.

#### 6.4. Debt instruments as subject of offer regulation

Despite the status of a debt instrument holder as a creditor, the provisions regarding offer regulation by means of disclosure through a prospectus apply to an offer to the public of both shares as well as debt instruments. Debentures, like shares, can readily be utilised to obtain funds from the general public and, as such, are open to abuse.<sup>178</sup>

Following from the discussion in paragraph 6.1 *supra* it is trite that a debt instrument is defined as that it “includes,” which indicates that not only debt instruments are included.<sup>179</sup> All debentures are therefore debt instruments, but not all debt instruments are debentures.<sup>180</sup> The issue of debentures, as noted above is a method of raising capital.<sup>181</sup> The holder is a creditor for the amount of the loan and interest.<sup>182</sup>

The legal distinction between a shareholder and holder of a debenture is that the shareholder is a holder of equity whereas the holder of a debenture is a creditor and the company the debtor.<sup>183</sup> The creditor has a legal right to the return of his capital contributed or a transfer thereof in shares, while the company is a going concern, unlike a shareholder who is

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<sup>178</sup> Cilliers *et al* (2000) *Corporate Law* paragraph 14.41.

<sup>179</sup> Henochsberg on the 2008 Act *supra*.

<sup>180</sup> *Ibid.*

<sup>181</sup> *Ibid.*

<sup>182</sup> *Ibid.*

<sup>183</sup> Stein & Everingham (2011) *Unlocked* 75.

not privy to such right.<sup>184</sup> The debenture may furthermore be secured or unsecured.<sup>185</sup>

Although the holder of a debenture is not a member or shareholder, many of the statutory provisions that regulate the allotment and the issue of shares and the issue of a prospectus apply also to debt instruments.<sup>186</sup>

The lack of clarity regarding a debt instrument and the definition applied to the type of transaction which a company may use to obtain external capital is to be found in the fact that the 2008 Act (as the 1973 Act did regarding debentures) does not contain a sufficient definition: it being unclear and ambiguous.<sup>187</sup> Due to the fact that the definition of debentures under the 1973 Act was found to be lacking the Courts had to interpret the term, using the common law and application of the underlying transactions. In support of the notion to interpret away the “not a loan” part of the definition of a debt instrument under the 2008 Act, it has already been mentioned that the exclusion may be due to sloppy drafting, and an attempt to exclude an underlying money loan transaction (for example from a Bank). It has been held that the word “debenture” denotes the written acknowledgment of debt rather than the transaction.<sup>188</sup> The

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<sup>184</sup> *Ibid.*

<sup>185</sup> *Ibid.*

<sup>186</sup> *Ibid.*

<sup>187</sup> Delpont *Die verkryging van kapitaal* (1987) 81-4.

<sup>188</sup> The application of a definition has been difficult and the same problems are foreseen under the 2008 Act, especially since the confusion is rife between the *genus* and *specie* of the field of application, notwithstanding the exclusion of “loans.” *Corporate Affairs Commission v David Jones Finance Ltd* [1975] 2 NSWLR 710, 714, 715. See also Delpont *Die verkryging van kapitaal* (1987) 87.

field of application must be curtailed and limited and it is submitted that the exclusion of loans be omitted and the definition be revisited *in toto*.<sup>189</sup>

#### 6.5. Specific issues relating to debt instruments

The issue of debt securities can be construed as taking deposits from the general public which, in terms of the Banks Act,<sup>190</sup> requires a banking license unless the debt securities are issued in accordance with the provisions of the Commercial Paper Regulations (CP Regulations) or the Securitisation Regulations published in terms of the Banks Act, in which case the issuer is not required to have a banking license.<sup>191</sup>

As was the case in the 1973 Act, the interrelationship with the Banks Act in respect of “deposits,” and the regulation of property syndication schemes has been ignored.<sup>192</sup> It is especially property syndication schemes that should have been included in the definition of a security.<sup>193</sup>

Problems with the definition of debentures will have an effect beyond company law as per N2173 in Government Gazette 16167 of 1994-12-14. This notice defines the term “commercial paper.”

In terms of the Banks Act if a person does the business of a bank as defined in section 1 of that Act, they must register a bank in terms of section 11 thereof. The business of the bank is defined in section 1 to

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<sup>189</sup> It was submitted that the definition of the 1973 Act be amended to define a debenture as: “the written acknowledgment of debt by a company, whether that debt is secured or not, excluding any claims which arise out of the normal business of a company; Delpont *Die verkryging van kapitaal* (1987) with quoted sources at 87.

<sup>190</sup> The Banks Act 94 of 1990.

<sup>191</sup> Getting the Deal Through: “Securities Finance in 18 Jurisdictions Worldwide” supplement on South Africa *supra* 118.

<sup>192</sup> Delpont (2011) *Manual* 22. See N 203 of 2006 under the Consumer Affairs Act 71 of 1988 in GG 28496 of 10 February 2006.

<sup>193</sup> Delpont (2011) *Manual* *ibid*.

include, amongst others, the acceptance of deposits from the general public (including persons in the employ of the person so accepting deposits) as a regular feature of the business in question and also the soliciting through all forms of advertising for deposits.

“Deposit” is also defined in section 1 to mean an amount of money paid by one person to another, subject to an agreement that that money will be repaid conditionally or unconditionally, with or without a premium, on demand or on specified or unspecified dates and interest may or may not be payable. A payment by a person to a company which must, at some stage, be repaid by the company will therefore be a deposit.<sup>194</sup>

This finds practical application in terms of offer regulation where if the company solicits a deposit, whether through an offer accompanied by a prospectus or not, as per the application of the definitions in terms of the Banks Act the company will be doing the business of a bank. Unless that debt by the company complies with the requirements of a commercial paper, it will be excluded from the definition of business as a bank by virtue of the notice in terms of subparagraph (cc) of the definition.

Regulation 1(b) of the commercial paper notice defines commercial paper to also mean the debentures or any interest-bearing written acknowledgement of debt issued for a fixed term in accordance with the provisions of the Companies Act, 1973. Therefore if a company issues a debt instrument under section 43, it must comply with the commercial paper requirement. Any loan by a company, although it may fall within

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<sup>194</sup> Delport “About Offers to the Public” 2011 *THRHR* 670.

the definition of a commercial paper, would not be possible as it is expressly excluded by section 43(1)(a) of the 2008 Act.<sup>195</sup>

A commercial paper is defined as any written acknowledgment of debt, irrespective of whether the maturity thereof is fixed or based on a notice period and irrespective of whether the rate, at which interest is payable in respect of the debt in question is a fixed or floating rate, and debentures or any interest-bearing written acknowledgement of debt issued for a fixed term in accordance with the provisions of the Companies Act of 1973, but does not include bankers' acceptances.<sup>196</sup>

The Companies Act, CISCAs and FAIS prohibit the marketing of securities without compliance with the provisions of those Acts. With the Companies Act as foundation, CISCAs and FAIS expound on publicity restrictions applied to the public offering of securities.

CISCAs require that specific information must be disclosed to the investor before entering into a transaction with them.<sup>197</sup> The FMA specifically refers in its definition of a security to CISCAs and collective investment schemes. CISCAs define a collective investment scheme as meaning a scheme, in whatever form including an open-ended investment company,

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<sup>195</sup> Delpont "About Offers to the Public" 2011 *THRHR* 670. The different concepts of public in the Banks Act as well as the Companies Act and the uncertainty regarding same will be alluded to in part C of this chapter. Suffice to state that the interpretational difficulty, insofar as avoidance of liability on the part of the company as well as the directors together with interpretational leeway, which may or may not be used in the circumvention of the provisions of offer regulation as per Chapter 4 of the 2008 Act, makes it apparent that the concept of effective offer regulation and clarity are severely inhibited.

<sup>196</sup> Government Gazette No. 16167.

<sup>197</sup> ANON "Association of Collective Investments ACI Guideline: Disclosure of Information Prior to Transacting with a Unit Trust Investor"

[http://www.inseta.org.za/qualifications/content/learning/downloads/12166\\_ACI\\_Guideline.pdf](http://www.inseta.org.za/qualifications/content/learning/downloads/12166_ACI_Guideline.pdf) (accessed on 1 February 2014), (hereinafter referred to as the ACI Guideline). There are a number of ways to meet this obligation, for example, by producing a comprehensive prospective or expanding current application forms to character for the additional information requirements.

in pursuance of which members of the public are invited or permitted to invest money or other assets in a portfolio, and in terms of which-

- (a) two or more investors contribute money or other assets to and hold a participatory interest in a portfolio of the scheme through shares, units or any other form of participatory interest; and
- (b) the investors share the risk and the benefit of investment in proportion to their participatory interest in a portfolio of a scheme or on any other basis.

In terms of section 3 of CISCA, the following information must be disclosed to the investor prior to entering into the transaction:

- a) Information about the investment objectives of the collective investment scheme. This will denote a short description setting out the objectives, for example, the mandate of the fund. It is recommended to indicate what type of investor would be most appropriate for that fund as well.<sup>198</sup>
- b) The calculation of the net asset value and dealing prices. This requirement is to inform the investor regarding the unit trust prices as calculated on the net asset value basis.<sup>199</sup>
- c) Charges. CISCA also provides for certain permissible deductions from the portfolio.<sup>200</sup>

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<sup>198</sup> *Ibid.* For example investors seeking a safe haven from market volatility, investors seeking an extra source of income etc.

<sup>199</sup> *Ibid.* Net asset value can be defined as the total market value of all assets in the unit portfolio including any income accruals and less any permissible deductions from the portfolio divided by the number of units in issue. They also need to be informed of any additional charges that could affect his investment, for example, exit fees.

- d) Risk factors. Risk factors associated with the collective investment scheme must be disclosed. These should include a generic description so as to highlight aspects such as the risk of falling share prices (equity funds), movements in the interest rates (fixed interest funds) and security risks (foreign and worldwide funds).<sup>201</sup>
- e) Distribution of income accruals. The date on which income accruals are declared must be disclosed as well as the disclosure of the amount distributed during the previous financial year, expressed as a percentage of the aggregate market value at the close of that year of all assets held in the fund.<sup>202</sup>

The manner in which information is disclosed to the investor is dependent on the nature of the offer extended to the investor to engage in the CIS. It

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<sup>200</sup> *Ibid.* In terms of section 93 of CISCA, costs which may be deducted from the portfolio include: brokerage, marketable securities tax and value added tax, auditors fees, bank charges, trustee and custodian fees and RSC levies, service charges of the manager. There are also various fees and charges which must be quantified in marketing material as a percentage. These include the maximum initial fee / manager charge inclusive of VAT. The manager's charge and the intermediary's commission must be disclosed. These can be disclosed as the maximum charges, as a range of charges or as a percentage split between the two charges. Although the annual management fee of the manager must be disclosed, together with exit fees, performance-based fees if applicable-the methodology and the quantum of these fees must be disclosed, the different classes, the fees and charges applicable to the different classes must be disclosed. For the purposes of the fund of funds, it must be stated that the fee structure for these funds is higher. In addition, the anticipated aggregate fees levied by the fund and by the other portfolio/s must also be disclosed. VAT on the initial charge will be charged at 14% and not as a percentage of 14%. Brokerage and marketable securities tax, auditor's fees, bank charges, trustee and custodian fees and RSC levies need not be quantified in marketing material but it must be indicated that these charges are levied against the portfolio. The fact that the fund manager may borrow up to 10% of the market value of the portfolio to breach insufficient liquidity and must also be disclosed in marketing material. Similarly, if the manager engages in script lending, the manager must disclose this material. Additionally, this fact will also have to be disclosed in quarterly reports and abridged annual unit holder statements, by highlighting the securities that have been lent, the value they offer and the composition and the nature of the collateral security help in respect of such alone.

<sup>201</sup> *Ibid.* There are also special disclosure requirements governing money markets in section 3.3 of the code of advertising.

<sup>202</sup> *Ibid.* In addition the following information must be disclosed: information that the manager considers necessary to enable the investor to make an informed decision must be given to the investor timeously and in a comprehensive manner. This could include for example information relating to past performance after CIS, changing fund manager or investment style, any mergers or acquisitions that may be underway. If the management company has any pending legal action against it, this must be disclosed.

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follows that if it is an offer to the public for the subscription or sale of securities, Chapter 4 regulation of the Companies Act will apply and a prospectus will be required, the content of which should comply with Chapter 4 regulation as well as the provisions of Cisca. Once a transaction qualifies in terms of Cisca as a collective investment scheme, Cisca will apply in conjunction with Chapter 4 of the 2008 Act.

#### 7. Concluding remarks

Like stacked dominoes, offer regulatory principles rely on each other in order to have the end result envisaged: promotion of the *Grundnorm* in establishing effective markets and investor protection. Clarity is required, including an effective regulatory body which depends on lucid and established regulatory principles which result in legislation which has holistic application *in lieu* of piecemeal amendments. As with the concept of an offer, the concept of what said offer denotes, being securities, is fraught with legislative grey areas and interpretational difficulty. Not only is legislative amendment necessary, but legislative amendment is required to be followed after each and every principle is carefully analysed with a view to what needs to be achieved and how it can be effectively integrated into existing legislation. It is not good enough to initiate change for the sake of change and allow change to be based on policy rather than academic research and empirical deductive reasoning. Policies have their place in politics and business. But not in law where such policies are to be used to draft a new legislative regime upon which the economic future of the Republic will depend.



The concept of what a security is and how it is applied to capital markets in offer regulation should denote a clear concept which will not be assailable by creative instrument structuring, nor should it be the source of uncertainty for companies. A security, whether the interest in the company is by means of a share or a debt instrument, should couple regulation to the instrument offered. In line with the discussion under this part, it is submitted that offer regulation is not in compliance with the principles of regulation as it is at this stage exposed to abuse by the unscrupulous and, more troublesome, it may be the source of undue liability exposure with regards to legitimate offers.

It is submitted that the concept of a security, as far as possible, should be interpreted alongside the principles of regulation, the former denoting an interest as subject matter to the offer made to the public. It is further submitted that prior to legislative amendments being effected to cure uncertainty and patent errors, a sufficient review of offer regulation should be conducted. The time is nigh. The concept of a security is intrinsically linked with the concept of an issuer and as such, the concept of an issuer as defined in the 2008 Act must be clarified as to expand the scope of offer regulation. The definition of a security must be reviewed alongside the recommendations of the Nel Commission Report and the definition of a security as per the 1933 Securities Act in the United States.<sup>203</sup> It would be ideal for the Legislature to consider the dictum in *Singer v Williams*<sup>204</sup> in this regard. The definition of a security should

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<sup>203</sup> See chapter 6 part B in respect of the United States.

<sup>204</sup> *Singer v Williams supra*.

denote a debt or claim to the payment thereof, which is secured. Such a definition should steer away from solely naming instruments but also cover the underlying precepts of the transaction envisaged by the instrument, i.e., an instrument which grants a secured right to either a debt and/or a claim against payment.

## CHAPTER 5

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### PART C: PUBLIC

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## 1. Introduction

The concept of “public” insofar as offer regulation is concerned depends in the main on the interpretation and application of definitions to transactional facts. In analysing the meaning of “public” in offer regulation, it is important to note what the purpose of regulatory principles is. Legislation should be drafted with this in mind in applying regulatory purview of the definitions to transactional relativity.

“Public” is utilized in Chapter 4 with good reason. The concept of “public” is required in Chapter 4 in considering whether an offer of securities would be public in nature and, thus, whether regulation in terms of disclosure requirements should apply in advancing the *Grundnorm*.

As stated, the meaning of “public” is important as it serves as determining integer as well as designating integer. Regarding the former, the concept of “public” serves as the last determining integer in deciding whether Chapter 4 applies or not. Concerning the latter, once the “public” is identified, it follows that disclosure must be made to that group of people.

At the onset, it is important to differentiate the framework in which the concept of “public” operates within offer regulation. Each of the considerations mentioned will be discussed in detail *infra*, whereas this discussion serves as an introduction only for the purposes of clarity.

The concept “public” consists of the public at large. It follows that a distinction would exclude a group from the ordinary meaning of “public”

and lending to the offer of a private nature (even though it may not be intended). Due to this implication, the concept of “public” includes “any section of the public” at large.

The inclusion of “any section of the public” expands the ordinary meaning of “public” to the extent that any offer may be considered as a public offer. Therefore there is the requirement for non-public offers, or safe harbours, where offers of a public nature, extended by public companies for securities, would not be considered to be offers to the public or to any section of the public.

Non-public offers or safe harbours may manifest either under the common law, designating a category of non-public offer under the common law, or the Legislature may elect to codify the common law and create specific exclusions.

It follows that the legislation should incorporate definitions, specifically definitions which define the scope of application of “offer to the public” as an inclusion as well as the exclusions which manifest as safe harbours. When considering whether an offer is to the public a two pronged approach applies. Firstly, in considering the inclusions; if an offer falls within the inclusions as a public offer, the exclusions should be applied in determining whether the offer is public in nature or not. If a common law non-public category exists, this will be applied in the second step of the test as well, after considering the codified exclusions.

The application of specific definitions applicable to offer regulation is at the forefront of determining this two-step test. Any definition must ultimately conform to the principles of regulation, in advancing the precepts of offer regulation. If not, the definitions would be ineffective and offer regulation towards the advancement of the *Grundnorm* would fail.

When considering the definitions, it is important to take heed of certain qualifying criteria. The first criterion is whether “public” is defined or not. There is a difference between the specific inclusion of “public” in the meaning of “offer to the public” versus the omission thereof. Where “public” is expressly included it will affect the ambit of “public” as well as the possibility of a common law non-public category. Where an offer is included in an offer to the public, the scope of a common law non-public category is diminished. This is due to the “offer” being included in any “offer to the public” denoting that any offer (even if a common-law non-public offer) will be a public offer, unless excluded under the legislated exclusions, where such exclusions do not provide for a common law exclusion (which the exclusions ought not to due to abuse of the common law non-public offer category). It is thus important for the definition of “offer to the public” to include specifically “any offer to the public.” To show the converse, where “public” is not defined and expressly included in the definition as to what may constitute an “offer to the public,” a common law non-public category may manifest as follows: where the definition only mentions that an “offer to the public” will include an offer to a “section of the public,” the scope of extending an offer (not to a

section of the public but to the public) will open up an “offer to the public” capable of being subjected to a non-public common law category due to the “include” which denotes a non-exhaustive definition. This possibly entails that ideally, “offer to the public” should be specifically included in the meaning of “offer to the public” and that the definition should be exhaustive.

The second criterion is the exclusionary provisions. Ideally, the definition of a “public offer” should stand alone and include “public” in the definition of “offer to the public” so as to exclude the interpretation of “public” as to denote a different category of offer, (excluding all offers and not certain offers), and not refer to the exclusionary provisions which should be in a different section altogether. This definition should be exhaustive, explicitly, otherwise it may create a safe harbour provision.

These concepts will be expounded in full *infra*. It is sufficient to encapsulate that “public” ought to have, in terms of company law jurisprudence, commenced with the expansion of the term to include “a section” thereof.

“Public” can bear its ordinary meaning when not defined, (which excludes a section thereof). Ordinarily the “section thereof” is defined under the meaning of an “offer to the public includes... .” Or “public” can be “defined” by including its sphere of influence explicitly under the meaning of “offer to the public” meaning [any offer to the public...and includes...any section of the public.]



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The use of “include” and/or “includes” may render a definition non-exhaustive, based on certain requirements of the definition, expounded on *infra*. Ideally, the meaning of “offer to the public” and “public” should be exhaustive so as to avoid abuse through circumvention.

### 1.1. Transactional relativity

Chapter 5 of the 2008 Act which deals with offers of shares in respect of compromises, amalgamations, arrangements and take-overs must be evaluated against the principles of Chapter 4 in determining whether they constitute offers to the public.<sup>1</sup>

Insofar as offer regulation of securities to the public is concerned, the last determinant, that of “the public,” is also the most enigmatic. Who is this “public” at risk of being defrauded? To whom are offers extended and, in addition, who is required to be protected by preventative regulatory measures as well as abbreviated liability provisions? By and large, the question is not singular in its nature, nor in its answer. The importance thereof is paramount. It follows that if the offer is not to the public, Chapter 4 regulatory provisions will not apply to a transaction and disclosure, including abbreviated liability, will be excluded. The public must not be defrauded by fraudulent offers; the public must be protected when it decides to invest by entering into an agreement either in the primary or secondary market; the public must be served by means of efficient capital markets and this is done via enabling and deterring principles. But for these principles to engage, the offer must be to the

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<sup>1</sup> Henochsberg on the 2008 Act 366.

public. There is a breadth of knowledge available on the topic of the public. This part will aim to provide a concise review of the major principles concerning the public in offer regulation in order to shed light on the 2008 Act and the definition of the public as it stands. The aim is to identify and where possible provide solutions where the 2008 Act falls short of the principles of offer regulation insofar as the concept of the public is concerned.

It is submitted that not only does the concept of an offer act as the third determinant to the answer as to whether Chapter 4 offer regulation should apply to a transaction, it also serves as a designator of at whom the disclosure should be directed by means of the prospectus requirements.

The question as to what constitutes an offer poses not only the most vexing question in offer regulation, but is also the source of the most case law.<sup>2</sup> If an offer of securities constitutes an offer to the public, the provisions of Chapter 4 offer regulation will apply together with the disclosure requirements which should be met by means of a prospectus. In addition to the question as to whether an offer of securities is to the public or not, certain “safe harbour” provisions exist which specifically exclude the application of disclosure requirements and the application of offer regulation.

As already alluded to, the purpose of Chapter 4 regulation should be to protect the public. It should also advance offer regulatory principles from

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<sup>2</sup> Cassim *et al* (2002) *Contemporary Company Law* 652.

which Chapter 4 derives its existence. This purpose is not to be ignored.<sup>3</sup> Offer to the public is not to be given an interpretation as having regard to the needs of particular investors, either in terms of being protected or in terms of requiring information. The generality of the offer attracts the operation of the regulatory principles.<sup>4</sup> Attention is to be focussed on the generality of the group the company is targeting, seeking them to part with their funds, and not on the investors in particular.<sup>5</sup> Were it otherwise, offer regulatory protection would be limited to the non-existent situation where all members of the public are in need of protection by Chapter 4 offer regulation.<sup>6</sup>

Company law may be found between the black and white words on paper, yet the application of company law is not as simple, for companies exist and operate in a tangible and three-dimensional reality. This is something of which legislators should keep cognisance. It is submitted that it follows that the concepts of an offer as alluded to in part A of this chapter, are interlinked with the public. It is the offer which is made in an attempt to obtain capital for the company and this offer is made to the public; the public which ought to be protected against a system without sound regulatory principles in place.

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<sup>3</sup> LAWSA (1995) paragraph 147.

<sup>4</sup> *Hurst v Vestcorp supra*. See also LAWSA (1995) *ibid*.

<sup>5</sup> *Corporate Affairs Commission (SA) v Australian Central Credit Union* [1985] HCA 64; (1985) 157 CLR 201 211; *Hurst v Vestcorp ibid*.

<sup>6</sup> *Hurst v Vestcorp ibid*.

## 1.2. Offers and Public

It is not possible to divorce the public from offers of securities. As primary integer the company and its nature is to operate in the commercial sphere as a vehicle to mobilise funds manifests, mainly, through the legal structure of the company limited by shares features in the first instance.<sup>7</sup> Secondly, the process which lends the company the structure to make investment opportunities is public in nature.<sup>8</sup> Also, in the third instance, the tradability as being the nature of a security, whether or not a share or debenture influences the public nature of the transaction through the secondary market.<sup>9</sup>

As secondary integer the nature of the first integer lends to the requirement of disclosure as a counter to improper offers.<sup>10</sup> Due to the disclosure requirements, the principles of offer regulation as well as the contingent history thereof, the road is paved for details of the offer to be disclosed. The nature of the offering of securities as underscored in part A, calls for the offer to be made to the public.<sup>11</sup> The offer is aimed at

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<sup>7</sup> Cilliers *et al* (2000) *Corporate Law* 256. The decisive factor in the evolution of the company as business enterprise was its suitability to serve as vehicle to mobilise funds from investors for business ventures. The *quid pro quo* being an investment made to an offer for subscription or sale providing venture capital to which the investor becomes entitled to a share of the rebate regarding dividends if and when declared and also having a say in the management of the company. Furthermore, the limitation of risk regarding the exposure of contributors to capital pertaining to the amount paid for their shares, perpetual succession, transferability of shares and a regulated structure adds to the genesis of the company which lends to the nature of the offer of shares to the public.

<sup>8</sup> The initial process being through the primary market (Cilliers *et al* (2000) *Corporate Law* *ibid*).

<sup>9</sup> *Ibid*.

<sup>10</sup> Regarding disclosure as a counter to improper offers see Cilliers *et al* (2000) *Corporate Law* 256. Due to the abuses occurring where securities are offered to the investing public, both in regard to the raising of capital for companies and the sale of existing investments. The basis of the regulations is the doctrine of disclosure, with the assumption of publicity of sufficient information relating to the company as well as the securities to the investing public as to be an enabling factor, allowing them to guard their own interests by making an informed decision. As a secondary spin-off the layered liability in terms of contravening offer regulatory principles also serves as a method of protecting the public.

<sup>11</sup> The importance of regulation due to recent spectacular collapses in securities investment schemes are referred to in Delpont "About Offers to the Public" 2011 *THRHR* 668.

bringing about a particular type of contract.<sup>12</sup> It follows that in order for an offer to be capable of being subjected to an offeree entering into the contract with the offeror, the offeree must be reached, hence the offer is made to the public. Given the nature of a company in offering securities to the public together with the nature of these securities makes that attractive to the potential investing public.<sup>13</sup> It follows that offers of a public company will necessarily be coupled to the concept of public, unless explicitly excluded by legislation or when the offers are not to the public by virtue of the concept of public.

It follows that private offerings, i.e., transactions by an issuer not involving any public offering, are bound to be exempt from public offer regulation.<sup>14</sup> On this exemption the concept of “public” and “offer regulation” rests. Exemption from the disclosure requirements under Chapter 4 is the key question.<sup>15</sup> Regulatory principles underscore the protection of investors by the promotion of full disclosure which is necessary to make informed investment decisions.<sup>16</sup> Loss suggests that the

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<sup>12</sup> The 2008 Act differentiates between two types of public contracts. The first being the PO (section 95(1)(i) and the second the IPO (section 95(1)(e)).

<sup>13</sup> Due to the public nature of these offers, the evolution of company law and offer regulation, together with the principles of offer regulation, the principle of disclosure of information required to enable the potential investor to judge the merits of a transaction, manifests. See the remark by Brandeis LD (1914) *Other People's Money and How the Bankers Use it* New York: Frederick A Stokes Company, as quoted by Loss (1988) *Fundamentals* 35: “Company law is based, for the most part, on the principle that ‘sunlight is said to be the best of disinfectants; electric light the most efficient policeman.’” See also Delpont “Disharmony” 2005 *SA Merc LJ* 388, as well as Cilliers *et al* (2000) *Corporate Law* 256.

<sup>14</sup> Loss (1988) *Fundamentals* 317. The exemption generally is directed to transactions where there is no practical need for the application of offer regulation or where the public benefits underlying the principles of offer regulation are too remote.

<sup>15</sup> Loss (1988) *Fundamentals* 319 referring to the 1933 Securities Act.

<sup>16</sup> *Ibid.*.

natural way to interpret whether an offering is public or not is to do so in light of a purposeful construction.<sup>17</sup>

Due to the integral ambiguity towards the precise denotation of the notion of “public,” this determinant is held to be potentially the most problematic.<sup>18</sup> A determination of the meaning of “public” is necessary as it is possible under the 2008 Act that the common law is excluded regarding as to when addressees are “not public.”<sup>19</sup> For this, the historical development will have to be considered.

Getting lost in regulatory arbitrage is apparent when considering the legislative meaning of “offer to the public” as it entails a dualistic approach: interpretation of the definition of “offer to the public” which entails that “offer” as subject must be aligned towards which offers are included and which are excluded. This distinction must then be interpreted against what the public purports to be.

When considering “public offers” it is of cardinal importance to heed the following qualitative factors when the meaning of the concept of “public” as applied to offers, are applied to chapter 4 offer regulation. It is submitted that these factors are the following:

- i. the public at large;
- ii. a section of the public at large;

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<sup>17</sup> *Ibid.* As per Loss, an offering to those who are shown to be able to fend for themselves is a transaction “not involving any public offering.”

<sup>18</sup> Delpont “About Offers to the Public” 2011 *THRHR* 671; Davies (2008) *Gower and Davies’ Principles* 873.

<sup>19</sup> Delpont “About Offers to the Public” 2011 *THRHR* *ibid.*

- iii. statutory exclusions in respect of when an offer to the public in terms of 1 and 2 above will not be considered to be an offer to the public;
- iv. the concept of a common law non-public offer will not attract regulatory purview under chapter 4 despite being an offer to the public, as same is not excluded by item iii above.

Items i and ii will be discussed in detail below and where necessary applied against items iii and iv.

## 2. Public at large

### 2.1. Introduction

As noted, the concept of “public” is important as it not only serves as the third determinant regarding the application of regulatory provisions or not, but it also serves as the determinant as to who are supposed to receive a prospectus.

Chapter 3 *supra* laid the groundwork for the development of company law together with offer regulation, focusing on English company law.<sup>20</sup> The development of English regulatory principles regarding their prospectus provisions had a major influence on the South African development of offer regulatory provisions.<sup>21</sup>

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<sup>20</sup> As per chapter 3 *supra*, the development of regulatory provisions had its genesis in the anti-fraud provisions of the English Act. Due to inefficiency, a move was made to include disclosure by means of prospectus provisions insofar as public offers are concerned.

<sup>21</sup> Delpont *Die verkryging van kapitaal* (1987) 426.

For a full discussion about the development of the concept of “public” see the discussion of Delport in *Die verkryging van kapitaal*.<sup>22</sup> The determination of who the “public” is, did not pose an interpretational problem at first. As the term was not defined in English law, the rules of legislative interpretation applied following the ordinary meaning of “public.” The major problem occurred where regulatory principles had to be applied to transactions and where the provisions were found to be lacking due to inefficiency and, as a result thereof, were circumvented.<sup>23</sup>

Rules of legislative interpretation dictate that the primary rule in the construction of statutes is that the language of the Legislature should be read in its ordinary sense.<sup>24</sup> “Public” is defined in the Oxford Dictionary as an adjective, in the first instance concerning or open to the people as a whole. “The public” is defined as a noun, meaning ordinary people in general; the community.<sup>25</sup>

Where the word “public” is not defined, it has been held that its ordinary or popular meaning, taking into account the particular context, must be used.<sup>26</sup> This implies the community as a whole, rather than the community as an organised body.<sup>27</sup>

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<sup>22</sup> *Ibid.*

<sup>23</sup> This will be discussed in detail, following the dictum in *Lynde v Nash* [1928] 2 KB 93 116. See paragraph 3 *infra*.

<sup>24</sup> *Union Government v Mack* 1917 AD 731, 739. See also Steyn LC (1981) *Die Uitleg van Wette 5de uitg* Kaapstad: Juta chapter 1.

<sup>25</sup> Pearsall J (ed) (2002) *The Concise Oxford English Dictionary 10<sup>th</sup> rev ed* Oxford England: Oxford University Press.

<sup>26</sup> *Lee v Evans* (1964) 112 CLR 276 283.

<sup>27</sup> *S v V and Others* 1977 (2) SA 134 (T) 137 D.



## 2.2. Development

The concept of “public” in the primary and secondary markets for securities has been the subject of regulation for more than 100 years. The concept made its first appearance in section 30 of the British Companies Act of 1900.<sup>28</sup>

Section 30 of the British Companies Act of 1900 first alluded to the concept of “public,” simply inferring that a prospectus means an offer to the public of shares and debentures.<sup>29</sup>

The prospectus was not the document accompanying the offer, but the offer itself.<sup>30</sup> Section 30 was incorporated verbatim as section 81 in the British Companies (Consolidation) Act of 1908.<sup>31</sup>

It follows that the prospectus was not the document that accompanied the offer but rather it was the offer itself. There was no definition of “public,” hence the ordinary meaning applied in the interpretation thereof. This brought to the fore the question as to whether an offer to a selection of the public or section of the public fell within the concept of “public.”<sup>32</sup>

In terms of the ordinary meaning of “public” and legislative interpretation, the concept of “public” at this stage in its development did not pose great interpretational difficulty in its application.

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<sup>28</sup> 63 and 64 Vict c 48.

<sup>29</sup> A concept which fundamentally differs in South Africa after 1947. The 1973 Act held that the prospectus is not the offer, but the document that must accompany the offer. See Delpont *Die verkryging van kapitaal* (1987) 428 for a full history of the development of this concept in South African law.

<sup>30</sup> Delpont *Die verkryging van kapitaal* (1987) *ibid*.

<sup>31</sup> 8 Edw VII c 69.

<sup>32</sup> Delpont “About Offers to the Public” 2011 *THRHR supra*.

Subsequently, the development of the meaning of “public” started showing signs of subjective delineation between who the public is and what is to be considered “non-public,” an offer to the public being: “an offer to any person who chose to come in and take them.”<sup>33</sup>

In *Lynde v Nash*<sup>34</sup> a determination was to be made as to whether an offer marked “strictly private and confidential” fell within the definition of “prospectus,” (thereby constituting a public offer).<sup>35</sup> It was held that no particular numbers are prescribed, and that the concept denotes that anything from two to infinity, even one, may serve as who may constitute the public.

What is of importance is, in terms of this judgement, that the offer as such must be open to anyone will be able to invest money and apply for subscription, whether the offer was addressed to him or not.<sup>36</sup>

The concept of “public” was further explained in *Lynde v Nash* in that the nature thereof would be: “...to obtain from all and sundry... the much desired subscriptions.”<sup>37</sup>

In terms of this explanation, chance selections were made and the offers were only addressed to the principal members who could not renounce the

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<sup>33</sup> Delpont *Die verkryging van kapitaal* (1987) 432-3. *Sherwel v Combined Incandescent Mantles Syndicate Ltd* 1907 23 LR 482 held that an offer to friends of the board and marked “Private and Confidential, Not for Publication” was not an offer to the public.

<sup>34</sup> *Lynde v Nash supra* 158.

<sup>35</sup> The definition of a prospectus was as per section 81 of the Companies (Consolidation) Act 1908, which was the equivalent of section 30 of the Companies Act of 1900 (Delpont *Die verkryging van kapitaal* (1987) *supra* as well as Delpont “About Offers to the Public” 2011 *THRHR supra*).

<sup>36</sup> *Lynde v Nash supra* as per Viscount Summer, quoted verbatim from 169 of the judgment: “No particular numbers are prescribed. Anything from two to infinity may serve: perhaps even one... the point is that the offer is such as to be open to anyone who brings his money and applies in due form.”

<sup>37</sup> *Lynde v Nash* 116.

offer in favour of outsiders. This was then considered to be a non-public offer.<sup>38</sup>

This explanation follows the ordinary interpretation of “public,” opening up the scope of offers to be made to arbitrarily selected addressees whereby only they were capable of accepting the offers.<sup>39</sup>

It follows and will be discussed *infra* that the expanded definition of “offer to the public” to include “a selection” of the public does not allow for an arbitrary selection and that the application thereof is wide, so as to include all possible offers.

### 2.3. Qualifying the public in an offer

Whether an offer is public or not is relevant as to the denotation of “offers.” This is coined an “inclusionary” provision as the ambit aims to include the application of offer regulation to the public. It will later be shown that the inclusionary provision can be expanded and that there may be exclusions applicable to it.

#### 2.3.1. Generality of offer

What makes an “offer” an “offer to the public” is the generality of the offer.<sup>40</sup> It has been held in *Hurst v Vestcorp Ltd*<sup>41</sup> that it is not the needs of the investors in particular which makes an offer public or not. The

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<sup>38</sup> Delpont “About Offers to the Public” 2011 *THRHR* 672.

<sup>39</sup> As referred to in *Gold Fields supra*: “randomly.”

<sup>40</sup> Blackman *et al* (2002) *Commentary* 142.

<sup>41</sup> *Hurst v Vestcorp Ltd supra* 43.

generality of the group which is the subject of the offer is to be taken into account and not the particular persons who are investing.<sup>42</sup>

Everyone is a member of the public, yet an offer need not be made to everyone to be open to anyone. To be an offer to the public, a narrow meaning of the word “public” is to be used.<sup>43</sup>

It is important to discern between private and public offerings, the former not being an offer to the public by virtue of its nature. The distinction is not between private and public offers or between offers to everyone and offers to less than everyone. It is between offers that are, and offers that are not, to the public.<sup>44</sup>

### 2.3.2. Offerees in a public offer

Insofar as the determination firstly as to who the offerees are in an offer and, in the second instance, as to whether an offer is an offer to the public is concerned, Blackman at the discussion of Chapter VI of the 1973 Act provides a substantial overview of the common law, which it is submitted, is still applicable to the 2008 Act due to the Act being silent on a definition concerning the public at large.<sup>45</sup>

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<sup>42</sup> *Hurst v Vestcorp* *ibid* 26, 42 and *Corporate Affairs Commission (SA) v Australian Credit Union* *supra* 64-5.

<sup>43</sup> *Government Stock & Other Securities Investment Co. Ltd and Others v Christopher and Others* [1956] 1 All ER 490, 493. See also *Hurst v Vestcorp* *ibid*.

<sup>44</sup> Blackman *et al* (2002) *Commentary* 142.

<sup>45</sup> For the full discussion see Blackman *et al* (2002) *Commentary* *ibid*.

Regarding an offer to the public, the public at large in respect of offerees is determined using the test with regard to who can accept the offer. Who receives the offer and who is capable of accepting it is not applicable.<sup>46</sup>

In *Lee v Evans*<sup>47</sup> it was held that:

The basic concept is that the invitation, though not universal, is general; that is an invitation to all and sundry of some segment of the community at large. This does not mean that it must be an invitation to all the public either everywhere or in any particular community. How large a section of the public must be addressed in a general invitation for it to be an invitation to the public in the relevant connection must depend on the context of each particular enactment and the circumstances of each case. But within that sufficient area of community, the invitation must be general.

The Court then quotes Viscount Sumner in *Lynde v Nash supra* as well as in *Sherwell v Combined Incandescent Mantles Syndicate Ltd*<sup>48</sup> where it was held that an offer of shares to the public is an offer to anyone who should choose to come in. The nature of the offeree has also been described in *Ex Parte Lovell; Re Buckley*<sup>49</sup> as that the offer should be made to the public generally and capable therefore of being acted upon by any member of the public.

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<sup>46</sup> *Ibid.*

<sup>47</sup> *Lee v Evans supra.*

<sup>48</sup> *Sherwell v Combined Incandescent Mantles Syndicate Ltd* 23 TLR 482 (1907) 483.

<sup>49</sup> *Ex Parte Lovell; Re Buckley* (1938) 38 SR (NSW) 153 159.

### 2.3.3. Determination of offer

This determination follows the above determination of “offeree,” which in turn follows the determination of “public.” Whether an offer is an offer to the public involves a factual inquiry of the true nature of the offer juxtaposed to the manner of communication thereof.<sup>50</sup>

The offer must be capable of being accepted by any member of the public and for this all relevant evidence must be considered to draw inferences towards the factual disposition. Deductions are to be made from the terms of the offer, its mode of communication and the number of offerees, the enquiry being a staggered approach and not conclusive piece-meal.

### 2.3.4. Terms of offer

The strongest determining factor as to whether an offer is open to any member of the public may be found in the terms of the offer.<sup>51</sup> It follows that even if not in express terms,<sup>52</sup> but that the logical inference may be drawn from the terms regarding a reverse analogy of “determination of offeree,” such a person must be able to rely on the terms to accept the investment.

### 2.3.5. Communication of offer

The method of communicating the offer to the offerees is relevant in determining the essential nature.<sup>53</sup> Whether the offer was advertised in the press, subjected to widespread general advertisement or whether any

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<sup>50</sup> Discussion in Blackman *et al* (2002) *Commentary supra* fn 44. See also *Lee v Evans supra* at 290.

<sup>51</sup> *O’ Brien v Melbank Corp Ltd* (1991) 7 ACSR 19 38.

<sup>52</sup> *Lee v Evans supra* at 276. *Hurst v Vestcorp supra* 25.

<sup>53</sup> *O’ Brien v Melbank supra* 63-4.

individuals were targeted and, if so, whether it was a case of offering to one individual after another until sufficient acceptance had been obtained, all needs to be considered. It is not necessary to show that by advertising, the company has reached out to the public at large, although obviously it would be highly relevant. In the absence<sup>54</sup> of advertising, it cannot be concluded that the character of the issue or offer is non-public.<sup>55</sup> It is submitted that the method of communicating the offer would require an objective test as to whether the method of communicating, by whichever means, was capable of reaching the unsuspecting public. As such, an offer marked “strictly private and confidential” does not conclusively indicate that the offer is not an offer to the public.

#### 2.3.6. Quantity of offer extension

As with the above determinants, the number of persons to whom an offer is made is relevant, but is not decisive.<sup>56</sup> The circumstances of each case need to be evaluated individually.<sup>57</sup>

As held in *Lynde v Nash*<sup>58</sup> anything from two to infinity may serve, even one, if the intention was that such an offeree was to be the first of a series of subscribers, but making further proceedings needless by subscribing to the whole.

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<sup>54</sup> *Hurst v Vestcorp Ltd supra* 27. See also fn 12 in Blackman *et al* (2002) *Commentary* 142, referring to *Hurst v Vestcorp* as well as *Re South of England Natural Gas & Petroleum Co Ltd* [1911] 1 Ch 573; *S v National Board of Executors Ltd and Others* 1971 (3) SA 817 (D) where in the latter case the offer was marked “strictly private and confidential – for information addressee only.” The offer, described as a private placing and sent out to several hundred recipients was found to be an offer to the public based on the facts, together with others.

<sup>55</sup> *Ibid* Blackman *et al* (2002) *Commentary*.

<sup>56</sup> *Ibid*. See also *Hurst v Vestcorp supra* 17.

<sup>57</sup> *Lee v Evans supra* 285-6. *Hurst v Vestcorp ibid* 26.

<sup>58</sup> *Lynde v Nash supra* 169.

An offer to one person, it has been held, can be capable of being a public offer when, in light of all the circumstances, the intention was that the statement of an invitation to somebody was made in order for the news about the offer to be disseminated.<sup>59</sup>

This point has also been confirmed in *O'Brien v Melbank Corp Ltd*<sup>60</sup> where it was held that an invitation may be to the public even when made to one person only with the knowledge that he will probably broadcast it to the public. A statement of an invitation may be to an individual but at the same time to the public, where the individual is a legal classification and the “public” availability thereof is fact.

#### 2.4. Summary

When considering the term “public” it is important to discern whether it is defined in legislation or not. Where it is not defined the ordinary meaning will apply: meaning the public at large.

It will be discussed *infra* that legislation followed an approach based on the development of “public” to include “a section of the public” in order to expand the meaning of “public,” bringing all offers in essence under regulatory purview unless they are not public in nature.

To this extent, sections in legislation which deal with regulation of offers developed an inclusion and exclusion part, where the definition would include what would be considered to be public offers and exclude, certain scenarios where offers would not be considered to be public in nature.

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<sup>59</sup> *Lee v Evans supra* 287.

<sup>60</sup> *O'Brien v Melbank supra* 29.



Ideally, in a definition, “public” should be included under the meaning of “offer to the public,” i.e., an offer to the public will include an offer to the public (specific inclusion) juxtaposed to an offer to the public will include an offer to a section of the public. The difference being clear: the latter acknowledging a public category, but not including it under offer, making any offer a public offer. The former includes any offer to the public, as a public offer, subject to regulatory purview.

It is submitted that the “public” remains the same under the 2008 Act and that the principles above should be considered when the “public” at large is considered.<sup>61</sup>

### 3. Section of the public

#### 3.1. Introduction

The definition of “offer to the public”<sup>62</sup> was developed to include an offer to “any section of the public.”<sup>63</sup> This development extends the meaning of an offer “to the public” beyond the accepted meaning thereof through the inclusion of the previous exclusion.

The practice of arbitrary selection of the addressees has received the attention of the Legislature. Section 38 of the British Companies Act of 1929<sup>64</sup> included as “public” any section of the public, *however selected*.<sup>65</sup>

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<sup>61</sup> This is due to “public” not being included in the meaning of “offer to the public.”

<sup>62</sup> Not of “public.”

<sup>63</sup> Blackman *et al* (2002) *Commentary* 6-6.

<sup>64</sup> 19 & 20 Geo V c 23.

<sup>65</sup> Own accentuation. It follows that this selection and the definition is so wide that limitations should be included making it otherwise impossible for a company to issue any securities without making a public issue (see Gower LCB (1954) *The Principles of Modern Company Law* London: Stevens 351).

Subsequently, the practice of arbitrary selections of the public at large ceased. The legislation did however bring to the fore interpretational questions as to whom or what is considered to be “a selection of the public.”

It has been held that the inclusion of “a section of the public” extended the meaning of “public” and eliminated the dichotomy between an invitation to select a group to whom, and to whom alone, the offer is addressed.<sup>66</sup>

In addition to providing an extension of the meaning of “offer to the public,” the inclusion in the definition includes “matters which otherwise would not be encompassed by it, and to avoid possible uncertainty by expressly providing for the inclusion of particular borderline cases.”<sup>67</sup>

An offer made to any section of the public would necessarily be in terms that would enable it to be made and accepted by the public at large, and it could thus be made with indifference to any random section of the public. That will not be the case where the offer aims at acquiring specific private property, for the terms of such an offer must necessarily be that it is directed to, and is capable of being accepted by, the owners of the property. Where the offer is made to a specific group of persons only, it will be a question of fact whether it qualifies as one made to a section of the public within the meaning of the definitions.<sup>68</sup>

It is therefore important to consider “a section of the public” in its proper, “technical,” context as applied in offer regulation, evident through its

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<sup>66</sup> *Corporate Affairs Commission (SA) v Australian Credit Union supra* 65.

<sup>67</sup> *Ibid* 61-2.

<sup>68</sup> Henochsberg on the 2008 Act 356.

historical development, in order not to make the mistake that the Supreme Court of Appeal made in the *Gold Fields Ltd and Another v Harmony Gold Mining Co Ltd and Others*<sup>69</sup> case.

It has been held that in construing the words of a statute it must be assumed that the Legislature used them in their popular sense, unless they have acquired a different technical meaning in legal nomenclature or unless the context or the subject clearly shows that they were intended to be used in a different sense.<sup>70</sup>

It therefore follows that in terms of the specialised nature of Chapter 4 that a review of the development and interpretation of the concept “section of the public” is required as applied to offer regulation.

### 3.2. Extension of inclusionary provision

Due to the application of “public” and the exclusion through arbitrary selections from the broad concept of “public” as alluded to above, regulatory principles (disclosure through a prospectus) were circumvented.

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<sup>69</sup> *Gold Fields supra*.

<sup>70</sup> *Beedle & Co v Bowley* (1895) 12 SC 401 402. See also Eckhard CH (1779) *C H Eckhardi Hermeneutica Juris* Germany: Jena 2.1. 78 at page 927 which shows that the general application of a word sometimes differs from the legalistic application thereof: “*Ex quo sponte intelligitur, in explicatione legum imp, tum ad grammaticam, tum ad curiae proprium significatum respiciendum esse.*” The rule that words must be understood in accordance with their application and use in the applicable field of application has been confirmed in *Kommissaris van Doeane en Aksyns v Mincer Motors BPK* 1959 (1) SA 114 (A) 119 and in *Stellenbosch Wine Trust Ltd and Others v Oude Meester Group Ltd and Others* 1977 (2) SA 221 (C) 242.

The effect of the *Lynde v Nash* judgment was that arbitrary selections were made and that the offers were addressed only to members who could not renounce the offers in favour of outsiders.<sup>71</sup>

Based on recommendations by the Cohen Commission,<sup>72</sup> the practice of arbitrary selection of the addressees received attention by the Legislature.

Section 38 of the British Companies Act of 1929<sup>73</sup> included as “public” any section of the public, however selected.<sup>74</sup>

Amendments to the British Companies Act 1948 included this expansion on the meaning of “public” and further amendments beyond provided that the concept of “public” would include any selection, “whether as clients of stockbrokers or otherwise.”

This development draws two clear distinctions. In the first instance, an offer to the public at large as expounded in 2 above. In the second instance, an offer to a “section of the public” now formed part of an expansion of an offer to the “public at large” as described in the *Lynde v Nash* judgment, being an offer (to the public at large) to all and sundry.<sup>75</sup>

This meaning will now include any selection of a “section of the public at large.”

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<sup>71</sup> Delpont “About Offers to the Public” 2011 *THRHR* 672.

<sup>72</sup> Great Britain & Justice Cohen (1945) *Report of the Committee on Company Law Amendment* Cm 6659 London: HM Stationary Off.

<sup>73</sup> 19 & 20 Geo V c 23.

<sup>74</sup> It follows that this selection and the definition is so wide that limitations should be included making it otherwise impossible for a company to issue any securities without making a public issue: Gower (1954) *Principles* 351.

<sup>75</sup> Delpont “Disharmony” 2005 *SA Merc LJ* 392.

Regarding offer regulatory principles (disclosure) an offer to the public at large and an offer to a section of the public at large are now considered as being the same thing.<sup>76</sup>

It is important to note that insofar as offer regulation is concerned, the possibility may or may not exist, depending on the interpretation of the relevant inclusionary provisions (which provides for offers to the public and/or a section thereof), that a particular transaction may be structured or addressed to a category of persons who it may be argued, are not members of the “public” and, therefore, also not a “selection of the public.” This denotes a common law non-public category. Also, regarding the application of this extension (and of the inclusionary provision), it has been written that the definition is so wide that, unless some limitations were imposed, it would be impossible to issue shares or debentures without making a public issue.<sup>77</sup>

For this reason, certain exclusions were incorporated to balance the regulatory effects of the “selection of the public at large” expansion on the concept of “public.”<sup>78</sup> It follows that the concept of “public” now included “any section of the public.” In order to curtail the impossible situation of every offer being public in nature, regulatory principles developed in order to provide for principles of non-public offers through exclusions.

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<sup>76</sup> *Ibid.*

<sup>77</sup> Delpont “About Offers to the Public” 2011 *THRHR supra*. See also Gower (1954) *Principles* 351. This provision was also incorporated into section 84*bis* of the South African Companies Act 46 of 1926 and eventually in section 142(1) of the 1973 Act.

<sup>78</sup> Delpont “About Offers to the Public” 2011 *THRHR ibid.*

These principles will be discussed in terms of their development below, save to allude that the majority of said principles were codified. Part 5.6 *infra* shall discuss these exclusions in detail as manifested in the 2008 Act. Below follows the development and interpretation of exclusionary principles as applied to a possible non-public common law category.

### 3.3. Non-public exclusionary principles

Non-public exclusions may be legislated or part of the common law. Non-public exclusions started out by means of transactional manoeuvring which brought the ambit of an offer outside the scope of the inclusionary provision and provided a suitable exclusion.

Both the British and the US systems will be referred to briefly, in order to gauge the possible determination and application of these principles.

The exclusionary principles are based on basic principles as to why the offers are not public, making them non-public or private.<sup>79</sup>

In terms of the development of these principles there is, up to a certain stage, a convergence in the development of the British and US systems.<sup>80</sup>

#### 3.3.1. Position in the United States

In the United States, the concept “public” was not initially defined. The determination of whether a particular transaction involves a public offer depended on all the surrounding circumstances.<sup>81</sup>

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<sup>79</sup> *Ibid.*

<sup>80</sup> *Ibid.* See also Loss (1988) *Fundamentals* 321.

The question arose as to when an offer was a non-public (or a private) offer. As alluded to above, the British Legislature extended the concept of “public” to include a section thereof. In the United States, section 4(2) of the Securities Act of 1933 stated the opposite, in that “transactions by an issuer not involving any public offering” are excluded from the prospectus requirements.<sup>82</sup> The effect was that a common law category of non-public offer was possible in terms of section 4(2).

In *SEC v Ralston Purina Co*<sup>83</sup> public offerings in the United States were, at the outset, judicially interpreted to denote that an offer to the public need not be open for acceptance globally, in contrast to the interpretation in the United Kingdom prior to expanding the inclusionary provision:

Decisions under comparable exemptions under the English Companies Acts and state “blue sky” laws, the statutory antecedents for federal securities regulation have made one thing clear – to be public an offer need not be open to the whole world.<sup>84</sup>

This concept was further defined in *SEC v Sunbeam Gold Mines Co*.<sup>85</sup> In this judgement it was held that, at its broadest, the term “public” distinguishes the general population at large from groups of individual members of the public, segregated due to a common interest or

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<sup>81</sup> Loss (1988) *Fundamentals* 317. Apart from the number of offerees, the relationship towards each other and to the issuer, the units offered and the manner of the offering applied (SEC. Act. Rel. 285 (1935)).

<sup>82</sup> Delpont “About Offers to the Public” 2011 *THRHR* 672.

<sup>83</sup> *SEC v Ralston Purina Co* 346 US 119 (1953).

<sup>84</sup> *Ibid.*

<sup>85</sup> *SEC v Sunbeam Gold Mines Co*, 95 F 2d 699 (CA 9th Cir Wash 1938) 701. See also Delpont “About Offers to the Public” 2011 *THRHR supra*.

characteristic. It was further held that the distinction of segregation due to a common interest or characteristic was not practical and therefore inadequate.<sup>86</sup>

In application, the interpretation of the United States Courts had the effect that the inclusionary provision extended the meaning of a public offer to include a section or selection of the public. An offering of securities to all existing stockholders was no less “public” than an unrestricted offering of a global nature. The Court held that in determining the distinction between “public” and “private” it is essential to examine the circumstances under which the distinction is sought and to consider the purposes sought to be achieved by such a distinction.

The application of regulatory principles, which is the protection of investors by means of the disclosure of information, should turn on whether the particular class of persons require protection in terms of offer regulation. An offering to those who are shown to be able to fend for themselves is a transaction not involving the public or a non-public offering. The Court remarked that rarely will an offer to a substantial number of persons be exempted. However there is no reason to superimpose a quantitative limit on private offerings as it is a matter for statutory interpretation.<sup>87</sup> It follows that the Court applied the principles of offer regulation in interpreting the inclusionary provisions so as to provide

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<sup>86</sup> In other words, not effective and therefore not adhering to regulatory principles: The Court held that an offering of securities to all existing stockholders of the General Motors Corporation is not “public” in a realistic sense, than an unrestricted offering to the world at large, for the means used to select the particular individuals to whom the offering is made bear no sensible relation to the purposes for which the selection is made.

<sup>87</sup> Delport “About Offers to the Public” 2011 *THRHR* 673.



for the requirement of information together with the basis of investor protection required.

A test was laid down in *Doran v Petroleum Management Corporation*<sup>88</sup> which required that an offeree must be able to acquire the information as would have otherwise been provided by the prospectus because of a “relationship based on factors such as employment, family, or economic bargaining power that enables the offeree effectively to obtain such information.”

The Court further held that sophistication of an investor is not enough.<sup>89</sup> Sophistication is not a substitute for the availability of information that disclosure would provide. Unless the offeree has been furnished with information directly, a relationship based on factors such as employment, family, or economic bargaining power that enables the offeree effectively to obtain such information must be shown.<sup>90</sup>

The *dictum* in *Doran* in respect of the non-public offer has subsequently been legislated. The essence of “transactions by an issuer not involving any public offering” or, in other words, exclusionary principles, were enacted in the United States in 1982.<sup>91</sup> Rule 506 of Regulation D of the Securities Act of 1933 substituted previous provisions regarding common law non-public offers.

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<sup>88</sup> *Doran v Petroleum Management Corporation* 545 F 2d 893 CA Tex 1977 903. See also Delpont “About Offers to the Public” 2011 *THRHR* 673.

<sup>89</sup> Thus enabling the investor to look after his or her own interests and fend for him or herself.

<sup>90</sup> Delpont “About Offers to the Public” 2011 *THRHR* 673.

<sup>91</sup> Substituting previous provisions, such as Rule 506 of Regulation D under the Securities Act of 1953 (Loss (1988) *Fundamentals* 324; Delpont “About Offers to the Public” 2011 *THRHR* 673).

In order to compensate for the multi-dimensional nature of the interests sought to be protected by company law, particularly, offer regulation, as well as the entity which such regulatory provisions seeks to control, it is stated by Loss that the doctrine of exclusionary principles as legislated should not be read literally, or even construed in accordance with a legislative intention, but the approach should be to comprehend the dominating general purpose of the inclusionary and exclusionary provisions holistically.<sup>92</sup>

The essence of the common law “transactions by an issuer not involving a public offering” was now provided for in legislation. Rule 506 provides the possibility to establish objective criteria to determine the non-public (or private) category of offerees.<sup>93</sup> These constitute the offeree profile and the availability of information.<sup>94</sup> Sophistication, or the ability to understand the risk; wealth; or qualification, based on a personal relationship to the issuer or a promoter, constitutes grounds in the offeree profile for exemptions.<sup>95</sup>

Rule 506 makes it possible to establish objective criteria to determine the non-public (or private) category of offerees (offerees able to fend for themselves, i.e., not in need of regulatory protection.) This determination, however, gave rise to an outcry, calling for legislative safe harbours.<sup>96</sup>

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<sup>92</sup> Loss (1988) *Fundamentals* 323.

<sup>93</sup> Particularly where the offerees are able to “fend for themselves,” (Delpont “About Offers to the Public” 2011 *THRHR supra*).

<sup>94</sup> See Loss (1988) *Fundamentals* 334 for a full discussion on offeree qualification.

<sup>95</sup> *Ibid.* Necessary caveats apply, for example a wealthy person as offeree in a risky private offering, if he had no understanding of financial matters or a competent advisor.

<sup>96</sup> Loss (1988) *Fundamentals* 324.

Regarding the objective criteria referred to above, they are divided into two sub-categories being, in the first instance, offeree profile and, in the second instance, the availability of information.<sup>97</sup>

In respect of the offeree profile, the requirements are either sophistication or wealth or the relationship with the offer.<sup>98</sup>

The criterion relating to the “rich and smart” class of non-public offerees is instructive in determining the common-law “non-public” category as it is based on common-law principles.<sup>99</sup>

Regarding availability of information, the requirement exists that the offeree must have access to the information to enable making a decision concerning investing or not. This enabling quotient may be attributed to an existing relationship; the offeree already has the information or, because of the financial bargaining power of the offeree, that the information can be readily ascertained.<sup>100</sup>

It is submitted that should it be shown that South African offer regulation provides for a non-public common law category, these principles should be used in interpreting same.

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<sup>97</sup> Delpont “About Offers to the Public” 2011 *THRHR* 673.

<sup>98</sup> *Ibid.* Sophistication will entail that the addressee will be able to understand the complexities of the investment and the risks involved. Wealth requires that the person is able to assume the risk of the investment, while the relationship is such that there is no practical need for disclosure (because the offeree is a senior employee or business associate with knowledge of the offer and the risks involved).

<sup>99</sup> *Ibid.*

<sup>100</sup> *Ibid.* See also Loss (1988) *Fundamentals* 339 concerning the financial bargaining power, offers to a bank in respect of loan capital is an example.

## 3.3.2. Position in Australia

Section 5(4) of the Companies (South Australia) Code<sup>101</sup> provides that:

A reference in this Code to, or to the making of, an offer to the public, or to the issuing of, an invitation to the public shall, unless the contrary intention appears, be construed as including a reference to, or to the making of, an offer to any section of the public.<sup>102</sup>

A non-public offer category is thus possible.

In *Corporate Affairs Commission (South Australia) v Australian Central Credit Union* the definition was expounded on.<sup>103</sup> It was held that section 5(4) is not intended to provide a comprehensive definition of what constitutes, in terms of the Code, an offer or invitation to the public. It does not include expressly the most obvious case of an offer to the public, namely an offer to the world. As the use of the word “including” indicates, the subsection is expansive of what would otherwise be included in the notion of an offer or invitation to the public.

That does not mean that none of the cases which the subsection includes would have been included in that notion. The function of such an inclusive “definition” is, commonly, both to extend the ordinary meaning of the particular word or phrase to include matters which otherwise would

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<sup>101</sup> “The Code.”

<sup>102</sup> Following the definition, the possibility of a non-public offer under the common law is evident, falling outside the expressly included exceptions.

<sup>103</sup> *Corporate Affairs Commission (SA) v Australian Credit Union supra*. See also Delpont “Disharmony” 2005 SA Merc LJ 392.

not be encompassed by it, and to avoid possible uncertainty by expressly providing for the inclusion of particular borderline cases.

The existing relationship requirement is further highlighted in *Corporate Affairs Commission*.<sup>104</sup> Here the offer for shares was made by the Australian Central Credit Union to its own members to effect a demutualization of the entity. Between the offeror and offeree a patent and existing relationship existed of such a fashion that the offerees had the information which would have ordinarily been provided for in a prospectus, or they could readily obtain it.

The Court held that the question whether a particular group of persons constitutes a section of the public cannot be answered in the non-figurative sense. Where there is a subsisting special relationship between offeror and members of a group or some rational connection between the common characteristic of members of a group and the offer made to them, the query as to whether this group constitutes a section of the public will be determined by a variety of factors, the most important being the following:

- a) the number of persons comprising the group;
- b) the subsisting relationship between the offeror and the members of the group;
- c) the nature and content of the offer; and

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<sup>104</sup> *Corporate Affairs Commission (SA) v Australian Credit Union* *ibid*. See also Delpont “About Offers to the Public” 2011 *THRHR* 673.

- d) the significance of any particular characteristic which identifies the members of the group and any connection between that characteristic and the offer.<sup>105</sup>

These requirements set out the non-public category and the test is qualitative, pertaining to its characteristics, rather than quantitative, denoting the number of offerees.<sup>106</sup>

Whether a particular group of persons constitutes a section of the public cannot be answered in the abstract in terms of the *Corporate Affairs Commission* case.<sup>107</sup>

It therefore follows that they must be a basic requirement, some existing relationship between the offer and addressees.<sup>108</sup>

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<sup>105</sup> *Corporate Affairs Commission (SA) v Australian Credit Union* *ibid.* The special relationship between the offeror and the members of a group or a rational connection between the common characteristic of members of a group and the offer made to them are pre-conditions for a group not to constitute a “section of the public.” If one of these pre-conditions is satisfied, whether the offeree group constitutes a “section of the public” will be determined by the factors listed. See also Blackman *et al* (2002) *Commentary* 6-7: A special relationship between the offeror and the offerees is not, on its own, sufficient to disqualify the offer from being made to the public. Also not every relationship between the offeror and the offeree or all common characteristics among the offerees and the offeror will assist in disqualifying the offer. Some relationships would be too tenuous to do so. Mason ACJ and Wilson, Deane and Dawson JJ stated that: “the question whether a particular group of persons constitutes a section of the public...cannot be answered in the abstract. For some purposes and in some circumstances, each citizen is a member of the public and any group of person can constitute a section of the public. For other purposes and in other circumstances, the same person or the same group can be seen as identified by some special characteristic which isolates him or them in a private capacity and places him or them in a position of contrast with a member or section of the public. In a case where an offer is made by a stranger and there is no rational connection between the characteristic which sets the members of a group apart and the nature of the offer made them, the group will, at least ordinarily, constitute a section of the public for the purposes of the offer. If, however, there is some subsisting special relationship between the offeror and members of a group or some rational connection between the common characteristic of members of a group and the offer made to them, the question whether the group constitutes a section of the public for the purposes of the offer will fall to be determined by reference to the factors listed above.”

<sup>106</sup> Delpont “About Offers to the Public” 2011 *THRHR* 674. See also Loss (1988) *Fundamentals* 321. Rule 506 is qualified by the provision that there ought to have been no “redistribution” by the offerees for at least a year.

<sup>107</sup> *Corporate Affairs Commission (SA) v Australian Credit Union* *supra*.

<sup>108</sup> Delpont “Disharmony” 2005 *SA Merc LJ* 393. See also Baxter R “Offer to the Public” (1988) 6 *Company and Securities LJ* 190; O’Connell A “What is an Offer to the Public?” (1986) 4 *Company*

In the *Corporate Affairs Commission* case the offer for shares was made by the Australian Central Credit Union to its own members, and there was a clear existing rational connection between the offer and offerees.

The elements and importance of this requirement stated that the characteristics which set the proposed offerees apart as a group which had to be interpreted as both restrictive and well defined. It was membership of ACCU. The rules of ACCU restricted eligibility for membership by reference to employment and/or residence and prescribed clear procedures for applications for membership and their rejection or acceptance. Membership of the credit union involved subscription for ten dollar (Z1) shares in its capital. The proposed offer by ACCU to its members would have a perceptible and rational connection with their membership.”<sup>109</sup>

In similar worded legislation, it was held that for said purposes and in some circumstances, each citizen is a member of the public and any group of persons can constitute a section of the public.

Following the same reasoning, such a person or group of persons, in other circumstances, can be identified by some special characteristic which isolates him or them in a private capacity and places him or them in a position of contrast with a member or section of the public.<sup>110</sup>

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*and Securities LJ 177 190*; RI Barret RI “Comment” (1982) 56 *The Australian Law Journal* 139 as well as *Eastern Petroleum Australia Ltd v Horseshoe Lights Gold Pty Ltd* (1985) 9 ACLR 980 (SC WA).

<sup>109</sup> Delpont “About Offers to the Public” 2011 *THRHR supra*.

<sup>110</sup> See also Henochsberg on the 2008 Act 356.

### 3.4. Position in the United Kingdom

Subsequent to the Gower Report, the eventual sections 85 and 86 of the Financial Markets Act 2000<sup>111</sup> as amended by the Prospectus Regulations 2005<sup>112</sup> provide that a prospectus must be made to the public<sup>113</sup> before an offer of transferable securities is made to the public,<sup>114</sup> unless the offer is exempt under section 86.

Section 86 follows the philosophy set out above, in providing exclusions to the inclusions (expansion of public at large by including “any section thereof.”)

Obviously the development of these principles in South African offer regulatory law followed British jurisprudence.

### 3.5. Test

Whether the group of offerees to whom an offer has been made is “a section of the public” depends on the particular circumstances of the case and cannot be determined in the abstract.<sup>115</sup> It will be a factual enquiry.<sup>116</sup>

The test for “public” or “non-public” for purposes of offer regulation is required to comply with the philosophy that the “non-public” includes

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<sup>111</sup> In the United Kingdom.

<sup>112</sup> SI 1433 of 2005 as amended by SI 1688 of 2011, as per Delport “About Offers to the Public” 2011 *THRHR* 674.

<sup>113</sup> Public is not defined.

<sup>114</sup> Section 85(1).

<sup>115</sup> Blackman *et al* (2002) *Commentary* 6-7.

<sup>116</sup> Henochsberg on the 2008 Act 365. Where the offer is made to a particular group of persons only, it is a question of fact whether it qualifies as one made to a section of the public within the meaning of the definitions. An offer, even to a section of the public, will be deprived of its character as an offer to the public if it is excluded by the exclusions as legislated or the common law exclusions of what constitute a non-public offer.



those “who are shown to be able to fend for themselves and are to be protected by the established principles of investor protection.”<sup>117</sup>

This test should be applied on an objective basis as to whether a reasonable person viewing the group of offerees from the position of the offeror would see the group as a section of the public.<sup>118</sup>

The Court stressed in *Corporate Affairs Commission (SA) v Australian Central Credit Union*<sup>119</sup> that whether an offer is one to the “public” is a matter of fact and depends on the circumstances of the offer.

It is submitted that, in the first instance, an analysis should be made of “public” as expounded above, only then, in the second instance, can the test of whether the “selection of the public at large” is indeed a “selection as envisaged in the development of these principles.”

A distinction is to be made between “public” and “private” and that the “circumstances under which the distinction is sought” and the “purposes sought to be achieved by such distinction” will be the determining factors relative to such distinction.<sup>120</sup>

If there is not an existing relationship between the offeror and the addressees, it is not capable of being a non-public offer, even where the legislative provisions may allow for a common law “non-public” category.

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<sup>117</sup> *SEC v Ralston Purina Co supra* 125.

<sup>118</sup> *Corporate Affairs Commission (SA) v Australian Credit Union supra* 62 63 65. See also Blackman *et al* (2002) *Commentary* 6-7.

<sup>119</sup> *Ibid* Blackman *et al* (2002) *Commentary*.

<sup>120</sup> Henochsberg on the 2008 Act 366. See also *SEC v Sunbeam supra*.

The danger of this is evident, in that “non-public” may be extended to unacceptable levels, contradictory to offer regulatory principles.<sup>121</sup>

### 3.6. Summary

An offer, even to a section of the public, will be deprived of its character as an offer to the public if it is excluded by the exclusions as legislated or the common law exclusions of what constitute a non-public offer.

In the first instance, it will have to be established whether the offer is an offer to the public (at large) following the principles canvassed above.

In the second instance, the definition of offer to the public (at large) should be considered in order to ascertain whether a section of the public is included. The scope of such provisions would also have to be considered.

Once the inclusions in steps 1 and 2 above are considered and it is established that the offer is public, and that the offer is to a section of the public; in the third instance, the exclusions either as legislated or possible under the common-law should be reviewed in order to ascertain whether the offering falls under a “section of the public at large” or whether it is a non-public offering.

It follows that the legislative exclusions would be easy to follow. For more about this, see below. The difficulty arises when a possible common-law non-public offer is to be considered.

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<sup>121</sup> Delpont “Disharmony” 2005 *SA Merc LJ* 394. Thus an offer to a “random section” of the public would be a “public offer,” but an offer in which there is a “rational connection” between the offeror and the characteristics which sets the section of the public apart can be a non-public offer. A mere rational connection is not sufficient. Other factors such as an existing relationship, are also required.

Where the offer is made to a particular group of persons only, it is a question of fact whether it qualifies as one made to a section of the public within the meaning of the definitions.

In order to gauge a common law non-public offer, the principles expounded on above should be considered.

In the first instance, the special relationship between the offeror and the members of a group must be established, and secondly, whether a rational connection between the common characteristic of members of a group and the offer made to them exists, as these are pre-conditions for a group not to constitute a “section of the public” under the common law as developed.

Thus an offer to a “random section” of the public would be a “public offer,” but an offer in which there is a “rational connection” between the offeror and the characteristics which set the section of the public apart can be a non-public offer. A mere rational connection is not sufficient. Other factors, such as an existing relationship, are also required.

Where there is a subsisting special relationship between offeror and members of a group or some rational connection between the common characteristics of members of a group and the offer made to them, the query as to whether this group constitutes a section of the public will be determined by a variety of factors, the most important being the following:

- i) the number of persons comprising the group;

- ii) the subsisting relationship between the offeror and the members of the group;
- iii) the nature and content of the offer; and
- iv) the significance of any particular characteristic which identifies the members of the group and any connection between that characteristic and the offer.

The above should be considered on a factual basis, depending on the nature of the offer *in toto*, applying an objective test of a reasonable person in the position of the offeror, when considering whether the offerees are a section of the public or not.

#### **4. South African development of public and section of public**

##### 4.1. Introduction

In order for this discussion to follow, a brief synopsis is provided of the development of the concept “offer to the public.” The aim is to provide a succinct outline which will aid in following the discussion commencing at 4.2 *infra*.

##### 4.1.1. 1926 Act

Section 84*bis*(1) provided that the concept “public” would include any selection, “whether as clients of stockbrokers or otherwise.” This was eventually incorporated into section 142(1) of the 1973 Companies Act. The term “public” was omitted in the definition, affecting the ambit of “public” and providing for a common law non-public category.

## 4.1.2. 1973 Companies Act

Section 142(1) was amended and provided for the specific inclusion of an offer to the public to denote any offer to the public and to include a section of the public. “Public” was specifically included. The scope for a common law non-public category fell away.

Section 144 as with section 84*bis*(4) of the 1926 Act provided for exceptions to solve the over breadth of the wide definition of “public” above.

The broad definition is typical of the scenario where the ordinary meaning of “public” was extended to curb abuse.

Section 144 provided that an offer would not be an offer to the public if it is not being calculated to result, directly or indirectly, in the shares becoming available to persons other than those to whom the offer was made.

Section 144(a) was eventually deleted by section 8 of the Companies Amendment Act 35 of 1998 due to abuse of section 144(a).

The effect of this substitution was that if an offer was included in an offer to the public by section 142(1) and did not fall within the exceptions in section 144, then it was one to the public.

## 4.1.3. 2008 Act

The concept of “public” under the 2008 Act is established from the definition of “offer to the public” in section 95(1)(h).

This definition is an exhaustive definition, utilising the word “includes.”  
The concept of “offer to the public” is defined, yet “public” is not defined.

An “offer to the public” includes any section of the public. This is the inclusion and expansion of the ordinary meaning of “public.”

The definition has an exclusion of what would not be considered to be an offer to the public: an offer in terms of section 96 and a secondary offer effected through an exchange.

Section 95(2) references a “member of the public” as part of the “public.”<sup>122</sup>

The language in section 95(1)(h) indicates that it is not exhaustive, but rather a safe harbour (indicating what would not be an offer to the public, although public in nature). Therefore it is submitted that the position under the 1973 Act reversed itself into the 1926 Act.

The definition does not include “an offer to the public” but merely adds categories that would be included in the common law definition.

The effect is that the *Gold Fields* case in which a “non-public” category was erroneously created under the wording of the 1973 Act would now be correct.<sup>123</sup>

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<sup>122</sup> A lost reference and an unnecessary relic of the old section 141 of the 1973 Act, inserted to extend the prohibition of hawking of shares. See Delpont “About Offers to the Public” 2011 *THRHR* 675; Lansdown Report; as well as Unie van Suid-Afrika, Dept van Handel en Nywerheid: [Voorsitter]: P Millin (1949) *Verlag van die Kommissie van Ondersoek Insake die Wysiging van die Maatskappywet* Pretoria: Die Dept. UG 69 of 1948 107; as well as the 1968 and 1971 *Rossouw* cases.

<sup>123</sup> Delpont (2011) *Manual* 45.

Obviously this change will affect regulatory efficiency. The subsequent discussion will aim to expound on these concepts.

#### 4.2. Summary of position under the 1926 Act

The concept of “public” appeared for the first time in section 30 of the British Companies Act of 1900.<sup>124</sup> This section was incorporated as is in the Companies (Consolidation) Act of 1908 as section 81.<sup>125</sup> It is in respect of this section and the word “public” that the House of Lords decided the *Lynde v Nash* case, holding that the concept of “public” denotes an offer open to anyone.<sup>126</sup>

The practice of arbitrary selection of the addressees received the attention of the Legislature. This practice was curtailed by section 38 of the British Companies Act of 1929.<sup>127</sup> Section 38 of the British Companies Act of 1929 included as “public” any section of the public, however selected.<sup>128</sup>

This provision was also incorporated into section 84*bis* of the South African Companies Act 46 of 1926 and, eventually, in section 142(1) of the 1973 Act.<sup>129</sup>

Section 81*bis* of the repealed 1926 Companies Act, in contrast to the definition in section 142(1) than of the 1973 Companies Act, did not define “public.”

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<sup>124</sup> 63 & 64 Vict c 48 (see also Delpont “Disharmony” 2005 *SA Merc LJ* 391).

<sup>125</sup> 8 Edw VII c 69.

<sup>126</sup> The practice of arbitrary selections of offerees, thereby sidestepping the application of the concept of “public” was alluded to above.

<sup>127</sup> 19 & 20 Geo V c 23.

<sup>128</sup> It follows that this election and the definition is so wide that limitations should be included, making it otherwise impossible for a company to issue any securities without making a public issue. See Gower (1954) *Principles* 351.

<sup>129</sup> Delpont “About Offers to the Public” 2011 *THRHR* 672.

Therefore, 81*bis* made it possible to establish a “non-public” category that fell outside the expressly included sections which would constitute the “public.”

This is similar to section 5(4) of the Company’s (South Australia) Code which provides as follows:

A reference in this Code to, or to the making of, an offer to the public, or to the issuing of, an invitation to the public shall, unless the contrary intention appears, be construed as including a reference to, or to the making of, an offer to any section of the public... .

This definition is identical to the definition in section 84*bis*. In *Corporate Affairs Commissioner* it was explained as follows at 794:

...plainly enough section 5(4) is not intended to provide a comprehensive definition of what constitutes, for the purposes of the Code, an offer or invitation “to the public.” It does not, for example, expressly include the most obvious case of an offer to the public, namely, an offer to the entire world. As the use of the word “including” indicates..., This subsection is expansive of what would otherwise be included in the notion of an offer or invitation to the public. That does not, however, mean that none of the cases which this subsection includes would have been included in that notion in any event. The function of such



an inclusive “definition” is commonly both to extend the ordinary meaning of the particular word or phrase to include matters which otherwise would not be encompassed by it and to avoid possible uncertainty by expressly providing for the inclusion of particular borderline cases.

The requirements as to the non-public category were stated as follows in the above case at 795:

...the question whether a particular group of persons constitutes a section of the public for the purposes of section 5 (4) of the Code cannot be answered in the abstract.... If, however, there is some subsisting special relationship between offer and members of the group and the offer made to them, the question whether the group constitutes a section of the public for the purposes of the offer will fall to be determined by reference to a variety of factors of which the most important ordinarily be: the number of persons comprising the group, the subsisting relationship between the offer and members of the group, the nature and content of the offer, the significance of any particular characteristic which identifies the members of

the group and any connection between that characteristic and offer.<sup>130</sup>

Section 38 of the British Company Act of 1929 was taken over in the South African Companies Act of 1926 as section 81*bis*(1) with the exclusions in order to curtail the inclusionary provisions, incorporated in section 84*bis*(4). To this extent the exceptions that were legislated in section 84*bis*(4) of the 1926 Act were incorporated in section 144 of the 1973 Act. The aim was to solve the problems in applying the overly broad definition.<sup>131</sup>

*S v National Board of Executors Ltd*<sup>132</sup> is no longer relevant to the extent that amendments to section 144(a) of the 1973 Act effectively closed this avenue of circumventing regulatory provisions and, of course, the fact that the 2008 Act effectively replaced the 1973 Act.

However, a brief synopsis is required to show the synergies between “public at large,” and “section of the public at large” which are the extended version of the concept of “public” and how the exclusions thereto function (effectively safe harbours, whether under the common law or legislated). *S v National Board of Executors Ltd* showed how circumvention would have occurred.

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<sup>130</sup> Brennan J in the minority judgment required that the common law characteristics between the group must be as a result of the relationship with the offeror. See 798 where he held: “But when an antecedent relationship exists between the offeror and a group of offerees and, by reason of that relationship, the offerees has a special interests in the subject matter of the offer, there is a ground for distinguishing the group from the public.”

<sup>131</sup> Delpont “About Offers to the Public” 2011 *THRHR supra*.

<sup>132</sup> *S v National Board of Executor supra*. See also Beuthin RC “By Invitation Only: The Public are not Invited” (1972) 89 *South African Law Journal* 8.

It is common cause that section 84*bis* read as follows:

**84*bis*** *Construction of references to offering shares or debentures to the public* – (1) In this Act any reference to offering shares or debentures to the public shall, subject to any provision to the contrary contained therein, be construed as including a reference to offering them to any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner, and reference in this Act, or in a company's articles, to invitations to the public to subscribe for shares or debentures shall, subject to the aforesaid, be similarly construed.

(2) The foregoing sub-section shall not be taken as requiring any offer or invitation to be treated as made to the public, if it can properly be regarded, in all circumstances, as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation, or otherwise as being a domestic concern of the persons making and receiving it, and in particular –

(a) a provision in a company's articles prohibiting invitations to the public to subscribe for shares or debentures shall not be taken as prohibiting the making to members or debenture holders of an invitation which can properly be regarded as aforesaid; and

(b) the provisions of this Act relating to private companies shall be construed accordingly.

Section 84*bis*(1) acts as the inclusion, extending the concept of a “public offer.” Section 84*bis*(2) acts as the exclusion to the overly broad definition as to inhibit every offering being public in nature (in order to cater for legitimate non-public offers where the philosophy of investor protection would not be required).

It was held by Harcourt J in the granting of an application to dismiss the State's case against the accused, that the words “if” and “receiving” in sub-section (2) of section 84*bis* of the Act envisaged two distinct methods by which the broad definition of subsection (1) could be avoided.

As there was no evidence led upon which a reasonable man acting carefully, could conclude that the invitation contained in the brochure was other than one which could “properly be regarded in all the circumstances, as not being calculated to result, directly or indirectly in the shares or debentures becoming available for subscription by persons other than

those receiving the offer or invitation” in terms of section 84*bis*(2) as amended, the Court dismissed the State’s case.<sup>133</sup>

The ambit for abuse is patent.

#### 4.3. Summary of position under the 1973 Act

By way of comparative analysis, the 1973 Act held the meaning of an “offer to the public” and any reference to offering shares to the public as to include an offer of shares to any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus concerned or in any other manner.<sup>134</sup>

Section 84*bis* was substituted by section 142 of the 1973 Act. Definitions were inserted in Chapter VI of the 1973 Companies Act, where section 142(1) provided that:

In this Chapter, unless the context otherwise indicates –  
“offer to the public” and any reference to offering shares to the public and include any offer of shares to a section of the public and include an offer of shares to a section of the public whether selected in any other manner.

The concept of “public” was clearly and exhaustively defined in section 142(1),<sup>135</sup> drawing two clear distinctions, namely an offer to the public and an offer to a section of the public.

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<sup>133</sup> *S v National Board of Executors supra* 835.

<sup>134</sup> Chapter VI of the 1973 Act, section 142(1).

<sup>135</sup> Delpont “Disharmony” 2005 *SA Merc LJ* 392.

Where the offer was not made to the public at large but to a selection thereof, however the selection is made (in any other manner), it would still have been an offer to the public for the purposes of Chapter VI.<sup>136</sup>

“Offer to the public” in section 142(1) did not qualify the word “public” with “includes” but rather used it to include a section of the public in the meaning of public. The intent therefore appeared to be that the definition of “public” in section 142(1) was exhaustive and did not include any other common law meaning.<sup>137</sup>

Insofar as regulation of public offers is concerned there is no difference between an offer to the public at large and an offer to a section of the public.

The definition of offer to the public in section 142(1) did not qualify the word “public” with “includes” but rather used it to provide for the inclusion of a section of the public in the general broad meaning of public as it has developed.

The intent therefore was held to be that the definition of public was to be exhaustive and did not include any other common law meaning.<sup>138</sup>

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<sup>136</sup> Unfortunately, the Supreme Court of Appeal applied the principles incorrectly and failed to decide correctly in the *Gold Fields* case *supra*.

<sup>137</sup> Delpont “Disharmony” 2005 SA Merc LJ *supra*. In terms of section 142(1) of the 1973 Act the concept of “public” was clearly and exhaustively defined. The definition applied to Chapter VI and had to be applied in the context of the meaning of “public” as it developed. The exhaustive definition drew two clear distinctions, in the first instance an offer to the public and in the second instance an offer to a section of the public. An offer to the public in terms of this, is an offer if it’s to all and sundry or to the public at large (public: as per *Lynde v Nash supra*), but also a section of the public however the selection is made (“in any other manner”) making it still an offer to the public for the purposes of Chapter VI.

<sup>138</sup> *S v Rosenthal* 1980 (1) SA 65 (A). See also Delpont “Disharmony” 2005 SA Merc LJ 392.

## 4.3.1. Section 144 of the 1973 Companies Act

In the 1973 Act, section 144 excluded certain public offers from regulatory purview, denoting same as “non-public.”<sup>139</sup>

The definition of “offer to the public” in effect provided in the 1973 Act for an extension of the ordinary meaning of “public” in that it included therein a section of the public whether selected as members or debenture holders of the company or as clients of the issuer of the prospectus “or in any other manner.”<sup>140</sup>

It follows that in accordance with Professor Gower’s remarks regarding its English law predecessor, the concept of public under the 1973 Act had an almost unlimited application to the concept and the Legislature proceeded to limit it by providing in section 144 for when an offer shall be construed as not being an offer to the public, following the common-law principles alluded to above.<sup>141</sup>

Section 144(a) of the 1973 Act prior to amendment read: “*not being calculated to result, directly or indirectly, in the shares becoming available to persons other than those to whom the offer was made....*”

(The *Lynde v Nash* exclusion).

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<sup>139</sup> Follow the wording: [An offer of shares in relation to an offer for subscription for or sale of any shares, shall not be construed as an offer to the public...]

<sup>140</sup> Section 142, Chapter VI: “Offer to the public” and any reference to offering shares to the public mean any offer to the public and includes an offer of shares to any section of the public, whether selected as members or debenture-holders of the company concerned or as clients of the person issuing the prospectus concerned or in any other manner.

<sup>141</sup> See the application of this and remarks concerning the unlimited nature thereof in *S v National board of Executors supra* 824.

This created a generic non-public category, but was repealed by section 8 of the Companies Amendment Act 35 of 1998. Due the abuse of, and uncertainty concerning section 144(a), the entire section 144 was redrafted and substituted by the Companies Amendment Act 35 of 1998.<sup>142</sup>

Many of the provisions in the Companies Amendment Act 35 of 1998 were part of a concerted effort to curb corruption and fraud in the corporate world.<sup>143</sup>

The amendment of section 144 of the 1973 Companies Act, which determined when an offer for the subscription or sale of shares would not have been construed as an offer to the public (with inferred protection by means of the regulatory provisions which would have ensured disclosure by means of a prospectus), was a direct result of the Masterbond as well as Supreme and other scandals.<sup>144</sup>

The old section 144(a) was vague in its terms and led to non-public offers, where the offer document was worded in terms of the exception in section 81bis(2):

As not being calculated to result...in the shares becoming available to persons other than those to whom the offer was made.

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<sup>142</sup> Which came into effect on 14 August 1998. See Cilliers *et al* (2000) *Corporate Law* 259 and Henochsberg on the 1973 Act 264.

<sup>143</sup> Loubser A “Recent Developments in Corporate Law: Part 1” (2000) 12 *SA Merc LJ* 1 2.

<sup>144</sup> *Ibid.*



It goes without saying that no prospectus would then be registered under the circumstances.<sup>145</sup>

The new section 144 clearly identified those offers of shares which need not be accompanied by a registered prospectus. Any other public offer would have had to comply with the provisions of section 145.<sup>146</sup>

The effect of this substitution was that if an offer was included in an offer to the public as provided for by section 142(1) and it did not fall within the exceptions listed in section 144 it will be an offer to the public.<sup>147</sup> It was held that under the previous dispensation no common law “non-public” category existed.<sup>148</sup>

#### 4.3.2. Short analysis of *Gold Fields Ltd v Harmony Gold Mining Co Ltd*

By way of illustration of the concepts alluded to thus far, it may be worthwhile to revisit the *Gold Fields Ltd v Harmony Gold Mining Co Ltd* case.<sup>149</sup> The principles alluded to in the *Corporate Affairs Commission* case was briefly dealt with in the *Gold Fields* case, albeit wrongly applied.

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<sup>145</sup> *Ibid.* As a result, millions of Rands from investors were lost.

<sup>146</sup> *Ibid.*

<sup>147</sup> Henochsberg on the 1973 Act 264.

<sup>148</sup> Delpont “Disharmony” 2005 *SA Merc LJ* 391.

<sup>149</sup> *Gold Fields supra*. See also Cassim MF “Gold Fields v Harmony: A Lost Opportunity to Clarify Section 145 of the Companies Act” (2005) 122 *South African Law Journal* 269 and Delpont “Disharmony” 2005 *SA Merc LJ*; 2005 Annual Survey of the Law 483-5 and Blackman *et al* (2002) *Commentary* 6-8. The concept of “section of the public” was considered by the Supreme Court of Appeal, finding that Harmony’s offer to the shareholders of Gold Fields to acquire one Gold Fields share in exchange for 1.275 Harmony shares, as the initial stage of a possible merger of the two mining companies, was not an “offer to the public.” In that the group consisting of all the persons who held shares in Gold Fields did not constitute a “section of the public” in the particular circumstances of the case. For a full discussion of the Court’s findings, see Blackman *et al* (2002) *Commentary* 6-8.

*Corporate Affairs Commission*<sup>150</sup> held that there must be a rational connection between the offer and the characteristic that sets the group apart.

The definition in section 142(1) drew two clear distinctions, namely an offer to the “public” and an offer to a “section of the public.” An offer to the public is an offer to the public, if it is to “all and sundry” or to the public at large.<sup>151</sup>

This was not the position in the *Gold Fields* case. If the offer is not made to the public at large, but to a section of the public, the definition made it clear that however the selection is made (“in any other manner”), it will still be an offer to the public for purposes of Chapter VI. The reference to, and the reliance by the Court on, the meaning of “public” in *S v V* and in *S v Rossouw* was therefore inappropriate as it may only serve to determine the meaning of public (at large), which is not an issue (rather a selection).<sup>152</sup>

#### 4.4. Summary

The 1973 Act provided for, in the inclusionary provisions, the explicit inclusion of “public” into the meaning of “offer to the public” which circumvented the application of the ordinary meaning of “public” (and the possibility of an offer which could be construed as non-public) due to a possible non-public common law category. Following the exclusionary

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<sup>150</sup> At paragraph 14 of the judgment.

<sup>151</sup> The definition of “offer to the public” in s 142(1) does not qualify the word “public” with “includes” but rather uses it to include a section of the public in the meaning of public. The intention, therefore, appears to be that the definition of “public” in s 142(1) is exhaustive and does not include any other common-law meaning.

<sup>152</sup> Delpont “Disharmony” 2005 *SA Merc LJ* 392.

provisions in section 144, together with the exhaustive definition in section 142, it follows that *Gold Fields* was incorrectly decided. The stated case serves as an example of the contentious nature of the concept of “public” in offer regulation, where a loophole was created by the Supreme Court in direct contrast to the legislation.

## 5. Public under the 2008 Act

### 5.1. Introduction

Following the jurisprudence of the 1973 Act, section 142 of the 1973 Act substituted section 84*bis* of the 1926 Act. Prior to amendment, section 142(1) provided:

In this Chapter, unless the context otherwise indicates –  
“offer to the public” and any reference to offering of  
shares to the public mean any offer to the public and  
includes an offer of shares to a section of the public  
whether selected in any other manner.

Section 142(1) was amended by the Companies Amendment Act 35 of 1998 to provide for the meaning of an offer to the public to denote an offer to the public and any reference to offering shares to the public meaning any offer to the public and including an offer of shares to any section of the public, whether selected as members or debenture holders of the company concerned or in any other manner.

The word “public” was included and circumvented the application of a common law non-public category.<sup>153</sup>

An offer was included in an offer to the public. This means any offer made was an offer to the public. If it did not fall within the section 144 exclusions, it remained open to the public. The possibility to manoeuvre around a possible non-public common law category as exclusion to being a public offer was not possible.

This section will consider the inclusionary provisions of the 2008 Act together with the exclusionary provisions and will also consider whether an inclusionary “public” category exists, as well as whether an exclusionary principle under common law applies.

## 5.2. Public under the 2008 Act

Public offer regulation is provided for exclusively by Chapter 4 of the 2008 Act.<sup>154</sup> The term “public” therefore in terms of the application and interpretation of Chapter 4 can only be interpreted in terms of section 95.

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<sup>153</sup> Delpont “About Offers to the Public” 2011 *THRHR* 674. See also Delpont “Disharmony” 2005 *SA Merc LJ* 391.

<sup>154</sup> In this regard note the heading to Chapter 4: “Public offerings of company securities.” Furthermore, section 95(1) provides: “In this Chapter, unless the context indicates otherwise...” prior to defining, *inter alia*, offer to the public in subsection (h). Under the 1973 Act, the meaning of “offer” in the context of regulation of offers to the public was defined in section 142, for the purposes of chapter VI of the 1973 Act. The relevance of this is to be found in the restriction of public offers of securities in terms of section 99 which prohibits in general terms the making of offers of securities to the public unless disclosure of information in terms of section 100 is made.

The term “public” is not provided for in the 2008 Act. Offer to the public is defined in section 95(1)(h) as:

**“offer to the public”-**

(i) includes an offer of securities to be issued by a company to any section of the public, whether selected-

- (aa) as holders of that company’s securities;
- (bb) as clients of the person issuing the prospectus;
- (cc) as the holders of any particular class of property; or
- (dd) in any other manner; but

(ii) does not include-

- (aa) an offer made in any of the circumstances contemplated in section 96; or
- (bb) a secondary offer effected through an exchange.

It would seem that by way of analysis, the position of the meaning of “public” has reversed itself into reflecting the 1926 Act.<sup>155</sup>

Section 95(1)(h) of the 2008 Act states that an offer to the public includes an offer of securities to be issued by a company to any section of the public, whether selected as holders of that company’s securities or any particular class of property, as clients of the person issuing the prospectus, or in any other manner. It does not include an offer made in any of the circumstances contemplated in section 96 or a secondary offer through an exchange.

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<sup>155</sup> See Delpont “About Offers to the Public” 2011 *THRHR supra*.

Section 96 deals with the non-public exclusions and is discussed *infra*.

Section 95(2) states that for the purposes of Chapter 4 a person is to be regarded by, or in respect of a company, as being a member of the public, despite that person being a shareholder of the company or a purchaser of goods from the company.

This is described as an unnecessary complication based on section 141 of the 1973 Act and its predecessors where reference to “member” of the public was inserted to extend the prohibition on “hawking” of shares.<sup>156</sup>

The continued extension of the meaning of “offer to the public” by the addition of subcategories “section of the public” is regarded as unnecessary. The reasoning is that a single subcategory such as that in section 95(1)(h)(i)(dd) would include all those above it (and would make the definition easier to understand).<sup>157</sup>

It is clear therefore, that the 2008 Act defines “offer to the public” and “member of the public” but does not define “public.”<sup>158</sup>

It is submitted that the ordinary meaning of “public” as it stands and is understood, is to be applied concerning the interpretation of the word “public” under the 2008 Act, and for Chapter 4, insofar as the regulation of offers is concerned, as the scope of application for Chapter 4 is exclusively reserved only for Chapter 4.

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<sup>156</sup> Delport “About Offers to the Public” 2011 *THRHR* 675. See also fn 122 *supra*.

<sup>157</sup> *Ibid.*

<sup>158</sup> *Ibid.*

The wording in section 95(1)(h)(i) includes an offer of securities to be issued by a company to any section of the public, whether selected by subsections (aa) to (cc) or in terms of subsection (dd) in any other manner.<sup>159</sup>

It is held that these words govern the word “selected” and the intent is that in determining whether an offer is one to the public, the consideration as to the manner of the selection of those to whom the offer is made is irrelevant.<sup>160</sup>

### 5.3. Section of public

In terms of section 95(1)(h), selections in respect of the general term “public” is included and then excluded.<sup>161</sup>

Section 95(1)(h)(i) pertains to the inclusions. Section 95(h)(ii) contains the exclusions, referring in (aa) to the exclusions under section 96 and in (bb) to secondary offers effected through an exchange.

In terms of this, an offer to the public may be made only to a section of the public.<sup>162</sup> It follows that said “section of the public” to which the offer is made, will have to be “public.”<sup>163</sup>

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<sup>159</sup> Whether it is offers as holders of that company’s securities; as clients of the person issuing the prospectus; as the holders of any particular class of property.

<sup>160</sup> See Henochsberg on the 2008 Act 366.

<sup>161</sup> *Ibid* 365. *Gold Fields supra* at 510 held that the Court considered as to whether there was a suggestion that the word “public” was used in any special sense and that it was “unhelpful and potentially misleading,” to attempt to determine by inference what is included in an “offer to the public” by referring to the inclusions and exclusions in section 142 and 144 of the 1973 Act (section 95(1)(h) and section 96 of the 2008 Act) and that the better approach is to ask whether an offer can be said to have been made “to the public as that term is ordinarily understood.” See also Henochsberg on the 2008 Act 365.

<sup>162</sup> Refer to section 94(1)(h) which mentions “any section of the public.”

<sup>163</sup> Henochsberg on the 2008 Act 356.

The delineation of “section of the public” is to be made via (i)(aa) to (dd).

An offer made to any section of the public would necessarily be in terms that would enable it to be made and accepted by the public at large, and it could thus be made with indifference to any random section of the public. That will not be the case where the offer aims at acquiring specific private property, for the terms of such an offer must necessarily be that it is directed to, and is capable of being accepted by the owners of the property. Where the offer is made to a specific group of persons only, it will be a question of fact whether it qualifies as one made to a section of the public within the meaning of the definitions.<sup>164</sup>

It is submitted that the jurisprudence under “section of the public” *supra* is to be utilised and will be applicable in considering the definition in section 95(1)(h).

Whether a particular group of persons constitutes a section of the public cannot be answered in the abstract in terms of the *Corporate Affairs Commission* case.<sup>165</sup>

Following the same reasoning, such a person or group of persons can in other circumstances, can be identified by some special characteristic which isolates him or them in a private capacity and places him or them in a position of contrast with a member or section of the public.<sup>166</sup>

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<sup>164</sup> Henochsberg on the 2008 Act 356.

<sup>165</sup> *Corporate Affairs Commission (SA) v Australian Credit Union supra*. In similar worded legislation, it was held that for said purposes and in some circumstances, each citizen is a member of the public and any group of persons can constitute a section of the public.

<sup>166</sup> See also Henochsberg on the 2008 Act 356.



It is important to note that 95(1)(h) qualifies the word “public” with “includes.”

The amended definition under the 1973 Act of “public” in section 142(1) did not qualify the word “public” with “includes.” It rather included a section of the public in the meaning of “public.” In section 142(1) therefore, the intent seems to be that the definition of “public” was exhaustive and did not include any other common law meaning.<sup>167</sup>

#### 5.4. Exclusionary application

The wording of section 84*bis*(1) of the 1926 Act gave the provisions of that subsection an almost unlimited application in terms of including activities which are frequently, in appropriate circumstances, regarded as other than public in character.<sup>168</sup>

An application of the above implies, irrespective of the manner of criteria of selecting a section of the public, that an offer would be an offer to the public, unless it falls within one of the exceptions in section 95(1)(h)(ii).

This application is doubted in light of the fact that the primary intent of the regulatory principles which must be to provide information to addressees other than those shown to be able to fend for themselves.<sup>169</sup>

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<sup>167</sup> Delport “Disharmony” 2005 *SA Merc LJ* 392. See also *S v Rosenthal supra*. Note that the definition of “public” under the 1926 Act was not exhaustive and included the word “includes” juxtaposed to “include.” The scope for other categories, such as a non-public common law category was therefore possible under the 1926 Act.

<sup>168</sup> Activities such as invitations to participate in rights, conversion or bonus issues (*S v National Board of Executors supra*). See also Henochsberg on the 2008 Act 366.

<sup>169</sup> Henochsberg on the 2008 Act 366. *SEC v Ralston Purina Co supra* at 125 highlights the regulatory purview of these principles. Henochsberg on the 2008 Act *ibid* holds that a distinction is to be made between “public” and “private” and that the “circumstances under which the distinction is sought” and

An offer to a “random section” of the public would be a “public” offer. However, an offer where there is a “rational connection” between the offer and the characteristics which set the section of public apart, can be an offer not made to the public.<sup>170</sup>

A mere “rational connection” is not sufficient and other factors, such as an existing relationship between the group and the offerees, is also required.<sup>171</sup>

Section 95(2) holds that for the purposes of Chapter 4, a person is to be regarded by, or in respect of a company, as being a member of the public, despite that person being a shareholder of the company or a purchaser of goods from the company.

This is a repeat of section 141(10) of the 1973 Act and unnecessarily creates “member of the public” as a third category apart from “public” and “section of the public.”<sup>172</sup>

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the “purposes sought to be achieved by such distinction” will be the determining factors relative to such distinction. See also *SEC v Sunbeam Gold Mines supra*.

<sup>170</sup> Henochsberg on the 2008 Act 366. See also *Gold Fields supra* at 510-11.

<sup>171</sup> *Ibid*. See also *Corporate Affairs Commission (SA) v Australian Credit Union supra*. The fact that a person holds a particular type of private property (as per the *Gold Fields* case *supra* at 511) does not make an offer one which is not to the public – in the absence of the other criteria, such as an existing relationship, as per *Corporate Affairs Commission (SA) v Australian Credit Union*.

<sup>172</sup> Henochsberg on the 2008 Act 367. This concept was used in section 141(10) of the 1973 Act and for a different definition in that section of public. The purchaser category would fall under the “or any other manner category” in section 95(1)(h)(i)(dd). Likewise, the category in subsection (cc) which was inserted in response to the *Gold Fields* case *supra*, would fall under that category. Offers within the categories of section 96 and secondary offers effected through an exchange are excluded by section 95(1)(h)ii). Off-market offers and trades of listed securities are not offers “through an exchange” and may not fall within this exception.

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5.5. Exhaustive definition or non-exhaustive definition

Section 95(1)(h)(i) defines an offer to the public as including “...*an offer of securities to be issued by a company to any section of the public....*”

“Offer to the public” is provided for, as well as “section of the public.” Furthermore, both “public” and “section of the public” are expounded on by a list, pre-empted by the plural use of “includes”: “*includes...to any section of the public, whether selected...*” The selection is followed by a list (aa) to (dd).

Definition provisions contribute to legal hermeneutic questions arising from their nature and presence in legislation. Based on their character, definitions are generally of two types: (i) inclusive, - i.e., providing all that is covered by specification while leaving the scope open to others also to be covered within the ambit of the provision, (ii) exclusive (or “means” definition), - i.e., those providing an exhaustive meaning to the term and no other meaning is permissible.<sup>173</sup>

In *R v Debele*<sup>174</sup> the Court recognised that the word “includes” may also signify that the list provides an exhaustive explanation of the term being defined. Fagan, JA held that it seems to be clear that “includes” in the definition of “peace officer” is equivalent to “means.” Fagan JA referred

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<sup>173</sup> Definitions: Inclusive v Exhaustive <http://legalperspectives.blogspot.com/2010/11/inclusive-versus-exhaustive-definitions.html> (accessed on 14 February 2014.)

<sup>174</sup> *R v Debele* 1956 (4) SA 570 (A).

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to the decision in *R v Ah Tong*<sup>175</sup> where the word “comprising,” had to be considered and where Solomon AJ said:

The word “include” is often used in the definition of Acts of Parliament for the purpose of enlarging the meaning of a word or phrase by bringing it under something which is not comprehended under the ordinary meaning of that word or phrase. But assuming that the words comprise and include are exactly synonymous, it is clear that this is not the sense in which the word is here used, for the shops enumerated are such as would ordinarily fall under the natural meaning of “refreshment shop.” In this section the word is used not for the purpose of extending the meaning of the expression “refreshment shops,” but for the purpose of enumerating the different kinds of shops which are intended to be comprehended under that denomination. That, I think, would be the result to be arrived at even if the Legislature had used the word “including” instead of “comprising.”<sup>176</sup>

Following this dictum and applying it to the exhaustive definition of “offer to the public” under the 1973 Act, it follows that the word “include,” in reference to a section of the public, singularly expanded the ordinary meaning of “public” to the extent of the inclusion of a section thereof and including any “offer to the public.”

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<sup>175</sup> *R v Ah Tong* 1919 AD 186.

<sup>176</sup> *Ibid* 189-90.

In *De Reuck v Director of Public Prosecutions, Witwatersrand Local Division, and Others*<sup>177</sup> the Constitutional Court considered the interpretation of statute and the meaning of “includes” in a definition of a section. The Court held<sup>178</sup> that the correct sense of “includes” in a statute must be ascertained from the context in which it is used. *R v Debele* provides useful guidelines for this determination. The Court held that as to the meaning of “includes” in the definition that the correct sense of “includes” in a statute had to be ascertained from the context in which it was used. If the primary meaning of the term was well known and not in need of definition and the items in the list introduced by “includes” went beyond that primary meaning, the purpose of that list was then usually taken to be to add to the primary meaning so that “includes” was non-exhaustive.<sup>179</sup>

Where the primary meaning already encompassed all the items in the list, then the purpose of the list was to make the definition more precise, in such a case “includes” will be used exhaustively.<sup>180</sup>

Between these two situations there is a third, where the drafters have, for convenience, grouped together several things in the definition of one term whose primary meaning - if it is a word in ordinary, non-legal usage - fits some of them better than others. Such a list may also be intended as

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<sup>177</sup> *De Reuck v Director of Public Prosecutions, Witwatersrand Local Division and Others* 2004 (1) SA 406 (CC).

<sup>178</sup> *Ibid.*

<sup>179</sup> It follows that the primary meaning of “public” is contentious, as well as the meaning of “a section of the public.” It is submitted that this is applicable to section 95(1)(h), where the primary meaning of “public” is well known, yet the meaning of “a section of the public” is not, going beyond the primary meaning of “public.” The purpose of the list, adds to the primary meaning, (being included by means of the use of “includes”), and being part of a list, and is thus not-exhaustive, opening the scope for a non-public common law category.

<sup>180</sup> This is clearly not applicable to section 95(1)(h).

exhaustive, if only to avoid what was referred to in *R v Debele* as “*n moeras van onsekerheid*” (a quagmire of uncertainty) in the application of the term.<sup>181</sup>

The Court held that the common sense of “includes” is non-exhaustive, signifying that the list extends the meaning of the term being defined.<sup>182</sup>

The Constitutional Court has held in *Minister of Health and another v New Clicks South Africa (Pty) Ltd and others*<sup>183</sup> that as a general rule, the terms “including” or “includes” are not terms of an exhaustive definition but terms of extension. However, they may, depending on the context, be used as terms of exhaustive definition. The Court referred to the case of *Dilworth v Commissioner of Stamps*<sup>184</sup> where it was held:

The word “include” is very generally used in interpretation clauses in order to enlarge the meaning of words or phrases occurring in the body of the statute; and when it is so used these words or phrases must be construed as comprehending, not only such things as they signify according to their natural import, but also those things which the interpretation clause declares that they shall include. But the word “include” is susceptible of another construction, which may become imperative, if the context of the Act is sufficient to show that it was not merely

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<sup>181</sup> At paragraph [18] at 418E/F - 419C.

<sup>182</sup> At paragraph 17.

<sup>183</sup> *Minister of Health and Another v New Clicks South Africa (Pty) Ltd and Others* (CCT 59/2004) [2005] ZACC 14; 2006 (8) BCLR 872 (CC); 2006 (2) SA 311 (CC) (30 Sept 2005) 455 (hereinafter referred to as *New Clicks*).

<sup>184</sup> *Dilworth v Commissioner of Stamps* [1899] AC 99 105-6.

employed for the purpose of adding to the natural significance of the words or expressions defined. It may be equivalent to “mean and include,” and in that case it may afford an exhaustive explanation of the meaning which, for the purposes of the Act, must invariably be attached to these words or expressions.

In the *New Clicks* case, the Constitutional Court held that the sense in which the term “including” is used must be ascertained from the context in which it is used.<sup>185</sup> Referring to *De Reuck v Director of Public Prosecutions, WLD*,<sup>186</sup> the Constitutional Court referred to “useful guidelines for this determination” and referenced *R v Debele*.

It is submitted that in interpreting the sense of “includes” in a statute, the context must be taken into consideration. In the first instance, the primary meaning will be accompanied by a list introduced by “includes.” Where this list goes beyond the primary meaning (“public” and “section of the public”) the purpose of the list is to add to the primary meaning (“public” and “section of the public”) by means of “includes” and is non-exhaustive. The primary meaning encompasses all the items in the list, the purpose of the list being an enabling factor: making the definition more precise.

In the second instance, where the primary meaning encompasses all the items in the list, then the purpose of the list is to make the definition more precise. In such a case, “includes” is used exhaustively. It is submitted

<sup>185</sup> *New Clicks supra* 456.

<sup>186</sup> *De Reuck v Director of Public Prosecutions, WLD supra*.

that this is not applicable to the definition of “offer to the public” in section 95(1)(h) of the 2008 Act.

In the third instance, where several items are listed together in the definition of one term for convenience, where such a term’s primary meaning (if it is a word in ordinary, non-legal usage) fits some of them better than others, such a list may also be intended as being exhaustive if only to avoid what was referred to in *R v Debele* as a quagmire of uncertainty regarding the application of the term. It is submitted that this is not applicable to the definition of section 95(1)(h). It is thus clear that the definition in section 95(1)(h) as well as section 96 are not exhaustive and that the first scenario applies in that the concept is now exhaustively defined.

By way of short summary, the current disposition is thus as follows. “Public” and “section of the public” find reference as expounded on *supra*. It will suffice to say that the expansion of “public” to include a section thereof required safe harbour provisions, as described in *Loss*, as well as to circumvent abuse of a non-public common law category, as per *Gold Fields* being the most recent example (although badly decided). The 1926 Companies Act provided for an offer to the public to include an offer to any section of the public however selected (section 84*bis*(1) with the exclusions in section 84*bis*(4)). The word “public” was omitted in this definition. The 1973 Act, prior to amendment, provided for an offer to the public to mean any offer to the public and to include an offer of shares to a section of the public, whether selected in any other manner. This



definition was amended due to abuse and uncertainty concerning the exclusion in section 144(a), the effect that an offer is included in an offer to the public by section 142(1), and does not fall within the exclusions of section 144. Prior to amendment, section 144(a) provided for an exception to an offer to the public as defined, where it would not be “calculated to result, directly or indirectly, in the shares becoming available to persons other than those to whom the offer was made” as per the dictum in *Lynde v Nash*. The 1973 Act, after amendment of section 142(1), included in the definition the word “public.” This affected the ambit of the word “public” as well as the possibility of a common law non-public category. The 2008 Act provides now for an offer to the public as per the 1926 Act. The Act defines “offer to the public” and “member of the public,” but does not define “public.” The definition excludes certain offers to a “section of the public,” as per section 96. Yet the language of section 95(1)(h) does not indicate that this exclusion is exhaustive, rather that it is a safe harbour (see the word “include” in 95(1)(h)(ii)).

#### 5.6. Exclusions

Apart from the exclusions built into the meaning of an “offer to the public” in section 95(1)(h), section 96 provides for seven instances where an offer will not constitute an offer to the public. These are the exclusions, or codified “safe harbours,” in respect of offer regulation under Chapter 4. Accordingly, section 96 will be used in determining whether an offer is an offer to the public by examination, in the second instance, of whether it falls into any of the seven exclusions.

The definition in section 95(1)(h) is broad, due to the phrase “in any other manner” which would have the effect that all offers would require a prospectus. It is accepted, however, that not everybody requires the information required in a prospectus, either due to their having the information or being capable of obtaining it. Therefore, although certain persons will fall within the ambit of the definition of an “offer to the public,” they will not be considered to be “public.”<sup>187</sup>

Section 96 provides that an offer is not to the public if –

- (a) the offer is made to no persons (or a combination) other than -
  - (i) persons whose ordinary business, or part of whose ordinary business, is to deal in securities, whether as principals or agents; or
  - (ii) the Public Investment Corporation as defined in the Public Investment Corporation Act, 2004;<sup>188</sup> or
  - (iii) a person or entity regulated by the Reserve Bank of South Africa; or
  - (iv) an authorised financial services provider, as defined in the Financial Advisory and Intermediary Services Act, 2002;<sup>189</sup> or
  - (v) a financial institution, as defined in the Financial Services Board Act, 1990;<sup>190</sup> or

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<sup>187</sup> Delport (2011) *Manual* 45.

<sup>188</sup> Act No. 23 of 2004.

<sup>189</sup> Act No. 37 of 2002.

- (vi) a wholly-owned subsidiary of a person contemplated in subparagraph (iii); or
  
- (iv) or (v), acting as agent in the capacity of an authorised portfolio manager for a pension fund registered in terms of the Pension Funds Act, 1956;<sup>191</sup> or as manager for a collective investment scheme registered in terms of the Collective Investment Schemes Control Act, 2002;<sup>192</sup>
  
- (b) if the total contemplated acquisition cost of the securities, for any single addressee acting as principal, is equal to or greater than the amount prescribed in terms of subsection (2)(a);
  
- (c) if it is a non-renounceable offer made only to -
  - (i) existing holders of the company's securities; or
  - (ii) persons related to existing holders of the company's securities;or
  
- (d) if it is a rights offer that satisfies the prescribed requirements, and -
  - (i) an exchange has granted or has agreed to grant a listing for the securities that are the subject of the offer; and

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<sup>190</sup> Act No. 97 of 1990.

<sup>191</sup> Act No. 24 of 1956.

<sup>192</sup> Act No. 45 of 2002.

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- (ii) the rights offer complies with any relevant requirements of that exchange at the time the offer is made;<sup>193</sup>
  - (e) if the offer is made only to a director or prescribed officer of the company, or a person related to a director or prescribed officer, unless the offer is renounceable in favour of a person who is not a director or prescribed officer of the company or a person related to a director or prescribed officer;
  - (f) if it pertains to an employee share scheme that satisfies the requirements of section 97; or
  - (g) if it is an offer, or one of a series of offers, for subscription, made in writing; and -
    - (i) no offer in the series is accompanied by or made by means of an advertisement and no selling expenses are incurred in connection with any offer in the series;
    - (ii) the issue of securities under any one offer in the series is finalised within six months after the date that the offer was first made;
    - (iii) the offer, or series of offers in aggregate, is or are accepted by a maximum of fifty persons acting as principals;

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<sup>193</sup> See Delport (2011) *Manual* 46. A rights offer is defined in section 95(1)(l) as “...an offer, with or without a right to renounce in favour of other persons, made to any holders of a company’s securities for subscription of any securities of that company, or any other company within the same group of companies.” The JSE however requires the rights offer to be in respect of the issuer and it must be renounceable (see the definition of rights offer in the JSE Listing Requirements 12). The letter of allocation for unlisted securities must be filed with the CIPC on CoR 46 (Regulation 49). The problem is that a letter of allocation is defined in section 95(1)(f) as the document which confers a right to subscribe for shares (not securities) in terms of a rights offer.

- (iv) the subscription price, including any premium, of the securities issued in respect of the series of offers, does not exceed, in aggregate, the amount prescribed in terms of subsection (2)(a);<sup>194</sup> and
- (v) no similar offer, or offer in a series of offers, has been made by the company within the period prescribed<sup>195</sup> in terms of subsection (2)(b) immediately before the offer, or first of a series of offers, as the case may be.
- (2) The Minister, by notice in the Gazette, may prescribe-
- (a) a value of not less than R100 000, to be the minimum value for the purposes of subsection (1)(b) and the maximum value for the purposes of subsection (1)(g)(iv); and
- (b) a minimum period for the purposes of subsection (1)(g)(v), which must not be less than six months.

In respect of (b) and (2)(a), the Minister prescribed in regulation 45 that the maximum is R 1 000 000.

In respect of (c) it has always been the principle that this category of persons has the information about the company and a prospectus will be superfluous. However, it is argued that “securities” includes a debenture holder who, as ordinary creditor, does not have any additional information

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<sup>194</sup> Prescribed at R 1 000 000 (Regulation 45).

<sup>195</sup> By the Minister in the *Gazette* (section 96(2)). Prescribed as 12 months (see Regulation 45). Since this offer does not have to be registered or filed with the CIPC, it will not be possible to determine whether there have been previous offers. A minimum period is prescribed, which makes a multitude of offers possible. See also Delpont (2011) *Manual supra*.

about the company, such as the annual financial statements.<sup>196</sup> The ambit for abuse in respect of debenture offers is patent. This exception refers to an offer to existing holders of the company's securities or persons related to them without the right to renounce any right to take up the securities in favour of others.<sup>197</sup>

There is an overlap between (c) and (d) of subsection 1. A "rights offer" can be in respect of listed or unlisted securities. If it is in respect of listed securities it cannot be a public offer. If it is in respect of unlisted securities, it is a public offer, unless complying with the requirements of paragraph (c).

The categories that are regarded as non-public apply to all offers of securities in terms of Chapter 4. Certain offers are, by their nature, excluded from the secondary offer regulatory provisions. For example, see subsection (g).<sup>198</sup>

For the purposes of Chapter 4 offer regulation, if an offer comes within the ambit of section 96(1) (a)-(g), it will be deprived of its public character.<sup>199</sup> Ordinarily, as follows from the discussion above, where an offer is made and there is no rational connection between the characteristic which sets the members of a section of the public apart and

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<sup>196</sup> Delport (2011) *Manual* 45.

<sup>197</sup> The fact that the offer is required to be non-renounceable does not in practice make much difference since holders of securities who subscribe to a new issue by a public company are able to dispose of the shares or debentures when they have acquired them hardly any less readily than they would have been able to dispose of the right to subscribe for them. In the case of a primary offering, it is logical that the shares offered will be that of the company, however in the case of a secondary offer by the company (of securities held in another company) this exception could apply as there are no requirements to the opposite). The exception does not apply to offers for subscription under section 95. See Henochsberg on the 2008 Act 373.

<sup>198</sup> Henochsberg on the 2008 Act 372.

<sup>199</sup> *Ibid* 356.

the nature of the offer made to them by the unfamiliar person, the group will constitute a section of the public in terms of offer regulation.<sup>200</sup>

If there is an underlying relationship or some rational connection between the common characteristics of the section of the public and the offer made to them, the question as to whether the offer is a public offer will divert to a number of differentiating factors.

Ordinarily the most important of these factors are whether the number of persons comprising the group, the subsisting relationship between the offeror and the members of the group, the nature and content of the offer, the significance of any particular characteristic which identifies the members of the group and any connection between the characteristics and the offer.<sup>201</sup>

Save, therefore, for the generic non-public category which was deleted from our company law jurisprudence, the remainder of the section 144 exclusions were incorporated into the 2008 Act into section 96, including some exclusions reserved for the secondary market.<sup>202</sup>

The provisions are based on basic principles as to why offers are not to the public.<sup>203</sup> The importance is to be found whether a determination must be made as to whether the exclusions contained in section 96 of the 2008 Act are principally sound. Of greater importance is the determination as to

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<sup>200</sup> Henochsberg on the 2008 Act 366.

<sup>201</sup> Henochsberg on the 2008 Act 366. The approach in *Corporate Affairs Commission (SA) v Australian Credit Union supra* was followed in *Gold Fields supra*, however only selected elements of the test in the Australian case were applied (Henochsberg on the 2008 Act *ibid*).

<sup>202</sup> Delport “About Offers to the Public” 2011 *THRHR supra*.

<sup>203</sup> In essence, non-public or private offers (Delport “About Offers to the Public” 2011 *THRHR ibid*).

what the requirements would be for any “common law” non-public categories.<sup>204</sup>

Under the 1973 Act, section 144 contained the exceptions as incorporated into section 84*bis*(4) of the 1926 Act. The original section 144(a) of the 1973 Act read: “*not being calculated to result, directly or indirectly, in the shares becoming available to persons other than those to whom the offer was made.*”<sup>205</sup> Section 144(a) was deleted by section 8 of the Companies Amendment Act 35 of 1998, resulting in the disappearance of the possibility of a *sui generis* non-public category which could have been determined on the basis of the particular offer.<sup>206</sup>

Most of the provisions of section 144 (*sans* the *Lynde v Nash* exclusion in section 144(a)), made their way into the 2008 Act as section 96, which now includes exceptions reserved for the secondary market.<sup>207</sup>

It is furthermore submitted that the wording of section 96 does not denote it to be an exhaustive exclusionary provision.

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<sup>204</sup> *Ibid.*

<sup>205</sup> See Delpont “About Offers to the Public” 2011 *THRHR* 674. This is the *Lynde v Nash supra* exclusion.

<sup>206</sup> *Ibid.* See also Blackman *et al* (2002) *Commentary* 6-11; as well as Delpont PA “Die problematiek met betrekking tot die begrip “publiek” in die Maatskappywet 61 van 1973” Henning JJ *et al* (1996) *Selected Essays on South African Entrepreneurial Law, Corporate Law Development Series* Bloemfontein: CRIC UOFS paragraph 3.5. The substitution was prompted by the fact that the previous exclusions in section 144 were vague, resulting in many offers being excluded on the ground that they were private placings, resulting in losses to investors of millions of Rands.

<sup>207</sup> Delpont “About Offers to the Public” 2011 *THRHR* *ibid.*



## 5.7. Common law “non-public”

In the *Gold Fields*<sup>208</sup> case the Court found that the ordinary meaning of “public” in terms of an offer would mean that it is capable of acceptance “by the public at large.”

This is in line with the dictum in *Lynde v Nash* holding that it is not necessary for the offer to be made to “the public at large” but also if it is made with “indifference to any random section of the public.”

Where the offer is aimed at acquiring specific private property, it is only capable of acceptance by the owner of the property (and the offer is addressed to only the person in the capacity as owner of private property,) that will have the effect that the offer is not extended to the public at large rather than a section of the public.<sup>209</sup>

A rational connection exists between the offer and the characteristics that set the group apart from the “public.” Based on this principle the Court found in *Gold Fields* that it was not an offer to the public under section 145 of the 1973 Act. The dictum in *Gold Fields* together with the new definition in section 95(1)(h), created the scope for the interpretation of a new common law non-public category in respect of offers. It is stated and agreed that the principles relating to Rule 506 of the United States of America Security Act of 1933 should be used as basis for the determination of this category of “non-public.”<sup>210</sup>

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<sup>208</sup> At 510F

<sup>209</sup> Delport “About Offers to the Public” 2011 *THRHR* 675.

<sup>210</sup> *Ibid.*

### 5.8. Secondary market and the concept of “public”

The confusion in the Companies Act of 1926 in respect of primary and secondary market regulation was thought to be solved with the incorporation of section 141 by relating to the secondary market in chapter V of the of the Companies Act of 1973 with the primary market being regulated in chapter VI.<sup>211</sup>

Since the inclusion of the secondary market in respect of the regulation of secondary offers the consequences may lead to permutations or unintended consequences.<sup>212</sup>

Secondary offers to the public are defined in terms of section 95(1)(m) as *“an offer for sale to the public of any securities of the company or its subsidiary, made by all on behalf of a person other than that company or its subsidiary.”*

Section 101 requires a written statement to be filed in the case of a public company in the event of a sale on the secondary market of securities.<sup>213</sup>

Section 101 is not applicable if the offer is in respect of listed shares.<sup>214</sup> the requirements as to the accompanying documentation<sup>215</sup> do not apply if the securities are offered by public tender by certain “functionaries” such

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<sup>211</sup> Delpont “Disharmony” 2005 *SA Merc LJ supra*.

<sup>212</sup> Delpont “About Offers to the Public” 2011 *THRHR supra*. The previous section 141 in the 1973 Act was in chapter V whereas primary market regulation of shares to the public was in chapter VI. The enactment of regulatory provisions in separate chapters was in order to avoid confusion between primary market regulation and that of secondary market regulation: see part A *supra*. See also Van Wyk de Vries Commission Supplementary Report 102.

<sup>213</sup> In terms of section 8 (2) securities of private companies can be sold in secondary markets but it cannot be issued to the public.

<sup>214</sup> See section 101(1). Although the written statement must name, for some or other reason, the exchange if the shares are listed (section 101(6)).

<sup>215</sup> Section 101(4)-(6).

as executors, administrators or trustees of various estates.<sup>216</sup> The significance of this differentiation in respect of an application is not clear.

The written statement (or the original prospectus which accompanied the PO or IPO) must accompany the secondary offer. If a prospectus was issued on the first distribution of shares, the prospectus must accompany the secondary offer. Generally, a prospectus ceases to have effect after the conclusion of the primary offer or, otherwise, four months after registration (filing). No offers may reasonably be accepted on it for the issue of shares thereafter.<sup>217</sup> Unless a choice is denoted. In terms of a secondary offer there is ambiguity as to when a prospectus will become ineffective. Instead, the seller may prefer to issue a written statement rather than a prospectus as the difference in civil liability, and also the possible defendant in case of such liability, will be more favourable. Furthermore, the amount of information required for a written statement is reduced and less detailed than that for a prospectus.<sup>218</sup> If a prospectus was not required in the primary issue, it may be that the written statement is nonetheless required in the on-selling of the securities. The situation may occur, although the same principles in terms of section 95(1)(h) and section 96 are used to determine who is “public,” that the secondary offer could be in respect of a different category and therefore public.

The principles of offer regulation as featured in Chapter 4 of the 2008 Act and as applied to an offer to the “public,” are easily applied and logically

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<sup>216</sup> Section 101(3).

<sup>217</sup> Section 107.

<sup>218</sup> See section 101(6)(d) for requirements for the written statement and regulations 54 and 55 of the Companies Act regulations (R351 in Government Gazette 34239 of 2011-04-26) for the prospectus requirements.

correct in respect of *bona fide* transactions in the primary and secondary markets where all the transactions will be at arm's length. Regulatory ambiguity, believed to be ineffective regulation of public offers due to the arbitrage, attribute it to substandard legislative drafting. A possible example of this is where the protection of disclosure through the prospectus will not be available to investors if the secondary market is used as an extension of the primary market. Such a primary market transaction will be structured to ensure that it is not an offer to the public by using one of the safe harbour provisions in section 96.

The subscriber for securities can then offer the securities for sale immediately and this “redistribution,” in the language of Rule 506 (and as regulated in the 1973 Act in section 146), will be subject only to the limited disclosure in a written statement in terms of section 101. Contravention of the regulatory principles with prejudice to investors is clear.<sup>219</sup>

#### 5.9. Concluding remarks

It will seem that the Legislature ought to revert to the drawing board in order to meticulously consider the jurisprudence surrounding the meaning of “public” in respect of public offers and offer regulation. The definition of “offer to the public” must be revisited as inclusionary provision in excluding any common law offers to the public. This can be done by incorporating into the definition an offer to the public as “any offer.” Furthermore, it is clear that the language should be amended to exclude a

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<sup>219</sup> The principle that “*people who are forced to undress in public will presumably pay some attention to their figures*” as per Loss (1988) *Fundamentals* 33 will not apply, at least not in full.

non-exhaustive interpretation. It may be worthwhile for the Legislature to close avenues of interpretation which could lend to a non-public category.

The exclusionary provisions in section 96 may be suitably adapted to provide that no other exclusionary principles apply, save for the codified categories.

Lastly, as noted in part A under the discussion of offers, the regulation of the secondary market within the primary market creates confusion and may have the implication that regulatory principles fail. A clear and distinct separation is required.

A review of the case law and jurisprudence in South Africa reveals that the opportunity to clarify “public” and “public offers” in terms of the following has not occurred as of yet:

- i) Inclusionary principles (public under the common law);
- ii) Inclusionary provisions which provide for “public” under the meaning of offer to the public (public as included (as per the 1973 Act) or not (as under the 2008 Act));
- iii) Exclusionary principles in applying items i) and ii) above to a transaction in deducing whether the term “public” applies or not, based on the meaning of “public” and “offer to the public” as deduced from the definitions and incorporating a possible non-public category under the common law; and

- iv) Exclusionary provisions, either legislated via the inclusionary provision (such as section 95(1)(h) of the 2008 Act which creates a safe harbour) or created via the specific exclusionary provisions which were incorporated into the legislation, following the jurisprudence of what is not to be considered to be a non-public offer.

Until such a time that the Supreme Court will apply itself fully or the Legislature enact amendments, offer regulation remains contentious and open to abuse to the detriment of the economy and investors.

#### **6. Conclusion of substantive regulatory aspects to Chapter 4**

Based on the discussion above of the three determinant factors of substantive aspects of offer regulation as per Chapter 4 of the 2008 Companies Act, it is submitted that offer regulation in terms of Chapter 4 does not constitute complete law. As a result thereof it also falls short of the principles of regulation. Offer regulation in South Africa is thus at risk of enforcement failure either through the ambiguous nature of the substantive provisions which allow for gaps in the regulation and enforcement thereof, alternatively due to the non-compliance of market participants due to no deterrent value of the liability provisions. It follows that the delineating aspects of Chapter 4 in need of revision are in the first instance the definitions and in the second instance, the regulation of secondary market sales of unlisted securities which are operating in an overlapping fashion with the primary market. The concepts of an offer (primary market subscription as well as sale) together with secondary

market resales as well as the concept of public and disclosure together with liability provisions require urgent attention.

## CHAPTER 6

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### COMPARATIVE DISPOSITION

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1. Introduction
2. *Tertium comparationis*
3. Problem statement
4. Ideal regulatory model



## 1. Introduction

The comparative study will review aspects concerning the regulation of offers in the United Kingdom and United States respectively. In each jurisdiction, brief remarks will be made concerning the model of regulation prior to discussing the substantive aspects relevant to the concept of an offer and then the concept of public as manifested in the respective jurisdictions, concerning the enforcement thereof. A synopsis of the relevance of the differences will conclude.<sup>1</sup>

Both jurisdictions feature strong capital markets with a well-developed offer regulatory system which share the principles of offer regulation. Both regulatory systems are well regulated and boast a healthy body of jurisprudence which overshadows that of South Africa. Due to the cosmopolitan nature of offer regulation and the transferability thereof it is submitted that both systems will contribute towards this review.

The scope of this research is not the methods of capitalisation of the company. The focus is on the scope of Chapter 4 offer regulation and the determination of the scope thereof concerning the concept of complete law towards the ideal of effective enforcement of the principles of enforcement in realisation of the *Grundnorm*. It is submitted that the parameters of effective regulation consist of a high probability of enforcement failure due to incomplete law, versus a low probability of

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<sup>1</sup> See Reitz JC “How to do Comparative Law” (1998) 46 *American Journal of Comparative Law* 617 for the prescribed method in which to conduct a comparative study. The nine principles as identified by Reitz in how to conclude a comparative study to fruition have been applied in this chapter in conducting the comparative review.

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enforcement failure due to complete law. It is submitted that the parameters be observed in three integral parts: liability provisions; substantive provisions and the definitions applicable in bridging the former concepts. The basis of delineation is in the first instance the regulatory regime, i.e., how and by whom regulation is occasioned. In the second instance, the definitions and concepts which apply to a regulatory regime as set out in legislation provide the foundation from which an objective deduction can be made towards its efficiency and effectiveness in serving as deterrent and in regulating the market in line with the *Grundnorm*. Particular focus will be on the regulation of secondary market public offerings as well as the definitions applicable in determining alternatives for South Africa and in confirming certain aspects concerning the regulatory regime in South Africa, identified as troublesome: for example the concepts of PO and IPO. The quandary is not that the markets are divided; that is logical. The problem is where different principles apply to the different transactions applicable to the market and where the interpretation thereof overlaps or is inhibited due to the overlap or the confusion concerning the contractual principles applicable to the markets. For example, had there been one regulatory regime applicable to the public regulation of offers in terms of Chapter 4, and where it provided for regulation across the markets with lucid and applicable definitions as applied to the substantive as well as liability provisions, no interpretational or application problems would have arisen with the enforcement thereof. Regulation needs not be market dependent or transaction dependent. Regulation need to focus on the offering of

securities to the public. It is submitted that a focus on market specific regulation creates undue delineation as the key concept is informational and liability provisions based on the disclosure. In the foregoing chapter it has been established that South African regulation of public offers are at an impasse concerning the concept of complete law and incomplete law through the development of offer regulation and the principles thereto, and the ignorance thereof, together with the common law, in preparing the 2008 Act. It is submitted that there is a high probability of enforcement failure.

## 2. *Tertium comparationis*

At the onset it is required to identify the *tertium comparationis* as essential element of the comparative method.<sup>2</sup> It is submitted that the South African disposition and the nature of this study denotes *tertia comparationis*. In the first instance the *tertia comparationis* as common point of departure, manifests in the following problem statement,<sup>3</sup> and in the second instance, the ideal legal position sought.<sup>4</sup>

The *tertia comparationis* of this chapter shall qualify in the conclusion and recommendations,<sup>5</sup> the identified jurisdictions with that of South Africa, insofar as this study allows. Each problem area of chapter 5 will be reviewed and compared *infra* to juxtapose the ideal to the problem

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<sup>2</sup> This refers to the common point of departure for the comparison. Typically a real-life problem or an ideal (Reitz “Comparative Law” 1998 *AJCL* 622). See also Zweigert K & Kötz H (1987) *Introduction to Comparative Law 2<sup>nd</sup> rev ed* Oxford: Clarendon Press 30; Vagts D (ed) “Book Reviews and Notes [Review of Edward McWhinney – Supreme Courts and Judicial Law-Making: Constitutional Tribunals and Constitutional Review]” (1988) 82 *American Journal of International Law* 370 421, 436.

<sup>3</sup> Point 3 *post*.

<sup>4</sup> Point 4 *post*.

<sup>5</sup> Chapter 7 *post*.

statement. However, it is necessary to state the general gist of the required comparative review.

### 3. **Problem statement**

Offer regulation is a specialist body of law and technical in nature. The basis of regulation is by means of defining the subject matter of regulation, i.e., offers of securities to the public. The importance of unambiguous, effective and efficient definitions and regulatory provisions in line with the principles of offer regulation in constituting complete law is important in aligning the statute with the principles of offer regulation in ensuring enforcement efficacy.

The understanding of offer regulation requires insight into the historical development thereof, the principles which manifested through the development and the aims of such principles. However, that is not enough. The domestic development of offer regulatory laws through enactments of various pieces of legislation, the interpretational difficulties and possible abuses of the legislation and the amendments thereof must be understood in full. Also, the scholar in offer regulatory law or securities law must be able to apply transactional relativity and corporate laws to his or her understanding of the workings of, on the one hand, the company, its functionaries, shareholders, and capital requirements together with the methods of obtaining capital; juxtaposed to the interest of the public and the regulators in regulating the process of obtaining capital on the other hand.

It goes without saying that the scope of difficulty comes to the fore in the following instances:

- i) Where the legislation fails to adhere to the principles of regulation, i.e., does not take into account the nature of offer regulatory principles as developed and applied to transactions; resulting in the avoidance of the *Grundnorm*;
- ii) Where as a result of i) the provisions constitute incomplete law, resulting in enforcement failure.

In chapter 5 *supra* certain aspects of offer regulation have been identified as applicable. It is not the intent to state each and every problem occasioned here. It may suffice to say that the 2008 Act in its development and as it stands today does not constitute complete law in respect of offer regulatory principles and that will impact the enforcement efficiency thereof. It is submitted that the ultimate reason of existence of offer regulatory laws are negated. An image is evoked of a Samurai fighter falling onto his own sword. The problem does not reside in the regulation of primary and secondary markets in one place alone, it is where the application of such provisions are not considered, ill-defined and haphazardly inserted where confusion comes to the fore. The ultimate regulatory framework is therefore important. What is also of importance is the application of the concept of an offer to regulatory principles and lastly how the concept of public is interpreted.

The problem statement is amplified through an understanding that despite decades of attempts to curb abuse and regulate markets and the existence of offer regulatory laws, there are still too many instances of corporate collapse and/or fraud.

Effective and clear legislation is required which promotes the *Grundnorm*, respects the past development thereof, and adapts effectively to contemporary requirements. To such an extent, the modern requirements should not be deduced from policy or imparted onto a piece of legislation without carefully reviewing the history and applying same in steering through the mist.

The problem statement may as well pre-empt the conclusion of this work in that offer regulation in South Africa is not complete and contributes to enforcement failure by not adhering to or promoting the principles of offer regulation.

#### **4. Ideal regulatory model**

In order to align towards an ideal regulatory model, it is submitted that in the first instance the problems already identified should be addressed. In the second instance, the regulatory framework or system should have the characteristic, through its functioning as well as enforcement, of promoting the principles of offer regulation. The existence of a criminal law system does not prohibit murder or burglary *per se*. In an ideal world perhaps; not in this one. That said, the principles of offer regulation should be strengthened and enforced by legislation to such an extent that

the evolution thereof follows an upward curve. The ideal is not to move backwards, as the counterpart is that abuse will move forward.

In order for offer regulation to comply with the *Grundnorm* and to constitute complete law, the following comes to the fore:

- i) In respect of offers, the regulation of the two capital markets ought to be divided, insofar the South African disposition is concerned;
- ii) The concept of an offer should be effectively applied to the underlying contractual basis;
- iii) In respect of the public, there should be an exhaustive definition of what constitutes a public offer and the concept public should at least be defined in transactional terms;
- iv) Liability provisions should take into account enforcement reality in respect of applicability and execution.

The remainder of this chapter will focus on the aspects outlined in i) to iv) above in respect of the comparative jurisdictions of the United Kingdom and the United States. Deductions based thereon will be used in concluding and recommending legislative reform in the final chapter.

## CHAPTER 6

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### PART A: UNITED KINGDOM

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1. Introduction
2. Legislative framework
3. Financial promotion
4. Prospectus regulation
5. Basis of regulation
6. Exemptions
7. Resales of unlisted securities
8. Liability
  - 8.1. Other civil remedies
  - 8.2. Damages
  - 8.3. Criminal and regulatory sanctions
9. Concluding remarks



## 1. Introduction

In the United Kingdom, company law and offer regulation diverged after the Gower Report and the promulgation of the Financial Markets Act. South Africa remained within the confines of the pre-Gower time whilst the UK saw massive developments in terms of offer regulation away from the Prevention of Fraud and Investments Act towards the Financial Markets Act.<sup>1</sup>

The crucial regulatory divide is similar across all markets, i.e., between offers to the public to acquire the company securities and offers which are non-public.<sup>2</sup> It follows that the regulatory regime will be more elaborate in the former case. This is *contra* the position where the crucial divide is a two pronged affair between public and non-public offers as well as offers in the primary market and offers in the informal secondary market.

The domestic law in the UK, especially the Companies Act of 2006 has been influenced by the Second Company Law Directive of the European Community.<sup>3</sup> The predominant piece of securities regulation is the Financial Services Markets Act of 2000. The past couple of years and especially 2013 have seen some dramatic changes on the regulatory front

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<sup>1</sup> Under the new dispensation, self regulation is preferred in a governmental controlled framework where the governmental controls are exercised by an authorised authority, i.e., *pro ante* regulation with a pro-active regulator.

<sup>2</sup> Davies (2012) *Gower and Davies' Principles* 873.

<sup>3</sup> Directive 77/91/EEC [1997] OJ L26/1.

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in the UK in respect of influences from the European Union as well as the divide of the Financial Services Authority into two regulators.<sup>4</sup>

## 2. Legislative framework

The regulation of securities markets in the UK is derived from the relevant European Community securities directives. Of relevance is the Prospectus Directive.<sup>5</sup> These directives were implemented into UK securities law by Part 6 of the Financial Services and Markets Act 2000 (FSMA) as well as secondary legislation as introduced by the FSMA.<sup>6</sup> Such secondary legislation pertains to the Prospectus Regulations 2005 (SI 2005/1433) as well as applicable provisions of the UK Companies Act of 2006. Financial services regulation is governed in the UK by the Financial Conduct

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<sup>4</sup> Financial Services Authority [http://www.fsa.gov.uk/about/what/reg\\_reform/background](http://www.fsa.gov.uk/about/what/reg_reform/background) (accessed on 24 March 2014). In June 2010, the Chancellor announced the government's intention to replace the FSA as a single financial services regulator with two new successor bodies, and to restructure the UK's financial regulatory framework. In 2013, the FSA was replaced by two new regulatory bodies that are carrying forward the philosophy of outcomes-based regulation, intensive firm supervision and credible deterrence: 1) The Prudential Regulation Authority (the PRA), which is a subsidiary of the Bank of England and is responsible for promoting the stable and prudent operation of the financial system through regulation of all deposit-taking institutions, insurers and investment banks; and 2) The Financial Conduct Authority (the FCA) which is responsible for regulation of conduct in retail, as well as wholesale, financial markets and the infrastructure that supports those markets. The FCA will also have responsibility for the prudential regulation of firms that do not fall under the PRA's scope. The FSA has now become two separate regulatory authorities. The Financial Conduct Authority can be found at [www.fca.org.uk](http://www.fca.org.uk) and the Prudential Regulation Authority at [www.bankofengland.co.uk](http://www.bankofengland.co.uk).

<sup>5</sup> Hudson (2008) *UK Securities Law* 13. There are five directives. First the Consolidated Admission and Reporting Directive of 2001 (Council Directive Number 2001/34/EC); which consolidates the principles of the earlier directives. Secondly, the Prospectus Directive of 2003 (Directive 2003/71/EC (2003 OJ L 345) which was implemented by means of the new listing rule arrangements effected by the then FSA (precursor to the FCA)) on 1<sup>st</sup> July 2005. Thirdly, the Transparency Obligations Directive (Directive 2004/109/EC (2004 OJ L 390)) which was scheduled to be implemented by the Companies Act of 2006. Fourthly, the Market Abuse Directive, dealing with the disclosure of price sensitive information and insider dealing, implemented in 2005 and lastly, the International Accounting Standards Directive, implemented in 2005 relating to the form and content of accounting information provided by companies. Relevant to this discussion is only the Prospectus Directive (PD) which are manifested in the UK through the Prospectus Rules (PR).

<sup>6</sup> This repealed the Financial Services Act of 1986.

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Authority (FCA);<sup>7</sup> the current regulator in terms of offer regulation which is the predecessor of the Financial Services Authority.

There are six EC Directives which are of relevance to public issues of securities.<sup>8</sup> Relevant for this discussion is the Prospectus Directive 2003/71/EC (2003) OJ L 345 as amended by the Prospectus Directive Amending Directive 2010/73/EU.<sup>9</sup> The Prospectus Directive sets out the regime for prospectuses in the EU. It is a level 1 Lamfalussy Directive under the EU Financial Services Action Plan.<sup>10</sup>

The Prospectus Directive is concerned with the approval of a prospectus by the competent authority in a Member State prior to the admission of securities to listing and to the admission of securities to trading on a regulated market.

The Prospectus Directive imposes the core principles on which the FCA Prospectus Rules are based. The Prospectus Directive was implemented in the UK by amendment to the FSMA which was done by means of statutory instrument known as the Prospectus Regulations 2005 and by the creation of the FCA Prospectus Rules.<sup>11</sup> The 2005 Prospectus

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<sup>7</sup> Hudson (2008) *UK Securities Law* 2. Including the manner in which different categories of client are to be classified and treated (derived from the Markets in Financial Instruments Directive (MiFID)); advertisement of financial instruments by way of financial promotion; aspects of market abuse and insider trading and core principles of corporate governance and accounting regulations. Sections 90, 90A and 150 of FSMA 2000 provide powers to impose civil penalties in relation to market abuse and heads of civil liability to pay compensation.

<sup>8</sup> *Ibid* 18. Consolidated Admission and Reporting Directive of 2001; Prospectus Directive; Transparency Directive (collectively the Securities Directives.) The Market Abuse Directive and International Accounting Standards Directive and MiFID (as replaced) related to financial matters generally.

<sup>9</sup> The Amending Directive was published on 24 November 2010 and it came into force on 31 December 2010. Member states had until 1 July 2012 to implement the Amending Directive into national legislation.

<sup>10</sup> FCA Brief: Prospectus Directive (PD).

<sup>11</sup> Hudson (2008) *UK Securities Law* 20.

Regulations<sup>12</sup> was implemented by means of the EC Prospectus Directive by amending existing sections of Part 6 of the FSMA, and also introducing new sections thereto.<sup>13</sup> In terms of publication requirements under the Prospectus Directive, a prospectus must first be approved and published before an offer is made to the public.<sup>14</sup>

An offeror of securities into the UK or to UK persons must determine whether an UK prospectus is required. Previously the distinction was that listed securities were governed by Part VI and Schedule 11 of the FSMA, while unlisted securities were governed by Part II of the Public Offers of Securities Regulations 1995<sup>15</sup> (the POS Regulations).<sup>16</sup> The POS regulations were repealed by the Prospectus Directive (PD). The PD was implemented in the UK on 1 July 2005 and the Directive came into force on 31 December 2010. It sets out when an issuer needs to publish a prospectus, the contents and mechanism for approval. The PD was introduced into UK law by amending Part VI and Schedules 7-11 of FMSA; introducing the Prospectus Rules and repealing POS.

The PD was further amended in 2012.<sup>17</sup> This changed UK law in four places. Firstly, changes to FSMA were made by the Prospectus Regulations 2012 SI 2012 No. 1538. Secondly, it changed the Prospectus

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<sup>12</sup> S.I. 2005/1433.

<sup>13</sup> Hudson (2008) *UK Securities Law* 26. This repealed the UK Prospectus Regulations 1995 S.I. 1995/1537 which dealt with unlisted securities and also the Financial Services and Markets Act 2000 (Official Listing of Securities) Order 2001 S.I. 2001/2958 and Regulations thereof (S.I. 2001/2956) which had dealt with offers of listed securities.

<sup>14</sup> *Ibid* 21.

<sup>15</sup> Statutory Instrument 1995 No. 1537 Financial Services: The Public Offers of Securities Regulations 1995.

<sup>16</sup> Howarth, C & Spencer C (2005) "Regulation of security offerings in the United Kingdom" Herbert Smith Freehills.

<sup>17</sup> The Prospectus Directive 2003/71/EC (PD) has been amended after Directive 2010/73/EC which came into force on 1 July 2012.

Rules made by the then FSA (now the FCA). Thirdly, two EU regulations which have direct effect in the UK, therefore no implementing legislation was required: EU No. 486/2012 and fourthly, a draft regulation at the time, published on 4 June 2012 which amended the EU Prospectus Regulation (EC) No. 809/2004). The FCA updated its Rule Book regarding the Prospectus Rules and incorporated these regulations so that only the Prospectus Rules and the FSMA need to be consulted.<sup>18</sup>

### 3. Financial promotion

Offer regulation in the UK is called prospectus regulation and it is important to differentiate whether securities are to be offered to the public, or whether they are to be the subject of a request for admission to trading on a regulated market; or alternatively whether the offer falls outside either of these categories, or is an exempt offer under the prospectus regulations. The only sense in differentiating between listed or unlisted securities is whether or not the FCA Listing Rules will apply or not.<sup>19</sup> Any offer of securities is likely to involve a financial promotion of the securities. These include all offers on a regulated market, including offers of securities in secondary market sale transactions. It is submitted that the important element is whether *any* offer will be public or not, rather than the question as is asked in South Africa imploring which regulatory regime will apply or not (even if the offer is public).

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<sup>18</sup> Ashurst, Publications by Expertise, (June 2012) “ECM Briefing” [http://www.ashurst.com/publication-list.aspx?id\\_Content=1361&expandExpertiseList=true&id\\_queryContent=5417&page=1](http://www.ashurst.com/publication-list.aspx?id_Content=1361&expandExpertiseList=true&id_queryContent=5417&page=1) (accessed on 1 February 2014); Slaughter & May (Jan 2011) “Amendments to the Prospectus Directive and Transparency Directive” <http://www.slaughterandmay.com/media/1501869/amendments-to-the-prospectus-directive-and-transparency-directive.pdf> (accessed on 16 March 2014).

<sup>19</sup> Hudson (2008) *UK Securities Law* 26.

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A financial promotion is prohibited under section 21 of the FSMA unless it:

- (i) qualifies for an exemption specified in the Financial Promotion Order 2001, for example if it is a promotion only to overseas recipients, investment professionals or high-net-worth companies, or where a prospectus is prepared, as set out below; or
- (ii) is made or approved by a person authorized by the Financial Services Authority (the FSA).<sup>20</sup>

Section 21 of the FSMA prohibits an invitation to engage in investment activity. This is denoted to mean in section 21(8) as entering or offering to enter into an agreement related to the making or performance of which either party constitutes a controlled activity. What is sought to be regulated is investment activity and the engagement therein.<sup>21</sup>

Schedule II to the FSMA, clause 27 provides that offering must be interpreted as including the invitation to treat. The regulated activities in Schedule II, clause 2 refer to section 22(1) of the FSMA and list dealing in investments, ergo the buying, selling, subscribing for or underwriting of investments or offering or agreeing to do so, either as principal or as agent, including as per clause 3, the arranging of deals in investments.

FSMA section 18 relates to regulated and prohibited activities, stating that

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<sup>20</sup> Howarth & Spencer 2005 “Regulation of security offerings in the UK”. Section 21 also lists the exemptions.

<sup>21</sup> It is submitted that this is compliant to the application of an offer in the primary market being an invitation by the company to engage in a contract for subscription. It is further submitted that the application of this definition can be equally applied in the secondary market as it does not rely on a differentiation between subscription and sale or definitions underlying transactions such as a public offering or an initial public offering.

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no person may carry on a regulated activity in the UK unless authorised or exempt.

#### 4. Prospectus regulation

The FCA relies on disclosure as basis of regulation, yet it does not rely on simple disclosure subsequent to an offer. The disclosure by means of the prospectus acts as application for the allowance of the offer to be approved. The disclosure requirements are prescribed and subjected to merit review of the prospectus requirements by the regulator, prior to the offer being approved. This is in stark contrast with South Africa. In South Africa, as already alluded to *supra* only once there is an offer, of securities, to the public, is a prospectus required. This prospectus is filed and filing constitutes registration at the CIPC. The CIPC does not limit trading prior to approval, in conducting a merit review of the prospectus requirements and whether it has been adhered to.<sup>22</sup>

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<sup>22</sup> The question may be begged as to either the continued relevance of offer regulation or the need for more stringent regulation into the affairs of the company in extending the offer. It is submitted that in the first instance, any offer regulatory regime must boast underlying legislation which is unambiguously stated without errors with reference to transactional relativity whereas all applications of the law is provided for. It follows that with ambiguously stated law, rife with errors, not only will the deterrent effect of the *ex ante* regulatory regime be inhibited but also enforcement efficacy by means of reactive *ex post* enforcement of the liability provisions. Only after the ideal situation as posited is obtained, can the role of the regulator be assessed. Currently the CIPC acts as regulator, yet it is a passive role insofar as enforcement is concerned when juxtaposed to the Securities Exchange Commission in the United States. In South Africa, the Courts act as reactive (*in lieu* of pro-active) enforcer, *ex post*. Although South Africa may be a long way from the substantial review of offering documentation based on merit requirements prior to the offer becoming effective (i.e., allowance obtained for trading), it is verily possible to introduce a pro-active mandate on the regulator in approving the prospectus (as offering) based on a review of compliance based requirements. Under such a regulatory dispensation, *any* offering of *any* security will attract regulatory purview in terms of the requirements to file an offering / prospectus prior to same becoming effective for trading, denoting compliance where the choice of a company is removed in respect of a public offering as to whether the company is required to disclose or not, and what needs to be disclosed. The offer will be filed with a declaration, indemnifying the CIPC from liability and confirming relevant details of regulation (type of offer, type of security). Where an exemption is relied upon, the regulatory dispensation will require an application for the exemption to be effective.

Section 87A(1) of the FMSA provides for the approval of a prospectus by the FCA and that the FCA may not approve a prospectus unless it is satisfied that:

- a) the UK is the home State in relation to the issuer of the transferable securities to which it relates;
- b) the prospectus contains the necessary information as prescribed by the FCA Handbook and Prospectus Rules, and;
- c) all of the other requirements imposed by or in accordance with this Part or the prospectus directive have been complied with (so far as those requirements apply to a prospectus for the transferable securities in question).

In terms of paragraph 3.1.8 of the Prospectus Rules, the FCA will only approve a prospectus when it considers and is satisfied that the information provided with the application is complete and is in final form.

Paragraph 3.1.9 of the Prospectus Rules provides that the FCA will follow the executive procedures for statutory notice decisions and statutory notice associated decisions if it:

- a) proposes to refuse to approve a prospectus; or
- b) decides to refuse to approve a prospectus after having given the applicant a written notice.

Paragraph 3.1.10 of the Prospectus Rules provides that a prospectus must not be published until it has been approved by the FCA.



Part II of the FSMA lists regulated and prohibited activities under the Act. Section 19 provides for the general prohibition in that no person may carry on a regulated activity unless an authorised person or an exempt person.

Section 19 must be read with section 22 which provides for regulated activities which are provided for as any activity of a specified kind which is carried on by way of business and relates to an investment of a specified kind or is carried on in relation to property of any kind. Schedule 2 provides for supplementation of regulated activities. Investment means any asset, right or interest and specified means specified in an order of the Treasury.

A security is defined in section 74(5) in terms of Part II as anything which has been or may be admitted to the official list. Listing means inclusion in the official list. Section 75 provides for listing and holds that admission may be granted only on application to the authority and same may not grant a listing unless satisfied that the requirements of the listing rules and any other requirements imposed by the authority have been complied with.<sup>23</sup> Section 84 provides for prospectuses and new securities being defined as those offered to the public for the first time prior to admission on the official list.

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<sup>23</sup> Section 75(4).

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**5. Basis of regulation**

Offers of transferable securities require the publication of an approved prospectus under section 85(1) of the FSMA. It is a criminal offence to fail to have a prospectus approved and to publish it.<sup>24</sup> The first offence deals with offers to the public without a prospectus, relating to an offer having been approved first under the FSMA, section 85(1):

It is unlawful for transferable securities to which this subsection applies, to be offered to the public in the United Kingdom unless an approved prospectus has been made available to the public before the offer is made.

Thus a prospectus must be approved and made available prior to the offer. Secondly, any request for admission to trading on a regulated market requires a prospectus in terms of section 85(2) of the FSMA which sets out a second criminal offence which may also give rise to civil liability to compensate for loss, in the following terms:<sup>25</sup>

It is unlawful to request the admission of transferable securities to which this subsection applies to trading on a regulated market situated or operating in the United Kingdom unless an approved prospectus has been made available to the public before the request has been made.

A prospectus must be published and approved by the FCA where there is an offer of transferable securities to the public (public offer trigger) and/or

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<sup>24</sup> Hudson (2008) *UK Securities Law* 28.

<sup>25</sup> *Ibid.*

when securities are admitted to trading on a regulated market in the EU (regulated market trigger).

The Prospectus Rules at rule 1.2 sets out the requirements for a prospectus and the exemptions thereto. This is not to be confused with the content of a prospectus. Rule 1.2 provides that sections 85 and 86 of the FSMA provide for when a prospectus approved by the FCA will be required.

Section 85(1) provides that it is unlawful for transferable securities to be offered to the public in the UK unless an approved prospectus has been made available to the public before the offer is made. In respect of listing, section 85(2) provides that it is unlawful to request the admission of transferable securities on a regulated market unless an approved prospectus has been made available to the public before the request is made.<sup>26</sup>

An offer is defined in Appendix A to the PR as an offer of transferable securities to the public. An offer of transferable securities to the public is defined in section 102B of the FSMA as:

- a) a communication to any person which presents sufficient information on:
  - i) the transferable securities to be offered, and

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<sup>26</sup> Section 85(3) criminalises these contraventions and the offender is liable to imprisonment not exceeding 3 months and/or a fine not exceeding the statutory maximum when summary conviction proceedings are followed, i.e., when an offender pleads guilty. On conviction on indictment, the prison term is 2 years without the option of a fine. Section 85(4) provides for civil liability for any person suffering loss due to contravention of the above requirements.

- ii) the terms on which they are offered to enable an investor to decide to buy or subscribe for the securities in question;
- b) which is made in any form or by any means;
- c) including the placing of securities through a financial intermediary;
- d) but not including a communication in connection with trading on:
  - i) a regulated market;
  - ii) a multilateral trading facility,
  - iii) any market prescribed by an order under section 130A of the FSMA.

The obligation to publish a prospectus arises when there is an offer of transferable securities to the public, or when an application is made for listing. It is an offence to seek to offer securities without an approved prospectus which has been published.<sup>27</sup>

Offer of securities to the public in terms of the PD means a communication to persons in any form and by any means, presenting sufficient information in the terms of the offer and the securities to be offered, so as to enable an investor to decide to purchase or subscribe to said securities. It is held as not a great example of drafting.<sup>28</sup>

The effect of requiring prospectuses to be prepared and published in an approved form in relation to any securities which are the subject of an

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<sup>27</sup> Section 85.

<sup>28</sup> Davies (2012) *Gower and Davies' Principles* 917. It does not help to define the trigger for disclosure.

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application for admission to trading on a regulated market, is that the prospectus regulations will now apply even to such offers which would previously have been exempted from the need of a prospectus.<sup>29</sup>

It is to be noted that in the UK, the prospectus is the offer and application for allowance to the market to trade, and the root of any contract for the acquisition of securities. The prospectus contains a series of representations on which purchasers will base their investing decisions.<sup>30</sup>

This is in contrast to South Africa, where an offer must be accompanied by a prospectus on the one reading and on the other; it will appear that the prospectus is the offer. Where the safeguard locally is that no offer may be made without a prospectus, (or that the prospectus is the offer) denoting the offer is to be accompanied by a prospectus; in the UK, regulation prohibits any security offerings without an approved prospectus. There is an offer of transferable securities to the public if there is a communication to any person which presents sufficient information as to the transferable securities offered, and the terms on which they are offered, so as to enable an investor to decide to buy or subscribe for the securities in question.<sup>31</sup>

An offer to only one person will be an offer to the public, unless exempted.<sup>32</sup>

Section 756 of the 2006 Companies Act also provides for the definition of what a public offer is. “Public” includes a section of the public (“however

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<sup>29</sup> Hudson (2008) *UK Securities Law* 27. The widening of the ambit of prospectus regulation in the EU has increased the costs associated with various kinds of securities issues which were previously exempt from this sort of regulatory scrutiny.

<sup>30</sup> *Ibid.*

<sup>31</sup> Section 102B.

<sup>32</sup> Hudson (2008) *UK Securities Law* 2.

selected”). The definition excludes an offer which “can properly be regarded, in all the circumstances, as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by person other than those receiving the offer or invitation.”<sup>33</sup> Also excluded are offers which are of “domestic concern” to the company, into which category fall, offers to the existing members or employees of the company, their families, and debenture holders of the company or a trustee for any of them.<sup>34</sup> This definition is in conflict with the definition of a “public offer” as used for public offerings of shares in the PD as it does not fit the definition of a public offer in the PD which determines whether a prospectus is required (and regulates the content thereof). Due to the “offerees only” exemption in the Companies Act, some offers regarded as private under the Act might be public under the PD. The exemption does not set a limit on the number of people who receive the offer nor does it impose any qualification as to their experience or qualifications as investors, whilst the central exemptions in the PD turn on both these issues.<sup>35</sup> A company can make a private offer without contravening the Companies Act and yet contravene the PD. The Company Law Review recommended alignment of the definition of a public offer in the Companies Act with that in the PD but opined that the lack of it was not in principle objectionable due to different policies being

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<sup>33</sup> Section 756(3)(a). If the securities do in fact end up in public hands within six months of their initial allotment or before the company has received the whole of the consideration for the shares, the company is presumed to have allotted them with a view to their being offered to the public in terms of section 755(3).

<sup>34</sup> Section 756(3)(b)-(6).

<sup>35</sup> Davies (2012) *Gower and Davies' Principles* 875-6.

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pursued by the two sets of rules.<sup>36</sup> It stands that the public offering definition in the Companies Act is coupled to the differentiation between a public and private company.

## 6. Exemptions

The PD at article 3(1)(a) and the FSMA section 86 which is incorporated in PR 1.2 lists the exempted offers to the public. Section 85(1) is not contravened in terms of section 86(1) if the offer is made to or directed at qualified investors; or to 150 persons other than qualified investors per EEA State; or the minimum consideration is at least 100 000 euros or are in denominations of 100 000 euros each or the total consideration for the securities offered in the EEA does not exceed 100 000 euros or the offer falls within subsection (1A).

Subsection (1A) provides that an offer will be exempt where the securities are resold or placed through a financial intermediary where the securities have been the subject of one or more offers to the public; any of such offers were exempt under 86(1)(a)-(e); a prospectus is available for the securities which has been approved by the FCA, meeting the requirements of subsection (1B); or the issuer, or other person who was responsible for drawing up the prospectus, has given written consent to the use of the prospectus for the purpose of the current offer.

Subsection (1B) provides that the conditions relevant to subsection (1A)(c) are that the prospectus had to be approved by the FCA no earlier than 12 months before the current date of the offer and supplemented by

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<sup>36</sup> *Ibid.*

every supplementary prospectus required in terms of section 87G; or in the case of non-equity transferable securities falling within article 5(4)(b) of the PD, that the securities concerned have not ceased to be issued in a continuous or repeated manner.

In terms of section 86(2) where a person who is not qualified as an investor has engaged a qualified investor to the markets in financial interments directive to act as his agent; and the terms on which the qualified investor is engaged enable him to make decisions concerning the acceptance of offers of transferable securities on the client's behalf, the offer made to or directed at the qualified investor is not to be regarded for the purposes of subsection (1) as having been made to or directed at the client.

Rule 3.1.7 provides for the approval of a prospectus in accordance with section 87A(1) of the FSMA. It provides that the FCA may not approve a prospectus unless it is satisfied of the UK being the relevant jurisdiction, that the prospectus contains the necessary information and that all of the other requirements imposed have been complied with. Rule 5.1.1 provides that a prospectus will be valid for 12 months after its approval, provided it is updated by a supplementary prospectus if required, under section 87G.

Rules 1.2.2 and 1.2.3 exclude certain types of securities. The PD at article 4(1)(b),(c) and FSMA section 86(5)(b) and Prospectus Rule 1.2.2 covers those who do not need the prospectus, but will be able to obtain the information by some other means. PD at article 4(1)(a),(d),(e) and FSMA section 86(5)(b) and Prospectus Rule 1.2.2 excludes offerings as



fundraisers, i.e., who receive new shares in the substitution for their existing shares if there is no increase in the issued share capital. This is typically employee or director's share schemes. Rule 1.2.3 covers the admission to trading on a regulated market in terms of exemptions. The exemptions do not behave a full exposition, save to state that the language in Rule 1.2.2 and Rule 1.2.3 do not allow for a non-public offering exemption. The inclusive exposition reads as follows: "*In accordance with section 85(5)(b) of the Act, section 85(1) of the Act does not apply to offers of the following types of transferable securities....*" (Rule 1.2.2). Rule 1.2.3 provides that: "*In accordance with section 85(6)(b) of the Act, section 85(2) of the Act does not apply to the admission to trading of the following types of transferable securities....*"

Lastly, and according to Davies, the most contention is where the information is admittedly useful but the cost of providing it is thought to be out of proportion to the benefits flowing from it, the PD excludes a number of small offers.<sup>37</sup> Where the offer is fewer than five million euros over 12 months, the PD will not apply. Also, where the offer is to fewer than 150 persons, legal or natural.

It is more desirable to have *ex ante* mechanisms in place designed to ensure that the information provide is complete and accurate prior to publication. The FCA Rules and the FSMA provides for same through a vetting by the FCA in accordance with PD article 13 and FSMA section 87A. It follows that debate surrounding an offer to the public or a section

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<sup>37</sup> PD at article 1(2)(h) and FSMA section 85(5)(a) and Schedule 11A paragraph 9. See also Davies (2012) *Gower and Davies' Principles* 920.

of the public is removed by this definition. Also, the possibility of a non-public common law offer is removed as the provisions regarding exemptions do not allow for ambiguity in that regard, setting a closed list, juxtaposed to South Africa where an unregulated non-public common law category exists and the United States where a regulated non-public common law category manifests itself.

#### **7. Resales of unlisted securities**

The informal secondary market sales of shares are prohibited per implication in terms of section 21 if not occasioned by an authorised person or an exempt person. Therefore any dealing in securities will attract regulatory purview under the definitions, and where a shareholder wishes to dispose of his or her shares, it must be done by means of an authorised person, registered as such with the FCA. Where such a sale constitutes a public offering, one of the exemptions would have to apply.

The offer of shares, depositary receipts or other securities will generally constitute a financial promotion, namely an invitation or inducement to engage in investment activity. A financial promotion cannot be made to a retail investment audience unless the promotion is communicated or approved by a firm authorised by the FCA or it benefits from an exemption from the financial promotion regime.

Article 3(2) of the PD provides for secondary market sales of unlisted securities. Resales of securities by intermediaries constitute separate offers under the PD and require a separate exemption from the original offer, or publication of a prospectus. The amendments provide that no

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new prospectus is required in a subsequent resale or final placement of securities as long as a valid prospectus is available and the issuer or the person responsible for the prospectus consents to its use by means of a written agreement.<sup>38</sup>

As stated, the Prospectus Rules apply also to unlisted securities. It replaces the old listing rules and the Public Offers of Securities Regulations.<sup>39</sup> The Prospectus Rules excludes certain types of offerings and securities from the obligation to publish a prospectus including offers addressed solely to qualified investors; offers made or directed at fewer than 100 natural or legal persons or offers of a class of securities representing less than 10 percent of the number of securities of the same class already admitted to trading on the same or regulated market.<sup>40</sup> Private placements are exempted and applicable to less than 100 persons and where the securities are not admitted to a regulated market. Also, an offer to qualified investors or where the minimum consideration is equal per unit to 50 000 euros and does not exceed in total 100 000 euros over 12 months.<sup>41</sup>

The core principle under the FSMA is that no person may trade in shares unless exempted or authorised. A person wishing to sell his or her shares in the informal secondary market will be obliged to use such a trader.

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<sup>38</sup> The annexures to the PR sets out the information required in such consent. The exemptions is subject to the conditions as set out in FSMA section 86(1A). Ashurst (2012) “ECM Briefing” *supra* advises that in the case of equity issues, this is only likely to be relevant in the rare cases of where Banks or Brokers buy the shares as principal and on-sells them to the public (usually the offer is either directly by the issuer or through the bank or broker as agent (firm underwriting)).

<sup>39</sup> Getting the Deal Through: “Securities Finance in 18 Jurisdictions Worldwide”- Supplement on the United Kingdom, Brien P & Symondson R, Slaughter and May. See also Statutory Instrument 1995 No. 1537 Financial Services: The Public Offers of Securities Regulations 1995.

<sup>40</sup> *Ibid.*

<sup>41</sup> *Ibid.*

Limiting the transactions in this market to authorised traders or intermediaries excludes abuse. The requirement for disclosure is avoided. The trader will be protecting his or her reputation and as he or she depends on the goodwill of the public, transactions will be considered with care. Information can be provided to the buyer by him or her due to the intermediaries' financial sophistication.<sup>42</sup>

It is not the intent to venture into the history and the applicability of section 101 of the 2008 Act. The history and development of the regulating provision in respect of resales has been written about in the exposition of Delport.<sup>43</sup> However, for context, it is worth stating that from an overview of the material available it is clear that section 101 is a historic remnant clinging to its applicability in a modern regulatory regime.<sup>44</sup>

Section 101 of the 2008 Act is the predecessor of section 141 of the 1973 Act. Section 141 was preceded by section 80*bis* of the 1929 Act. Section 80*bis* was inserted into our law by the Companies Amendment Act 23 of 1939 in recommendation of the Lansdown Commission.<sup>45</sup> Section 80*bis* was derived from section 356 of the English Companies Act of 1929, which was inserted on recommendation of the Greene Commission to prohibit the hawking of shares and to ensure a minimum requirement of

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<sup>42</sup> See discussion in Delport *Die verkryging van kapitaal* (1987) 665-695.

<sup>43</sup> Delport *Die verkryging van kapitaal* (1987) Chapter 12.

<sup>44</sup> The extent of investor protection based on the information to be disclosed is questionable. It was argued *ibid* that the trading of shares in the secondary market be limited to approved dealers or intermediaries. This excludes the concept of public and disclosure as is relevant in the system currently in place in the UK. Self-regulating with governmental purview of traders or intermediaries and an obligation on the latter to ensure that offers comply with the required provisions will ensure a more effective system.

<sup>45</sup> Lansdown Report 16. See also Delport *Die verkryging van kapitaal* (1987) 677.

disclosure. Section 356 was replaced by section 12 of the Prevention of Fraud (Investments) Act of 1939 after a short run on the statute books. This Act followed recommendations from the Bodkin Commission<sup>46</sup> and Anderson Commission.<sup>47</sup> The 1939 Act was replaced by the 1983 Act with same title. It was the aim of the latter Act to regulate the secondary market by means of registered or exempt traders or intermediaries.<sup>48</sup> The prohibition was against the distribution of circulars aiming to conclude a transaction or to conclude a transaction with the aim to make a profit from trading in securities. An important exemption was a primary offer

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<sup>46</sup> Great Britain & Bodkin AH (1937) *Share-Pushing: Report of the Departmental Committee Appointed by the Board of Trade 1936-37* London: H M Stationery Off. See also Delpont *Die verkryging van kapitaal* (1987) 681.

<sup>47</sup> Great Britain, Board of trade Committee on Fixed trusts, Sir Alan Garrett Anderson (1936) *Fixed Trusts: Report of the Departmental Committee Appointed by the Board of Trade* London: HMSO. See also Delpont *Die verkryging van kapitaal* (1987) 681.

<sup>48</sup> See chapter 5 part A, paragraph 2.3 *supra*. PFIA of 1958 regulated the secondary market of securities by means of registered or exempted traders. No person may have distributed documents or cause to distribute circulars which contained an invitation to conclude an agreement or to make an offer to conclude an agreement in order to obtain securities, to alienate, to subscribe or underwrite, or to conclude an agreement with the aim of obtaining a profit from the proceeds of the securities or from the difference in the price of the securities. See sections 14(1)(a)(i) and 13(1)(a),(b) and (c) of PFIA. These provisions if contravened constituted criminal offences. The only persons who could conduct the business with reference to dealing in securities had to be licensed or exempt traders. Primary market transactions were excluded as the issuance of a prospectus on application form of shares together with a prospectus did not denote trading in shares in terms of the PFIA section 2(2)(b) and (d). Where a person wished to trade in securities they had to apply for a license in terms of section 3 and 4 of the PFIA. Where the PFIA relied on governmental regulation, the Financial Services Act provided for regulation inside a statutory framework. The result was that no person could trade as if not part of an investment firm or investment business unless exempted or authorized to do so per section 326 of the Financial Services Act. This has been carried forward in the FSMA. It follows that secondary market transactions of unlisted shares had to be in accordance with a licensed or exempt dealer. In general the provisions of section 101 have to be complied with concerning offers extended to the public for the sale of securities, unless it is a trade in the formal securities market under which it is then excluded and regulated by the Financial Markets Act of 2012. It was recommended by Delpont that the trading of shares in the informal market be limited to approved traders or intermediaries whereby a couple of deficiencies could be excluded (see Delpont *Die verkryging van kapitaal* (1987) 695). The concept of “public” as expounded in the *Gold Fields* case perpetuated the problems occasioned in the interpretation of the *Rossouw* cases which added to the recommendations in the Van Wyk de Vries Reports. In the 2008 Act, these problems are extended to impact on the liability and enforceability of Chapter 4 regulation of offers. Delpont opined that the secondary market offer to the public and the information required to be submitted was insufficient for an investor to make an informed choice. The information might also be difficult to obtain or impossible due to the fact that it is exclusively within the control of the company. It is submitted that these problems still exist. Following the system currently in place in the UK will have the benefit that all trading will be done by licensed or authorized persons and the requirements for disclosure are excluded. The intermediaries are dependent upon public opinion in successfully conducting their business and will ensure above board trading.

transaction where a prospectus was issued or not required. Traders had to be licensed or exempt and only some could trade on behalf of investors. The Financial Services Bill, following Gower, provided for the replacement of the 1983 Act.<sup>49</sup> The Financial Service Bill provided for the Financial Services Act which gave rise to the FSA, which ultimately gave rise to the dispensation currently in force in the UK under the FSMA and the FCA. The most important deduction to be made is that South Africa is still stuck with provisions replaced in 1939. The short synopsis of the history above shows constant evolvement in the UK. These developments had to be considered prior to merging the provisions of section 101 into Chapter 4 as it is evident that although regulation is required in respect of the secondary informal market, the existing provisions are outdated and do not contribute towards the premise of complete law.

In this regard, in the UK, Statutory Instrument 2005 Number 1529: Financial Services and Markets<sup>50</sup> controls certain activities and controlled investments. In terms of clause 3 to Schedule 1, Part 1, the dealing in securities and contractually based investments are controlled activities. Buying, selling, subscribing for or underwriting securities or contractually based investments are controlled. Clause 4 provides for the arranging of deals in investments and provide for the control of making arrangements as either principal or agent for another person to buy, sell, subscribe for or underwrite an investment which is a security, a contractually based investment or an investment specified by the Order. Section 4 defines

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<sup>49</sup> Delpont *Die verkryging van kapitaal* (1987) Chapter 12.

<sup>50</sup> Statutory Instrument 2005 Number 1529: Financial Services and Markets “The Financial Services and Markets Act 2000 (Financial Promotion) Order 2005.

controlled securities as above and controlled investments per reference to Schedule 1. Section 5 and section 21(1) restrict financial promotion. Part VI in sections 12 to 73 provides an extensive list of exemptions applicable to exempt communications pertaining to the controlled activities where relevant. The discussion does not behave an exposition on this save to state that once-off real time communications concerning an offer are exempt, together with unsolicited communications on a once-off basis. These are to be read with section 21 of FSMA which restricts financial promotion that provide for the prohibition of communicating in the course of business, an invitation or inducement to engage in investment activity. An authorised person and the content of the disclosure, where approved are exempt. Engaging in an investment activity means the entering or offering to enter into any agreement for the making or performance related to a controlled activity. Section 21 provides for criminal liability if these provisions are contravened. Section 26 provides that any agreement in contravention of the general prohibition is unenforceable and the claimant may claim *restitutio in integrum* as well as damages.

In South Africa, the Financial Markets Act of 2012 provides in section 1 for a definition of “advice” as to mean any recommendation, guidance or proposal of a financial nature furnished, by any means or medium to a client or group of clients in respect of the buying and selling of securities. Section 5 provides for, under Chapter II, the regulation and supervision of financial markets in what seems is a move towards the FSMA. These regulations have not yet been published. Section 5(1)(a) provides for the regulation of unlisted securities. It is submitted that the stage is set for

regulation in accordance with the Financial Promotion Order read with the FSMA and to do away with section 101 *in toto*. Until then, interim arrangements per amendments are required and will be dealt with in the following chapter.

## 8. Liability

In addition to the statutory provisions which create a compensation remedy for those who have suffered loss as result of misrepresentations in, or omissions from prospectuses, the FSMA in section 85(4) provides for a civil remedy for a person who has suffered loss as a result of a breach of the prohibition to offer shares to the public before a prospectus is published. Section 90 of the FSMA provides liability to compensate to persons who have acquired securities and suffered loss as a result of a misleading statement or omission. In terms of this section anyone who has acquired the securities, whether for cash or otherwise, or whether directly from the company or by purchase on the market, can claim for damages. The previous section in the 1985 Companies Act provided for only those who subscribed for shares and excluded purchases on the market.<sup>51</sup> The extension to the markets may seem unreasonable, but Davies argues that the fact is that the prospectus is intended to influence not only applications to the company for shares but also the initial dealings in them, not trading below the offer price after purchase. Reliance need not be shown, only that the error affected the market place.<sup>52</sup>

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<sup>51</sup> Davies (2012) *Gower and Davies' Principles* 931.

<sup>52</sup> *Ibid.* A causal connection between the loss and the misstatement or omission will have to be proven. This section also does not apply to invitations published separately from the prospectus, nor is the Admission Document under AIM covered. The investors under the latter will have to rely on the



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Concerning the persons responsible and thus liable to pay the compensation, the Prospectus Rules at 5.5 lists the usual suspects of the issuer, its directors with prohibitions concerning publication without knowledge or consent, persons named in the prospectus per authorisation, persons accepting responsibility, authorised the contents and the offeror of the securities or the company seeking admission and its directors where it is not the issuer. The latter takes account expressly of secondary offers, but the offeror will not be liable if it is making the offer in association with the issuer and the issuer has taken the lead in drawing up the prospectus. What is telling is the specific inclusion of the issuer, which affords a remedy against the company itself.<sup>53</sup>

#### 8.1. Other civil remedies

Typical remedies available under securities laws are superior to those under general law. This brief discussion will elucidate on the subject. Typical there may be cases where the legislation does not apply. Typically non-prospectus material or where there is no public offer. Alternatively, rescission may be required other than damages. The law of misrepresentation in issue documents will apply, following the exposition of English law in terms of its well-developed criminal and delictual jurisprudence related to company law.

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common law or under the UK Misrepresentation Act; although Davies *ibid* opine that lower level liability is required.

<sup>53</sup> Davies (2012) *Gower and Davies' Principles* 933.

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## 8.2. Damages

It follows that a misrepresentation at the common law is understood as a misstatement of a fact rather than an opinion or a promise or forecast. There must be a positive misstatement rather than an omission to state a material act. An omission which causes the document as a whole to be misleading or falsifies a statement is however actionable. Only fraudulent misstatements which were knowingly false or reckless concerning the truth were actionable, ergo an honest belief in the truth of the statement will not be deceit. This was followed in the *locus classicus* of *Derry v Peek*<sup>54</sup> which led to the introduction of statutory curtailment relating to misstatements in prospectuses as per above. In addition, delict requires reliance by the recipient on the statement, and that the maker of the statement should have intended for the recipient to rely on it. It follows that these are formidable hurdles to establish liability.<sup>55</sup> Since then, section 2(1) of the Misrepresentation Act of 1967 introduced a statutory remedy for negligent misstatement, which also reverses the burden of proof to the defendant to show he or she is not liable. Section 2(1) is typically used for misstatements in any other document than a prospectus, but related to the offer, noting that liability only extends to the subsequent contract, i.e., it will not be possible to sue the directors or the company, but the agents thereof where incitement to make an offering for subscription was extended due to a non-prospectus related document or enticement.<sup>56</sup> It is unsure whether the company can be held liable for

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<sup>54</sup> *Derry v Peek supra*.

<sup>55</sup> Davies (2012) *Gower and Davies' Principles* 935.

<sup>56</sup> *Ibid*.

accepting the offer without providing the prospectus. It verily may be that the question depends on reliance on which document and it will come down to a matter of evidence. The company may be sued subsequently as a new contractual relationship between the purchaser and the company comes into existence.

Rescission and breach of contract may also be considered as options, but will not be discussed in detail here, save for the issue of breach of contract. The problem with breach of contract is that it must be provided for explicitly by means of legislation. The shareholder might be able to claim for the loss of the expected profit on the shares. The difficulty facing such claims against the company is that the processes of allotment of shares and entry in the register entail a complete novation. The old contract is based on the prospectus. The new contract novated the old one upon registration with the company of the shares. *Addlestone Linoleum Co. Re*<sup>57</sup> illustrates the possibilities and problems arising out of breach of contract claims against the company, or where statute does not exclude novation in respect of liability provisions. In section 655 of the Companies Act of 2006, the rule that a shareholder cannot recover damages against the company unless the allotment of shares is also rescinded has been abolished. Also prospectuses stop short of making explicit promises about future value or performance.<sup>58</sup>

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<sup>57</sup> *Re Addlestone Linoleum Co Re* (1887) 37 Ch D 191 (CA). See also the discussion in Davies (2012) *Gower and Davies' Principles* 939.

<sup>58</sup> Davies (2012) *Gower and Davies' Principles* 938-9.

### 8.3. Criminal and regulatory sanctions

FSMA section 85(3) grants powers to the FCA to invoke criminal sanctions. The maximum penalty is a prison term of not more than two years and/or a fine. The principal non-civil actions are regulatory ones in the hands of the FCA.<sup>59</sup> True to the nature of a pro-active regulatory regime, the FCA has *ex ante* controls and *ex post* sanctions. Concerning *ex ante* controls it has two veto powers relevant to the public offering process. It can refuse admission to listing where the applicant does not meet the eligibility requirements. Secondly, it must not approve a prospectus if it does not contain the required information or where other breaches of the applicable rules are detected. Concerning *ex post* sanctions, an offer or listed securities may be suspended together with various fines.<sup>60</sup>

## 9. Concluding remarks

FSMA Part II provides for a general prohibition against regulated activities unless authorised or exempt.<sup>61</sup> Section 21 provides for financial promotion and prohibits communication or invitations relating to investment activities, unless authorised or an exemption applies. Regulated activities denote in terms of section 22, investments or property related offers. Of importance are the application of section 85 and 86 to the Prospectus Rules and also the application of the concept of “financial promotion” towards the statutory instrument related to unlisted securities in the secondary market. In South Africa, section 101 has evolved from

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<sup>59</sup> FSMA section 401.

<sup>60</sup> Davies (2012) *Gower and Davies' Principles* 941.

<sup>61</sup> Section 19.

earlier rudimentary provisions in English law, aimed against the hawking of shares. Interpretational difficulty in respect of the interpretation of secondary market sales in offer regulatory provisions in South Africa secured the recommendations that primary market and secondary market regulation occur in different Chapters of the 1973 Act. In England, these types of provisions were done away with. Similarly, in South Africa there were arguments against this type of regulation, even in the 1973 Act due to limited applicability and value of provisions regulating the resales of securities to the public. In the UK, these types of transactions are not differentiated from primary market transactions. All offers of any securities to the public will fall under regulatory purview. In the UK, provision is made for bona fide resales to be conducted through authorised brokers, unless the transaction is a public offer. It follows that when it is a public offer, the transaction will be regulated in terms of the disclosure and merit requirements of the regulator. Therefore, the UK does not differentiate between primary and secondary market regulation in respect of public offers.

## CHAPTER 6

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### PART B: UNITED STATES OF AMERICA

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2. Legislative framework
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4. Disclosure mechanism
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## 1. Introduction

The United States, at federal level, opted for a disclosure based system, following the UK,<sup>1</sup> which in turn was followed by South Africa in respect of the disclosure aspect juxtaposed to pure merit regulation.<sup>2</sup> It will thus be worthwhile to review the regulatory regime in the US. The focus of this review will be with the federal legislation. It will be shown in this part, that the US in its Securities Act of 1933 does not differentiate between an IPO and a PO. An issuer must file a registration statement with the SEC as part of the registration process.<sup>3</sup> Two principle settings for buying and selling securities exist - issuer transactions which are primary market transactions and trading transactions which are typically in the secondary market.<sup>4</sup> There are also no separate regulatory provisions in respect of primary market transactions and informal secondary market transactions as is present in South Africa. It will be shown that in the US, any offer to the public will fall under regulatory purview, unless exempted. The exemption provisions form the basis of regulation as all offers are subjected to the registration and disclosure requirements in section 5.

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<sup>1</sup> Loss (1988) *Fundamentals* 1-3.

<sup>2</sup> Delpont *Die verkryging van kapitaal* (1987) Chapter 13.

<sup>3</sup> Getting the Deal Through: "Securities Finance in 18 Jurisdictions Worldwide"- Supplement on the United States, Greene M (ed), Cravath, Swaine & Moore LLP  
<https://gettingthedealthrough.com/area/36/jurisdiction/23/securities-finance-2014-united-states/>  
(accessed on 16 March 2014). To facilitate disclosure of material information about the issuer and the offering, the SEC promulgated Regulation S-K which governs disclosure generally and Regulation S-X which governs financial disclosure, which collectively codifies the US disclosure requirements for registration statements, regardless of whether the offered securities are in the primary or secondary markets.

<sup>4</sup> Cornell University Law School, Legal Information Institute "Securities, The Setting for Buying and Trading" <http://www.law.cornell.edu/wex/securities> (accessed on 2 February 2014). On the one hand, issuer transactions are the means by which businesses raise capital. These transactions involve the sale of securities by the issuer to investors. On the other hand, trading transactions refer to the purchasing and selling of outstanding securities among investors. Investors trade outstanding securities through securities markets that can be either stock exchanges or "over-the-counter."

These aspects will be reviewed in detail below. Because the US does not differentiate between the regulation of offers as in Chapter 4 (which is based on the analysis of the UK an artificial divide and a remnant from history which has outlived its usefulness), it is important to note the system in the US in order to derive at a conclusion as to how to implement a suitable system in South Africa with necessary variations.

## 2. Legislative framework

The first of the federal securities laws is the Federal Securities Act of 1933, which regulates the public offering and sale of securities in interstate commerce.<sup>5</sup> The 1933 Act or Securities Act, adapted the disclosure philosophy of the British prospectus provisions of 1929 by requiring the registration with the SEC of distributions of securities.<sup>6</sup> The Securities Act requires that every offer and sale of a security in the US be registered with the SEC unless an exemption is available.<sup>7</sup> Therefore it is submitted that avoidance or confusion between regulatory regimes which are market dependant is excluded. Secondly, the Securities Exchange Act of 1934 regulates distribution in the secondary market (post distribution).<sup>8</sup>

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<sup>5</sup> *Ibid.* This Act also prohibits the offer or sale of a security not registered with the Securities Exchange Commission and requires the disclosure of certain information to the prospective securities' purchaser.

<sup>6</sup> Loss (1988) *Fundamentals* 36.

<sup>7</sup> *Ibid* 8-15. Not all states have implemented the Uniform Securities Act. Notable exceptions are New York and California. At state level, state regulatory legislation is predominantly anti-fraud in their nature with merit based regulation through the registration of securities. The two systems synergize where the federal prospectus becomes effective, it automatically becomes effective at state level unless the state administrator has issued a stop order under the substantive standards of state securities legislation. A coordination philosophy thus exists without sacrificing the traditional regulatory philosophy of the states to the disclosure philosophy under federal laws.

<sup>8</sup> Fn 5 *supra*. The SEC is charged with administering federal securities laws. The Securities Exchange Act of 1934 also regulates officers, directors, and principal shareholders in an attempt to maintain fair and honest markets. The Act requires that issuers, subject to certain exemptions, register with the SEC if they want to have their securities traded on a national exchange. Issuers of securities registered under the 1934 Act must file various reports with the SEC in order to provide the public with adequate information about companies with publicly traded stocks. The 1934 Act also regulates proxy solicitation and requires that certain information be given to a corporation's shareholders as a



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The Securities Act of 1933 regulates newly issued securities. The Act provides for the filing of a registration statement with the SEC as well as general prohibitions to trading, exemptions and liability provisions. The Securities Exchange Act of 1934 provides for the regulation of trading concerning issued securities. It established oversight by means of the SEC and has reporting standards together with broad anti-fraud provisions.<sup>9</sup>

### 3. Basis of regulation

Offer regulation in terms of the 1933 Act is occasioned by the interrelationship between the definitions in section 2 and the prohibitions relating to interstate commerce and the prohibitions in section 5. Under section 5 of the Securities Act, all issuers must register non-exempt securities with the Securities and Exchange Commission (SEC). Section 5 regulates the timeline and distribution process for issuers who offer securities for sale. The actual registration process is laid out in Section 6, under which registration entails two parts. First, the issuer must submit information that will form the basis of the prospectus, to be provided to prospective investors. Second, the issuer must submit additional information that does not go into the prospectus but is accessible to the public.<sup>10</sup>

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prerequisite to soliciting votes. The 1934 Act permits the SEC to promulgate rules and regulations to protect the public and investors by prohibiting manipulative and deceptive devices and contrivances via the mail system or other means of interstate commerce. Section 10(b) deals with trading fraud, and section 10(b)-5 protects against insider trading. Under 10(b), non-government plaintiffs can bring a private cause of action against perpetrators of securities fraud that directly caused the plaintiff financial injury.

<sup>9</sup> Quinn R (2014) "Securities Regulation" American Washington College of Law <http://www.wcl.american.edu/faculty/quinn/> (accessed on 10 March 2014) 1. The main point of regulation consists of already issued securities on the formal secondary market. Its purpose is to assure public availability of adequate information about companies with publicly traded stocks.

<sup>10</sup> Fn 5 *supra*.

Section 5 provides that it shall be unlawful for any person, directly or indirectly to sell a security unless a registration statement has been filed. Section 5(b)1 provides that offers should be made only through a prospectus as defined in section 10. It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transporting or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed, unless such prospect meets the requirements of section 10.

Section 5(a) prohibits any person directly or indirectly from using instruments of communication in interstate commerce to sell a security unless a registration statement is in effect. It also prohibits using the mails to deliver the securities unless a registration statement is in effect. Section 5(b) requires the delivery of a statutorily satisfactory prospectus, and section 5(c) requires the filing of a registration statement before making offers to sell any security. According to section 5(a) sales may take place only when the registration statement is in effect. Section 8(a) declares that the effective date of a registration statement is the twentieth day after it is filed or such earlier date as the SEC may determine, having due regard to the adequacy of the information publicly available about the issuer and other related factors.<sup>11</sup>

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<sup>11</sup> Clark (1986) *Corporate Law* 723. A seller may however not file the registration statement and wait 20 days prior to selling with or without the SEC's approval. In order to have a complete and legally adequate registration statement, the price at which the securities will be offered must be stated. Since market conditions change constantly, and the investment banking firm that is doing the underwriting will decide the optimal offering price just before making the offer, e.g., on the day prior to the effective date, the actual offering price cannot be inserted into the registration statement when it is originally filed. To get it in, there has to be an amendment to the registration statement, which begins another 20

The key provision to the 1933 Act is section 5.<sup>12</sup> This section imposes registration and prospectus requirements on public offerings of securities. The issuing company must prepare and file a registration statement containing extensive and detailed information about itself and the offering, as specified by section 7 and Schedule A. In the words of Loss, the provision covers the universe, making it unlawful to use the mails or any means of interstate commerce to sell securities unless a registration statement is in effect and a specified prospectus is delivered. Section 5 was designed to place the facts before the investing public in two ways. Firstly, adequate and accurate information in the form of a registration statement is to be made a matter of public record for a period of twenty days. This waiting or cooling period was to be used by issuers only to inform prospective investors about the issue and not to attempt to sell it. Secondly, underwriters and dealers are to furnish prospective investors with a prospectus based on the information in the registration statement. Certain types of offers, but not sales, are allowed during the waiting period. Here, section 5(b)(1) prohibits the forwarding of a prospectus unless it meets the requirements of section 10. As section 2(10) provides for written offers, oral offers may be made.<sup>13</sup>

Section 5 must be read as if it applied to any transaction by an issuer or underwriter in connection with a primary distribution to the public, by the

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day cycle, at the end which the price will be stale. This is avoided by cooperation with the SEC, following its guidelines as to what should be in the statement and should respond to the suggestions in a letter of recommendation about the original version of the registration statement. Here the SEC has the power then to accelerate, serving as vehicle by which many of the SEC's policies about desirable disclosures have been implemented.

<sup>12</sup> *Ibid* 720.

<sup>13</sup> Loss (1988) *Fundamentals* 90-1.

issuer; or a secondary distribution by a person in a control relationship with the issuer; or any transaction by a dealer within forty and sometimes ninety days after the beginning of such a distribution, or during such longer period as he personally may be engaged in distributing. The method and procedure for registration are specified in sections 6 and 8 and the contents of the registration statement and prospectus are prescribed in sections 7 and 10 and Schedule A of the Act. The counter-balance is sections 3 and 4 which exempt transactions or securities.

Section 7 gives the SEC full authority to determine what information issuers must submit, but generally included is information about the issuer and the terms of the offered securities that would help investors form a reasoned opinion about the investment. The requirements are extensive, and include descriptions of the issuer's business, past business performance, information about the issuer's officers and managers, audited financial statements of past business performance, executive compensation, risks of the business, tax and legal status, and the terms and information about the securities issued. Often, the issuer will submit the prospectus with the registration statement. All of this information becomes public soon after filing with the SEC, through the SEC's online EDGAR system.<sup>14</sup>

Aside from the registration and prospectus provisos, there are four sections which makes conduct unlawful or actionable. Section 18 is a general antifraud provision. It is applicable to all securities, whether registered or exempt. Section 23 prohibits misrepresentation with respect

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<sup>14</sup> Fn 5 *supra*.

to the effect of registration. Section 24 makes it a crime not only to wilfully violate any further provisions but also to wilfully include a misstatement or half-truth in a registration statement.

Regulation is in essence based on broad sweeping definitions and centralised around exemptions to said definitions as applied to the all-encompassing provisions of section 5. This is in contrast with the position in South Africa where regulation is based on specific definitions aimed at establishing regulatory purview by including and excluding transactions to specific markets. It would also seem that the exemptions under section 96 of the 2008 Act come as an afterthought, rather than the basis of establishing regulatory purview or not, as is the case in the US in respect of exemptions to regulation. Chapter 4 attempts to fit transactions within defined parameters, rather than providing for the regulation of public offers.

The US has the SEC as primary regulator which fulfils its role in a proactive manner. The Courts where relevant, only feature as reactive regulators or enforcers, as such, where needed.<sup>15</sup> Therefore, broad sweeping definitions bring regulation of any public offers for distribution or sale under the purview of the SEC and the requirement to file a registration statement. The centralised exemption structure allows the SEC to evaluate offers against the exemptions, rather than deciding whether an offer is an offer or not; the staff of the SEC may merely decide whether the offer applies or not to regulation. The exemptions are

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<sup>15</sup> It is stated that the Courts only feature where relevant as the SEC has broad powers to hear and adjudicate matters.

supplemented by Regulations and Rules issued by the SEC and the extent thereof is quite vast.

In South Africa, the situation is different and the decisions must be taken by market participants and the Courts. Although a Court will be able to enforce the US system, it must be remembered that one of the principles of regulation is that prevention is better than cure, therefore pre-emptive regulation is preferred. The South African system must rely much more on effectively defining the parameters of regulation.

Underwriting constructions are provided for as being akin to the primary distribution from an issuer and regulation as well as liability attaches to the underwriter in equal parts. The “hawking” of shares is therefore provided for in such a manner, including any subsequent resales, which will have to comply with the 1933 Act unless an exemption is available. *Bona fide* sales of shares by a shareholder will under certain circumstances be exempt, especially if it is a private placement or a sale by a person other than a dealer. In terms of the 1933 Act, underwriting constructions are provided for in terms of regulation as part of the 1933 Act. Therefore an underwriter will also fall under regulatory purview.<sup>16</sup> In terms of the wording of the 1933 Act, any offer for sale of securities will fall under the 1933 Act.<sup>17</sup> This will imply secondary market transactions as well. However, certain secondary market transactions are exempted in section 4.

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<sup>16</sup> Loss (1988) *Fundamentals* 75-86.

<sup>17</sup> Section 2(a)(3).

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**4. Disclosure mechanism**

Section 2(a)(10) provides that the term “prospectus” will mean any prospectus, notice, circular, advertisement, letter or communication; written or by radio or television; which offers any security for sale or confirms the sale of any security, i.e., a written confirmation of sale or offer.

Any written offer of sale can therefore be considered to be a prospectus and it must comply with section 10.<sup>18</sup> A communication will not be a prospectus if it states from whom a written prospectus, meeting the requirements of section 10, may be obtained and in addition, does not disclose more than the identity of the security; the state of the price; state by whom the order will be executed and other information as may be required by the SEC.<sup>19</sup> Section 10 provides for the informational requirements to be set out in a prospectus.

The SEC reviews registration statements to ensure that all required disclosures have been made. Barring glaring deficiencies or omissions, the registration statement is effective within 20 days, per Section 8. The SEC does substantively evaluate the registration statement and prospectus, and can issue "deficiency letters" suggesting changes. Thus, the SEC can aid in shaping disclosure to meet investor needs. Companies tend to comply

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<sup>18</sup> There are of course various exceptions to what would otherwise constitute a prospectus: Rule 169 exempts sections 2(a)(10) and 5(c) from application for regularly released business information; Rule 168 exempts the latter sections for forward looking information as well in respect of regularly released business information; and Rule 163 exempts section 5(c) from application for communications by or on behalf of well-known seasoned issuers; oral offers. Rule 134 in respect of communications and information also apply.

<sup>19</sup> Bernardo PJF (2011) “Securities Regulation: Reach of Securities Act Regulation” Harvard Law School  
[http://www.academia.edu/1748452/Notes\\_on\\_Securities\\_Regulation\\_Harvard\\_Law\\_School\\_Fall\\_2011](http://www.academia.edu/1748452/Notes_on_Securities_Regulation_Harvard_Law_School_Fall_2011)  
(accessed on 7 February 2014) 5-7.

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because the SEC has the power to accelerate the effective date, which allows the company to sell its stock and raise capital earlier. The registration process protects investors in two ways. Issuers cannot offer to sell securities without disclosing information about the company, and developing and delivering a prospectus that the SEC has reviewed. In addition, issuers are liable for any material misstatements or omissions in the prospectus or registration statement, providing a way to enforce truth in disclosure.<sup>20</sup>

Schedule A to the Securities Act lists 32 items to be set out in the registration statement. It is not within the scope of this work to review the items, save to state that the issuer must disclose information about the company, its business operations and its capital structure, financial condition and performance, directors, officers, their position towards the issuer, terms of the offer, uses to which the proceeds of the offering will be put, commissions and so forth.<sup>21</sup> The SEC reviews registration statements to ensure that all required disclosures have been made. Barring glaring deficiencies or omissions, the registration statement is effective within 20 days, per Section 8.

Section 8(b) authorises the SEC to issue refusal orders. Where a registration statement appears on its face to be inaccurate or incomplete in any material respect, the SEC may, after notice and opportunity for a hearing, issue an order refusing to permit the statement to become effective. Under section 8(d), it can issue a stop order suspension,

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<sup>20</sup> Fn 5 *supra*.

<sup>21</sup> Clark (1986) *Corporate Law* 723.



suspending the effectiveness of a registration statement if it appears to contain material misstatements or omissions. This is done after notice and the opportunity for a hearing. The SEC is furthermore empowered to conduct examinations in order to determine whether a stop order should issue. Section 20(a) empowers it to demand statements from suspected violators, section 20(b) empowers it to bring injunctive actions in the federal district Courts and to refer matters to the Attorney General for criminal proceedings. Section 20(c) empowers it to apply to the District Courts for writs of mandamus to compel compliance to the Securities Act.<sup>22</sup>

## 5. Definitions

The application of definitions as per section 2 of the 1933 Act is important as the structure follows that of South Africa where definitions are used in section 95 to provide for the scope of application of provisions to the subject of offer regulation, i.e., transactions and the parties thereto. For this reason and to follow the application thereof in terms of the relevant exemptions, a brief overview of the relevant exemptions is required.

### 5.1. Sale / sell

Firstly, there is the definition of the term “sale” or “sell.” It shall include every contract of sale or disposition of a security or interest in a security for value. Section 2(3) further provides that the term “offer to sell,” “offer for sale,” or “offer” shall include every attempt or offer to dispose of, or solicitation of an offer to buy a security or interest in a security for value.

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<sup>22</sup> *Ibid* 724.

It follows that this is a sweepingly broad based definition, aimed to include every transaction irrespective of nature. There are limitations to this definition, aimed at preliminary negotiations between an issuer and underwriter, but this is not relevant for the current discussion.<sup>23</sup> The definition of offer to sell goes beyond the common law concept of an offer as every attempt is provided for.<sup>24</sup>

### 5.2. Issuer

The term “issuer” is defined in section 2(4) as meaning: “...*the person or persons performing the acts and assuming the duties of depositor or manager pursuant to the provisions of the trust or other agreement or instrument under which such securities are issued....*”

### 5.3. Underwriter

The term “underwriter” in terms of section 2(11) means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, but such term shall not include a person who’s interest is limited to a commission from an underwriter or dealer, not in excess of the usual and customary distributors’ or sellers’ commission. As used in this paragraph the term “issuer” shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under

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<sup>23</sup> “Offer to buy” shall not include preliminary negotiations or agreements between an issuer and any underwriter or among underwriters who are or are to be in privity of contract with an issuer. It is only limited to underwriters and not to dealers or brokers.

<sup>24</sup> Securities Act Release No. 3844 (8 October 1957) includes the “conditioning of the market” and it is prohibited to initiate a public sales campaign in the pre-filing period.

direct or indirect common control of the issuer. Section 2(11) provides a broad definition of underwriter.<sup>25</sup> Section 2(11) concludes, stating for the purposes of applying the definition of underwriter, the term issuer shall include any affiliate of the actual issuer. “As used in this paragraph the term “issuer” shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under directly or common control with the issuer.”<sup>26</sup> By “actual issuer” is meant the entity against which the securities represent an investment interest.<sup>27</sup> Persons acting as conduits are considered underwriters under section 2(a)(11). The seller assumes the risk of violation of the registration requirements of the Act and consequent civil liabilities. Sales separated by six months are considered in terms of Rule 506(a) as not subject to integration where an offering should be regarded as a part of a larger offering made.<sup>28</sup>

In the US, firm underwriting is not underwriting as in South Africa where it features in the classic insurance sense. Its purpose and effect are much the same in that it assures the issuer of a specified amount of money at a certain time and shifts the risk of the market to the investment bankers.

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<sup>25</sup> Wharton University of Pennsylvania: Financial Institutions Centre Presentation by Taliye Teleri on The Securities Act of 1933: Registration Exemptions <http://fic.wharton.upenn.edu/fic//cmbt/Taliye%20Teleri.ppt> and <http://fic.wharton.upenn.edu/fic/> (accessed on 11 March 2014).

<sup>26</sup> *Ibid.*

<sup>27</sup> Getting the Deal Through: “Securities Finance in 18 Jurisdictions Worldwide” supplement on the United States *supra*. Securities Finance 2006 supplement on the USA. Section 2(a)(11) provides that an underwriter means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors or sellers commission. The term issuer shall include in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.

<sup>28</sup> Bernardo (2011) “Securities Regulation” *supra*.

The issuer is the manufacturer of the securities, the members of the underwriting group are the wholesalers and the selling group are the retailers. Under the Securities Act, only negotiations between issuers and underwriters are permitted before the filing of the registration statement.<sup>29</sup>

The determination whether a person is an underwriter is therefore important. Also, underwriters are in the US subjected to section 11 civil liability for deficiencies in the registration statement.<sup>30</sup>

Prior negotiations with an issuer with an underwriter are not included in the definition of “offer for sale” in section 2(3). When an underwriter’s contract is signed, there will not be a prospectus requirement in terms of section 5. No contractual basis is required for the relationship between the underwriter and the issuer. Delpont opines that it thus follows that where the conditions in terms of section 2(11) are met, the underwriter will be the distributor of the shares.

A key aspect to the definition of an underwriter is the concept of distribution, which in this context is synonymous with an offer to the public. The test is subjective, as to whether the person bought the shares with an investment purpose or a distribution aim. This would have to be answered in terms of objective facts.

#### 5.4. Dealer

In terms of section 2(12) the term “dealer” means any person who engages either for all or part of his time, directly or indirectly, as agent, broker, or

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<sup>29</sup> Loss (1988) *Fundamentals* 75-85. There are of course variations, like best effort underwriting.

<sup>30</sup> *Ibid* 252.

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principle, in the business of offering, buying, selling, or otherwise dealing or trading in securities issued by another person.<sup>31</sup>

### 5.5. Security

Section 2(a)(1) of the Securities Act defines a security as follows:

The term “security” means any note, stock, treasury stock, security future, security-based swap, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral trust certificate, pre-organization certificate or subscription, transferable share investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas, or other mineral rights, any put, call, straddle, option, or privilege on any security, certificate of deposit, or group or index of securities (including any interest therein or based on the value thereof), or any put, call, straddle, option, or privilege entered into on a national securities exchange relating to foreign currency, or, in general, any interest or instrument commonly known as a “security,” or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of,

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<sup>31</sup> The term “person” is defined in section 2(2) as an individual, a corporation, a partnership, an association, a joint-stock company, a trust, any unincorporated organisation, a joint-stock company, a trust, any unincorporated organisation, or a government or political subdivision thereof. As used in this paragraph the term “trust” shall include only a trust where the interest or interests of the beneficiary are evidenced by a security.

or warrant or right to subscribe to or purchase, any of the foregoing.<sup>32</sup>

Concerning the complexity of the financial world, Loss opines that there is still a constant stream of cases seeking to draw the line between what a security is and real property or tangible or intangible personal property or various hybrids emanating from the banking and insurance industries.<sup>33</sup>

To contrast, the definition in section 1 of the 2008 Act is: “...means any shares, debentures or other instruments, irrespective of their form or title, issued or authorised to be issued by a profit company....”<sup>34</sup>

The concepts of an “investment contract,” “evidence of indebtedness” and “unless the context otherwise provides” came under review by the SEC and the Courts. In *SEC v W.J. Howey Co.*,<sup>35</sup> the Supreme Court ruled that an investment contract involves the investment of money; in a common enterprise; with an expectation of profit; solely from the efforts of others as elements.<sup>36</sup>

i) Investment of money and expectation of profit

An investment of money has been defined in *International Brotherhood of Teamsters v Daniel*<sup>37</sup> as to denote where a person gives up a specific consideration in return for separable financial interests with the

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<sup>32</sup> As per Loss (1988) *Fundamentals* 165, this definition borrowed from the earlier Blue Sky definitions, which had already developed judicial precedent. Section 401(1) of the Uniform Securities Act is identical, except for the oil and gas language and the exclusion of orthodox insurance and annuities.

<sup>33</sup> *Ibid.*

<sup>34</sup> As substituted by section 1(1)(bb) of Act 3 of 2011.

<sup>35</sup> *SEC v W. J. Howey Co* 328 US 293 (1946).

<sup>36</sup> Bernardo (2011) “Securities Regulation” chapter 5, page 6.

<sup>37</sup> *Teamsters v Daniel* 439 US 551 (1979).

characteristic security. Under an expectation of profit, the Court in *United Housing Foundation Inc., v Forman*<sup>38</sup> held that it meant either capital appreciation resulting from the development of the initial investment or the participation in the earnings resulting from the use of investor funds.<sup>39</sup>

The core tenant is the purchaser giving up a tangible and definable aspect in return for an interest that had substantially the characteristics of a security. Profit denotes either capital appreciation resulting from the development of the initial investment or participating in the earnings resulting from the use of investor funds.<sup>40</sup>

ii) Common enterprise and sole effort of others

Common enterprise has not been interpreted by the Supreme Court. Two clear formulations have been identified.<sup>41</sup> The vertical commonality focuses on the community of interest of an investor and the company. The strict vertical commonality test requires that the capital of the investor be linked to that of the third party or company in that the proceeds are linked. The broad vertical commonality test requires that only the capital of the investors be linked to the efforts of the third party or company.<sup>42</sup>

Concerning the sole effort of others requirement of the *Howey*<sup>43</sup> test, it speaks for itself in the investor and company set up. The *Howey*<sup>44</sup> test

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<sup>38</sup> *United Housing Foundation v Forman* 421 US 837 (1975). Here the purchase of the “share” was motivated by the desire to “use or consume the item purchased” i.e., the investors were attracted to the prospect of acquiring a place to live, not by financial returns on their investment.

<sup>39</sup> Bernardo (2011) “Securities Regulation” chapter 5 page 1.

<sup>40</sup> *Ibid.*

<sup>41</sup> *SEC v Koscot Interplanetary Inc* 497 F 2d 473 CA Ga 1974.

<sup>42</sup> Bernardo (2011) “Securities Regulation” chapter 5 page 1-2.

<sup>43</sup> *SEC v W.J. Howey supra.*

<sup>44</sup> *Ibid.*

however can be evaded with a requirement of modicum effort from the investor. The guide is to not follow a literal application as it will frustrate the remedial purposes of the 1933 Act.<sup>45</sup>

Under common enterprise, the vertical commonality concerns under the broad construction, efforts of the promoter linked to the fortune of the investors and under strict constructions, the connection between the fortunes of the promoters are linked to the fortune of the investors. Effort of others depends on a functional test as to whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise.<sup>46</sup>

iii) Evidence of indebtedness and context otherwise for provided

Not all debt or indebtedness is considered to be securities. Evidence of indebtedness denotes documents which on the face thereof establish a primary obligation to pay the holders thereof a sum of money.<sup>47</sup>

## 6. Relevant exemptions

Section 4 exempts transactions and section 3 exempts securities. The focus will only be on private sales (private placements or non-public sales) as well as secondary market resales. Exempt securities are still subject to the anti-fraud provisions. Section 28 provides the SEC with rule making power to exempt any person, security, or transaction from any

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<sup>45</sup> Bernardo (2011) "Securities Regulation" *supra*. In *United States v Leonard* 529 F 3d 83 CA 2 (NY) 2008 it was held that the "solely" qualification should not be construed literally.

<sup>46</sup> *Ibid.*

<sup>47</sup> *United States v Jones* 450 F.2d 523 (5<sup>th</sup> Circuit 1971).



provision of the 1933 Act.<sup>48</sup> When determining the public interest for purposes of creating a new exemption, the SEC must also consider whether a rule will promote efficiency, competition, and capital formation.<sup>49</sup>

Following from the discussion above it was determined that the SEC regulates in essence all offers by all persons in respect of any securities regardless the designation of the transaction. For this reason, the 1933 Act relies heavily on exemptions, amplified by Rules issued by the SEC to determine the scope and application of the regulation via exemption provisions.

This discussion will focus on two relevant exemptions concerning the disposition around secondary market regulation and then of the concept of public offers and private offers. The 1933 Act provides in section 3 for exempted securities and in section 4 for exempted transactions. Securities Act exemptions are divided into private offerings; small offerings; resales of restricted securities; sales by controlling persons; mergers and other exemptions.<sup>50</sup>

Section 3 lists various categories of securities that are exempt from registration. These securities apply not to transactions but to the securities and are a permanent exception from registration requirements.<sup>51</sup> Section 4

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<sup>48</sup> Beyond the statutory exemptions found in sections 3 and 4. Exemptions may be provided in terms of transactions, persons and securities if in the public interest and consistent with investor protection. Taliye Teleri (not dated) 1933 “Securities Act Exemptions” *supra*.

<sup>49</sup> Bernardo (2011) “Securities Regulation” chapter 6 page 1.

<sup>50</sup> Clark (1986) *Corporate Law* chapter 17.

<sup>51</sup> The following are exempted securities: securities of governments, banks, insurance companies, and qualified pension plans (section 3(a)(2)); certain short term commercial papers (section 3(a)(3)); securities issued by non-profit, religious, educational, and charitable organisations (section 3(a)(4));

describes a variety of transactions that qualify for an exemption for registration.<sup>52</sup> Section 4 exemptions require at the resell thereof, another exemption otherwise it must be registered with the SEC. Of importance are sections 4(a)(1) and 4(a)(2). Section 4(a)(1) provides for transactions by any person other than the issuer, underwriter or dealer. Section 4(a)(2) provides for transactions not involving a public offering, therefore it is considered to be a private offering. Regulation D provides a safe harbour although the anti-fraud provisions still apply even though it is a private offering. The extension of liability applies therefore beyond the scope of offer regulation. Section 4(a)(3) provides for transactions by a dealer to be exempt. Each of these will be canvassed below for context in terms of application.

### 6.1. Resales

The Securities Act of 1933 also focuses on re-sales to public investors by persons who previously purchased securities from the issuer in private transactions (restricted securities) and to persons in control positions who hold securities of the issuer (control securities).

Section 4(1) exempts transactions by any person other than an issuer, underwriter or dealer. Securities acquired in a non-public distribution may

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securities of building and loan associations, farmers cooperatives and the like (section 3(a)(5)); securities issued by federally regulated common carriers (section 3(a)(6)); certificates issued under the Bankruptcy Act by Receivers and Trustees (section 3(a)(7); insurance policies and annuity contracts (section 3(a)(8)).

<sup>52</sup> Section 4 contains a number of exemptions that apply to specific transactions. The exemptions extend to the transaction, not the individuals. Section 3(b) authorises the SEC by means of rules and regulations, to add any class of security to the securities exempted as provided for in the Act, if the SEC finds that the enforcement is not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering, subject to the limitation that the aggregate amount at which the issue is offered to the public cannot exceed US\$ 5 million. Exemption relates to only the requirement to register under the Act and not from the anti-fraud provisions, civil liability or other provisions of the federal securities laws.

not be resold into the public without registration or an exemption.<sup>53</sup>

Section 4(1) applies to a trade in the secondary market and acts as an exemption. The definition of an underwriter determines in terms of section 4(1) whether the registration requirements in respect of securities traded on the secondary market will depend whether such seller is an underwriter is or not.

Section 4(a)(1) provides typically for secondary market transactions, i.e., resales by non-issuers. *Bona fide* trades by a shareholder of its securities would apply and it is submitted that the scope applies to transactions that would typically fall under section 101 of the 2008 Act. When individual investors wish to resell their securities, it can be done without registration, as long as they are not an underwriter. Sections 4(1), 4(3) and 4(4) apply to these types of transactions.<sup>54</sup> Typically, these offers will not be public, but where they are, it can be exempted either by means of section 4(1) or 4(2) if need be. Where it is indeed public, ergo protection of investors is required, then the seller would have to register the securities.

Section 4(1) exempts from registration, any transactions by any person other than an issuer, underwriter or dealer. Under the definition of an issuer, any person who is controlling the issuer falls under the definition. Rule 405 provides that control equates to the possession, direct or indirect, of the power to direct or cause the direction of the management and policies of a person, whether through ownership of voting securities, by

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<sup>53</sup> Bernardo (2011) "Securities Regulation" chapter 6 page 7.

<sup>54</sup> Quinn (2014) "Securities Regulation" 34.

contract or otherwise. A dealer is defined as anyone engaged in the business of selling for another.<sup>55</sup>

An underwriter is defined in section 2(a)(11) which provides for a typical underwriter construction i.e., any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security or a statutory underwriter construction i.e., not technically an underwriter, but the intent to distribute securities is present through direct or indirect participation in a selling effort, or purchasing securities from an issuer or a control person, with the view to distribute or where the selling of securities for an issuer or control person is done in connection with the distribution.<sup>56</sup>

Section 4(3) provides an exemption to a dealer unless the securities are traded within 1 year or as part of a larger deal or by means of an underwriter. Section 4(4) provides for broker transactions for over the counter markets. It provides that solicitation is excluded.<sup>57</sup>

Section 4(1) exempts trading between investors, in securities already issued, not distributions by issuers.<sup>58</sup> Section 4(1) interacts with the definition of an underwriter in that it exempts transactions other than those subject to underwriting constructions. Read with section 2(11) which is an overly wide description of an underwriter, any *bona fide* secondary market sale will not be exempt where the security was purchased with a view of its distribution, either from the issuer or from

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<sup>55</sup> Section 2(a)(12).

<sup>56</sup> Quinn (2014) "Securities Regulation" 43-5.

<sup>57</sup> *Ibid.*

<sup>58</sup> Clark (1986) *Corporate Law* 734.

anybody who is in a control relationship with the issuer. Control and distribution are not defined. Section 4(3) exempts all transactions by a dealer. Dealer is defined in section 2(12) as to include a broker. The Act is, in the main, concerned with distribution rather than sale. Therefore, dealers that are participants in the distribution are subject to section 5 as long as it may take them to get rid of their unsold allotments or subscriptions and all dealers, are subject to section 5 for a minimum of 40 days after the effective date.<sup>59</sup>

Rule 144 provides for public resales.<sup>60</sup> If any person sells a non-exempt security, it must be registered unless exempted. Section 4(1) provides for such an exemption, by a person other than an issuer, underwriter or dealer, including a control person. Section 4(1) is to be read with Rule 144. Rule 144 covers two types of transactions:

- a) sales of restricted securities by any person for his own account;
- b) sales of restricted or any other securities by any other person for the account of an affiliate of the issuer of such securities.<sup>61</sup>

Under Rule 144, if the registered offering under the IPO was sold to a control person, the resale must comply with the Rule. Controlled securities are securities owned by a control person, referred to in Rule 405 as an affiliate. This includes any person that directly or indirectly, through one or more intermediaries, controls or is controlled by, or is under

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<sup>59</sup> Loss (1988) *Fundamentals* 88.

<sup>60</sup> In guiding the requirement to structure a transaction in order to rely on Rule 144.

<sup>61</sup> Rule 144(b).

common control with, the person / issuer specified. The superior knowledge places this person on the same footing as an issuer and investors must be afforded protection.

The basic approach of this Rule is to provide an exemption or safe harbour for persons who might otherwise be classified as underwriters as long as certain objective criteria are met. Five conditions must be met to satisfy the Rule.<sup>62</sup> The first condition is that adequate public information must be available about the issuer of the securities. This will denote a reporting issuer under the Exchange Act which is filing the required reports and is current in same. Other companies must have made the information specified in the Rule public. Second, if the securities sold are restricted, a holding period applies. The person that has sold them must have been the beneficial holder for at least two years. Third, there are volume limits on the sales. A seller is unable to sell too much too fast. Fourth, there are limits on the manner of sale. The securities must be sold by means of a broker. Fifth, a notice must be filed with the SEC or the Exchange (if applicable).

If the conditions of the Rule are met, then either type of selling person is deemed not to be engaged in a distribution of the sold securities and can therefore not be an underwriter.<sup>63</sup>

Section 4(4) is an exemption for broker transactions executed on instructions of customers on any exchange or in the over-the-counter

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<sup>62</sup> Clark (1986) *Corporate Law* 736.

<sup>63</sup> Rule 144. Restricted securities are acquired directly or indirectly from the issuer or an affiliate of the issuer in a transaction not involving a public offering as per Rule 144(a)(3).

market. It was held in the case of *In the Matter of Ira Haupt & Co.*,<sup>64</sup> that the intent of Congress was focused on exempting secondary trading by investors in already issued securities, which is distinct from the distribution of securities to investors. The SEC has held in *Haupt* that section 4(4) permits individuals to sell their securities through a broker or in an ordinary brokerage transaction, during the period of distribution or while a stop order is in effect, without regard to the administration of a prospectus requirement of section 5. But the process of distribution itself, however carried out, is subject to section 5. Section 4(4) is simply a counterpart of section 4(1). Section 4(1) is what gives the investors their exemption from section 5, and section 4(4) for is what gives it to their brokers.<sup>65</sup>

## 6.2. Private offerings

Section 4(2) provides that section 5 shall not apply to transactions by an issuer not involving any private offering. In order for it to be a public offering, it must be an offer from an issuer. In order to be exempted, the offer must comply with section 4(2), i.e., not be a public offering or the terms of the safe harbour in Regulation D can be used. The issuer cannot engage in solicitation or advertising, and certain limits apply on the number of offers.

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<sup>64</sup> *In the Matter of Ira Haupt & Co* 23 SEC 589 (1946). See also the discussion in Clark (1986) *Corporate Law* 735.

<sup>65</sup> Clark (1986) *Corporate Law* *ibid.*

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*SEC v Ralston Purina*, as discussed in chapter 5 part C *supra*, applies to this exemption.<sup>66</sup> In terms of a private offering, in deciding the class of people, sophistication and access must be considered as well. In terms of Rule 146, disclosure of information or effective access to information is sufficient. Knowledge and wealth cannot substitute access to information.<sup>67</sup> The case of *SEC v Ralston Purina, Co.*, still applies in the US for determining the scope of a public or non-public offer. The confirmation is whether the number of people exposed requires protection. The key factors remain as being sophistication and access to information. In determining whether the exemption is available under section 4(2) four factors are to be considered. Those are firstly, offeree qualification, i.e., can they fend for themselves? Wealth and sophistication and knowledge with the ability to assume risk are determinants in offeree qualification. Secondly, the relationship of the offeree with the offeror. Thirdly, the availability of information prior to sale, and fourthly, the manner of offering and the absence of redistribution, restricting transferability of privately placed securities to avoid resales.<sup>68</sup>

Of importance is Regulation A which provides for an exemption from civil liability under section 11, although still subject to the anti-fraud provisions of section 10(b) of the 1934 Act. Regulation A consists of

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<sup>66</sup> Ralston in *Ralston v Purina Co supra* made private offering to “key employees” without registering it and used the mail. They claimed a private offering exemption and claimed that all the employees were key personnel. Exempt transactions, as held are those to which there is no practical need for the application of the Act. The question depended on the class of persons affected and requiring the protection of the Act. Some employee offerings will be exempt under section 4(2) where the employees are executives, i.e., have access to the required information. Absent same, employees are just members of the public in need of information. Rules to be considered are the availability of information to the class of people; investor sophistication; the relationship between the issuer and the offerees; number of investors and the size of the investment.

<sup>67</sup> Quinn (2014) “Securities Regulation” 35.

<sup>68</sup> Bernardo (2011) “Securities Regulation” chapter 7.



Rules 251 – 263. Of importance is Rule 251 and 254. Rule 251 holds that Regulation A is only available to US or Canadian companies. Regulation A can only be used if less than 5 million US dollars are sold within six months, so it is ideal for smaller companies. Transactions will not be considered to be integrated where a 6 months interval applies. The SEC must be notified of the reliance on this exemption. Rule 254 provides that an issuer can solicit interest before the offering goes out, with oral and written communications. Typically Regulation A is a mini-registration, but Regulation D is more popular due to the cost of Regulation A as well as the technicalities which are akin to a full blow registration.<sup>69</sup>

Regulation D provides for exemptions from section 4(2). An issuer can rely on section 4(2) but implement the transaction following Regulation D. An issuer can therefore structure the transaction to be considered a private offering without doubt as to whether the common law principles apply. As with Regulation A, Regulation D also consists of a number of Rules which consist of Rules 501 to 508. The most important are Rules 504, 505 and 506. Rule 504 provides for small start-up companies where the offerings must not exceed 1 million dollars in a 12 month period and it is not available to companies which must register under the 1934 Act. There is no limit on the number of investors. It must comply with Rule 502(a), (c) and (d).<sup>70</sup> Regulation D is a safe harbour in that where a transaction meets certain requirements, it is safe from attack from the SEC as an illegally unregistered offering of securities nor can it be attacked by

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<sup>69</sup> Quinn (2014) “Securities Regulation” 39.

<sup>70</sup> *Ibid* 39-40.

private parties.<sup>71</sup> If a transaction does not meet the requirements, it may still qualify as an exempted private offering or other exempt transaction.

Rule 502(a) provides for offerings that are separated by more than six months to be deemed not part of the same offering. Whether offerings within six months are considered integrated offerings depends on: 1) whether they are part of a single plan of financing; 2) involve the same class of securities; 3) are made at the same time; 4) involve the same consideration; 5) are made for the same general purpose or not.<sup>72</sup>

Rule 502(c) provides for the manner of offering, i.e., the securities cannot be advertised or be subject to general solicitation. Rule 502(d) provides a limitation on the resale of securities, i.e., they cannot be resold by the purchaser unless another exemption applies or the securities are subject to a registration statement. The issuer must ensure that the purchasers are not underwriters, i.e., those who buy towards distribution and not towards an investment. This is done by the buyer signing a letter confirming investment or restricting the stock against resales.<sup>73</sup>

Rule 505 provides for offerings up to 5 million in any 12 month period. Rule 502 applies as well. Rule 505 also provides for a limitation on the purchasers to only 35 and an unlimited number of accredited purchasers. Purchaser is defined in 501(e) as excluding an accredited investor. An accredited investor is a bank, person with net worth of 1 million dollars or more, income of 200 000 per annum or more; savings and loan

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<sup>71</sup> Clark (1986) *Corporate Law* 730-1.

<sup>72</sup> Quinn (2014) "Securities Regulation" 39.

<sup>73</sup> *Ibid.*

association, credit union, insurance company, investment company etcetera. For any unaccredited investors, the information in Rule 502 must be furnished to them, Rule 502(b) requires disclosure pertaining to the type of information, disclosure to purchasers only and no information required to be disclosed to accredited investors.<sup>74</sup>

Rule 506 provides for no dollar limit on the offering. Securities can be sold to 35 purchasers or an unlimited amount of accredited investors, but the purchasers must have knowledge and experience in financial and business matters that enables them to evaluate the risks. The limit is not in regard to offerees, but on purchasers. Disclosure applies, in terms of Rule 505(d) and 502(b). Form D must be filed, no advertising or solicitation: offers to large numbers of offerees may be viewed as advertising, resulting in loss of exemption.<sup>75</sup>

Section 3(B) provides for limited exemptions to a list of securities exempted from registration if enforcement is not necessary for the public interest and for the protection of investors by reason of the small amount involved or the limited nature of the offering, where the aggregate does not exceed US 5 million dollars.

Case law and Regulation D differentiate between a public and private offering. Section 4(2) exempts transactions not involving any public

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<sup>74</sup> *Ibid.*

<sup>75</sup> *Ibid.*

offering. The principles in the case of *SEC v Ralston Purina Co.*,<sup>76</sup> applies in discerning whether an offer is a public or private placement.

The availability of the exemption depends on the need for protection of the offeree, provided by the Act. Whether this need is present turns on whether the offerees have access to the kind of information that registration will provide and whether they are able to fend for themselves. The exemption is not available merely because the offering was made to a small number of people, or to a delimited class of people.

It therefore follows that although in the US the possibility of a private placement is possible, similar to a common law non-public offer in South Africa; the regulatory purview applicable to the dispensation in the US offers more protection to investors and the public. It is submitted that under the model of regulation in the US, it is not necessary for an exhaustive definition of the concept of public and what a public offer would constitute, as the regulatory dispensation is heavily regulated and merit reviewed. It makes sense that in South Africa a non-exhaustive list of exemptions are required in order to exclude the non-public common law private offer, as there is no protection for any investor subsequent to the subjective decision that Chapter 4 does not apply.

It follows that any offer that falls under an exemption as per section 3 or 4 will not be regulated as a primary market transaction. It further follows that secondary market transactions may still fall under the purview of section 5. This is where no exemption under the 1933 Act is available. All

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<sup>76</sup> See paragraph 3.3.1, chapter 5 part C *post*.

other transactions are regulated in terms of the 1934 Act, unless it is a private offering in terms of the 1933 Act.

## 7. Anti-fraud

One of the most famous and often used SEC rules is Rule 10b-5, which prohibits fraud in securities transactions as well as insider trading. The most well-known securities regulatory provision is Rule 10b-5, promulgated pursuant to Section 10b of the 1934 Act. This Rule is the most often used Rule in the area of securities law, and almost every securities fraud case involves, in one way or another, Rule 10b-5.<sup>77</sup>

Because interpretations under rule 10b-5 often deem silence to be fraudulent in certain circumstances, efforts to comply with Rule 10b-5 and to avoid lawsuits under 10b-5 have been responsible for a very large amount of corporate disclosure.<sup>78</sup>

Section 10(b) of the 1934 Act provides that it shall be unlawful for any person to use or employ, in connection with the purchase or sale of any security on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations that the SEC may prescribe. Section 17 of the 1933 Act prohibits fraud in the sale of securities but not the purchase thereof. Rule 10(5)(b) was adopted because Section 10(b) alone did not make anything unlawful unless the SEC has adopted a rule to prohibit it. This Rule provides for the unlawful construction to defraud,

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<sup>77</sup> Astarita MJ Esq, Sallah Astarita & Cox LLC “Introduction to the Securities Law: The NASD the SEC, The States and Much More” <http://www.seclaw.com/seclaw.htm> (accessed on 16 March 2014).

<sup>78</sup> Lin TCW “A Behavioral Framework for Securities Risk” (2011) 34 *Seattle University Law Review* 325.

to make untrue statements of material facts or to omit to state a material fact necessary to make the statements not misleading, or to engage in any act, practice or course of business which would operate as a fraud or deceit on any person, in connection with the purchase or sale of any security. Under defences, it follows that full disclosure will manifest as a defence. If there is complete disclosure, even if the transaction is unfair, there is no deception and therefore no liability.

### 8. Concluding remarks

The regulatory system in the US provides for offer regulation without a distinction concerning transactions in the primary market and secondary market. The definitions are so reflected in legislation as to exclude reliance on the type of market construction in an offer to delineate transactions of any offer to be covered. A general prohibition is in place against which transactions, in terms of the definitions, may be measured. Exemptions to the prohibition exist in order to exclude regulatory purview in certain cases.

The US features a heavily regulated regime where all securities and offers are to be registered, together with the disclosure document. The regulatory system in the United States requires registration and regulatory purview of any securities and any offers to the public, regardless of the market and the underlying transaction. In the secondary market, the Securities Exchange Act regulates the organised secondary market, yet a clear distinction between the primary and secondary markets is not made *per se*

in the Securities Act as all offers and all securities are subjected to regulatory purview.

Insofar as offers and a division of the markets are concerned; no reliance is placed on artificial definitions between an IPO and a PO. An all-encompassing definition of what constitutes an offer is provided for and it is submitted that this provides for the common law construction concerning invitations to subscribe or to sell in terms of underwriting constructions.

The Securities Act does provide for hawking of shares by providing for underwriting constructions to be included in terms of regulatory purview. In terms of the public information available in terms of issuing companies as mandated by the 1934 Act, any seller not exempted will be able to obtain the required information and therefore be able to provide a prospectus with the necessary permutations. Secondary sales of securities are exempted in terms of section 4, but it must be read with Rule 144 which provides conditions to be adhered to prior to the safe harbour being validly used. Under the exemption of offers which are not to the public, Regulation D provides for mechanisms to structure transactions which will not infer SEC regulation. It is submitted that all of the above contribute to constitute complete law juxtaposed to the system currently in force under Chapter 4 in South Africa.

## CHAPTER 7

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### CONCLUSION AND RECOMMENDATIONS

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1. Introduction
2. Historical perspective on offer regulation
3. *Grundnorm*
4. On the nature of principled offer regulation
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## 1. Introduction

The hypothesis in respect of Chapter 4 offer regulation in terms of the 2008 Companies Act, provides that effective and efficient offer regulation is based on the premise of complete law which ensures enforcement in terms of the principles of offer regulation and thus that incomplete law will contribute towards enforcement failure, together with failure of the legislation in adhering to the *Grundnorm*.<sup>1</sup>

Based on the foregoing review it is submitted that Chapter 4 of the 2008 Act does not constitute a set of complete law as it is ambiguous, incomplete and not lucid. As a result it does not conform to the principles of offer regulation, impacting on the effectiveness and efficiency of the regulatory regime. The probability of enforcement failure is thus high.

It is evident that Chapter 4 offer regulation is based on a reactionary enforcement model.<sup>2</sup> Although a costly and complicated pro-active regulatory authority would be more in line with international development and policies, and although such a regulatory enforcement system would be more in line with the principles of regulation; it is submitted that it is not necessary provided that Chapter 4 is in line with the requirements of a reactionary enforcement model, i.e., Chapter 4 must be brought in line with the requirements of what is regarded as complete law: unambiguous,

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<sup>1</sup> Incomplete law will contribute towards failure of the legislation at the core of the *Grundnorm*. The *Grundnorm* supersedes the Guidelines due to the weight attached to the *Grundnorm* and viewed against the development of the 2008 Act which was clearly not a lucid exercise in terms of Chapter 4.

<sup>2</sup> Chapter 4 sets *ex ante* regulation in place, to be enforced *ex post* by the Courts, based on a reactionary model, i.e., when an aggrieved party decides to approach the Courts.

complete with no errors and adhering to the underlying principles of offer regulation and the common law concerning transactional relativity. It must also be clear in order to sufficiently act as deterrent and eventually, where needed, as effective means of enforcing the liability provisions.

In this chapter brief remarks will be made on the nature of principled offer regulation and the concept of complete law as necessary for effective offer regulation. The development of statutory protection of investors against fraud is viewed from a historical perspective. A succinct discussion of the principles of offer regulation follows. The development of the 2008 Act is referred to in contrasting same with the principles of offer regulation. Thereafter the statutory evolvement of offer regulation in South Africa is contextualised and select problems are highlighted where the current regulatory regime is in conflict with the principles of offer regulation and of the concept of complete law. The comparative disposition in the United States and the United Kingdom is contrasted with the position in South Africa. Lastly, liability is briefly referred to in showing the effects of incomplete law at the juncture of liability provisions which ought to be the last hurdle of deterrence in an *ex ante* regulatory system which relies on the Courts as enforcement type regulator, *ex post*.

In the concluding part of this chapter, recommendations for legislative reform are made. The changes that are deemed expedient are first addressed from a policy objective point of view. The true purpose of principled offer regulation as method of protection is proposed. The

public policy based objectives for offer regulation are highlighted against the implications of the Constitution of South Africa, Act 108 of 1996.

Lastly, proposals are made for legislative reform with reference to the subject matter and the scope of investor protection in terms of the regulation of offers of securities to the public; specifically concerning separate regulation of offers to the public; the definition of an offer; public offer exemptions, and effective enforcement through liability provisions. These proposals are made with reference to the concept of complete law in ensuring effective offer regulation.

## 2. **Historical perspective on offer regulation**

The history of offer regulation is closely tied with the development of the company as vehicle for the amassing of capital in funding its ventures. Offer regulation as a branch of securities law evolved via attempts by the Legislature to provide for anti-fraud provisions as well as additional liability provisions which were superior to the common law. This gave rise to *ex ante* disclosure requirements, to be enforced *ex post* in a reactionary fashion, based on the decision that an investor must make, coupled with merit requirements concerning the levels of disclosure. Soon *ex ante* regulators were introduced, tasked with the *ex ante* enforcement of the regulatory provisions as is evident in the United Kingdom and the United States. South Africa does not feature the latter type of regulator, relying on *ex post* enforcement. Two historic stages are differentiated, the historic state with its reactionary basis in attempt to curb fraud and the post-historic stage, which is also coined the reformist stage, which gave

rise to *ex ante* regulatory principles. This lead to the reformist stage of *inter alia* Gower. The historic stages are known for their development of rules in reaction to market integers of abuse. The reformist stage is known for the violation of these rules and the Legislature providing for the law to be more effective. The contemporary stage is where the principles, as developed, are met with advancements in technology and the markets, and the challenges to evolve the principles of offer regulation towards the advancement of the *Grundnorm* through principles of efficiency. Where company law is concerned with the corporate entity i.e., the legal personality, registration of companies, capacity and representation, shareholders, and capitalisation; securities law is concerned with how the company capitalises itself. This is to address inequities of fraud and abuse of the corporate entity and the market.

### 3. *Grundnorm*

The *Grundnorm* developed from the historical context and manifested as offer regulation which was implemented as intercessor to address and prevent fraud. This gave rise to investor protection by means of disclosure regulation as an *ex ante* mechanism,<sup>3</sup> which also, as added benefit, ensures efficient capital markets by ensuring allocative efficiency.

### 4. **On the nature of principled offer regulation**

Efficiency is a specific requirement of securities regulation, where the legislation is to conform to the *Grundnorm* in complying with the

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<sup>3</sup> Irrespective of the type of regulatory enforcement model followed. The first tier of offer regulation entails an *ex ante* regulatory regime.

requirement of efficacy, in advancement of the principles of offer regulation and the *Grundnorm*. With inefficiency, further evolvement will, or ought to occur in order to balance the scales towards efficacy. Coupled with this is the concept of complete law and enforcement failure, ergo, law which is not complete manifests, with the effect of probable enforcement and deterrent failure. Incomplete law means that relevant applications of the law are missing, or that they are ambiguously stated in law. When law is incomplete, law enforcers are unable to stipulate whether a particular action will fall within the scope of the law and will therefore attract sanctions or not. It follows that incomplete law will, as a result, also lose its deterrence value. Enforcement failure and incomplete law, together with market failures gave rise to the emergence of *ex ante* regulators *in lieu* of *ex post* enforcer-regulators such as the Courts.

A divide is made between pro-active regulators such as the FCA in the UK and the SEC in the US, and a regulatory regime aimed at offer regulation as in South Africa, *sans* an *ex ante* regulatory authority which is pro-active in its enforcement. *In lieu* of the latter, South Africa features an *ex ante* regulatory regime to be enforced by the Courts as *ex post* regulator by means of enforcement. The Courts are a regulator-enforcer and the regulatory provisions in Chapter 4 serve as guide to market participants and the Courts, as well as deterrent to would-be offenders. For this reason it is important for the South African regulatory regime to be construed as complete in law.

It is submitted that law in the offer regulatory sphere will be complete where it is aligned with the established principles of regulation, in addition to being stated unambiguously and providing for deterrence value as well as all applications of the law. The regulatory design in achieving efficiency is designed with principles aimed towards investor protection and capital market efficiency. These are achieved through enabling principles, deterring principles and continued disclosure principles aimed at equality and reduction of risk. It follows that the principles posit natural law tendencies in contrast with the Guidelines which pre-empted the 2008 Act. This severely impacted the regulatory regime in place, as per Chapter 4, which heralds a shift in policy towards a positivist regime. The Guidelines does not refer to the established principles of offer regulation. It lists the alignment of company legislation with the constitutional dispensation, in order to facilitate the political climate and social as well as economic environment, based on the goals and policies identified in the Guidelines.<sup>4</sup>

The Guidelines also lists principles which can be applied to offer regulation: shareholder and investor protection are cursorily mentioned as part of securities law only three times in the Guidelines. The review process envisaged an extensive review of detailed provisions of the new dispensation and an assessment of the provisions of the 1973 Act against international best practice and developments. This has not happened. What has happened is that a differentiation was drawn between company law and securities law, the latter to be regulated in the form of the

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<sup>4</sup> What followed was a copy and paste exercise of one of the most complex pieces of legislation.

Security Services Bill as it was known at that stage. It is submitted that an artificial distinction was drawn. Also, the prospectus requirements at paragraph 4.3.1 of the Guidelines only state that maximum disclosure is sought with adequate vetting *sans* substantive objectives. Of the cardinal errors in the review process that gave rise to the 2008 Act, was the fact that the guidelines in the Guidelines were confused with principles. The divide is that guidelines are standards setting out goals to be reached in economic, political or social structures. Principles are standards to be observed on a basis of justice, fairness or morals. This in essence posits the differences between the naturalistic, established principles of regulation and the positivist policies and imported guidelines of the review process. Although change was due, the review process was not a review process at all. It was an overhaul based on a drafting process *in lieu* of a review process and aimed at an overhaul and redrafting of the existing provisions. The nature of capital market transactions and the common law were not noted nor considered in the Guidelines which focused rather on non-specific goals *in lieu* of a concentration on substantial issues. This paved the road towards a formalistic approach in terms of the Guidelines instead of a substantive and considered overview.

#### **5. Guidelines and section 7 of the 2008 Act**

It is submitted that the 2008 Act is a step back in the evolvement of offer regulation and investor protection. The main concern with the Guidelines is that it failed in its objectives to provide for company law in South Africa, in respect of offer regulation, which ought to have been clear,



facilitating, predictable and consistent. This has been shown throughout this thesis. The vision of the Guidelines in providing for company law which promotes the competitiveness and development of the economy by encouraging entrepreneurship; promoting innovation and investment in domestic markets and companies through flexibility and an effective and predictable regulatory market; has not been achieved in respect of the subject matter.

As a result thereof, the purposes of the 2008 Act as per section 7 thereof have not been achieved and are currently at risk of failure. Little change has occurred in terms of offer regulation and the changes that were effected were only changes to the structure of the regulatory regime, without due consideration of the substantive aspects thereof.

The main reasons for same may be found in the developmental aspects which gave rise to the 2008 Act juxtaposed to that of the 1973 Act; highlighted by the differences between the Guidelines and the Van Wyk de Vries Commission Report, both which gave rise to the respective acts. Also, the Memorandum of Objects of the Companies Bill of 2008 is vague, cursory and outdated and of little use in reviewing the rise of the 2008 Act with little to no information available concerning the review and drafting of Chapter 4. As such the goals of the reform process, as set out in the Guidelines, were not achieved or only partially achieved. This is evident from the fact that the Guidelines, as prepared by the DTI, had to guide the law reform process as envisaged. It however only served as guideline to the drafting of the Bill without a reform process of note. Offer

regulation was not part of the six priority areas, identified for consideration. The primary function of the working groups which considered the priority areas was to recommend broad principles for the drafting process in the relevant areas of provisions. It is submitted that broad principles applied to a drafting process is insufficient, as the scope of this type of legislation and the subject matter of regulation is quite technical and detail oriented. No record exists of a refining process of these broad principles.

Firstly, it is submitted that in respect of Chapter 4 offer regulation, in recommending amendments to the regulatory regime, it is important to consider the motivation thereto. With respect to offer regulation, which Chapter 4 purports to achieve, it is important to apply the reasoning behind the legislation, ergo the principles of regulation. These principles have developed in response to the common law failing or the non-existence of provisions aimed, in the first instance, at anti-fraud and in the second instance, protection of investors and the requirement for allocative efficiency. Incomplete law failed where enforcement was attempted of the remedies available. The evolution of offer regulatory laws has seen this ebb and flow of market infractions met by legislative attempts to provide against same. Therefore, it is important to consider the principles of regulation as developed, in steering clear from past mistakes and adhering to principles that are effective.

The three dimensional reality of corporate law must be considered as it is not feasible to merely change the letter of the law without considering the

effect thereof in practice. It is not in the statute that the law will be seen reaching its objectives, but in the existence and trading of companies on the market place and through enforcement of the legislation. That said, no single law can operate in isolation and therefore cannot be considered in isolation. For this reason, the common law as developed, especially in respect of transactions relative to public offers, must be considered. The overall aim of offer regulatory law is to adhere to the principles of regulation and to provide for an offer regulatory regime which is effective and efficient in regulating offers to the public so as to ensure in its operation and enforcement success, whether it is enforcement by means of compliance and legal certainty, thereby acting as deterrent *ex ante*, or enforcement by means of the Courts *ex post*.

The importance of adherence to complete law in counteracting enforcement failure is of particular importance in a regulatory regime where regulation is based on *ex ante* regulatory provisions, enforced *ex post* by the Courts. In terms of the South African disposition concerning aspects of Chapter 4 offer regulation, the reality of two separate markets has been identified together with the fact that the philosophy in South Africa has changed between the 1926 Act and the 1973 Act, due to recommendations by the Van Wyk de Vries Report, that these markets be separately regulated.

Although the 1926 Act did not provide for explicit separate regulation, it did differentiate between the two capital markets, applied conjunctively. The 1973 Act took it one step further; it differentiated between the two

regimes and applied its regulation towards a separation model. The 2008 Act provides for differentiation as per the 1926 Act only.

The basis of regulation is disclosure and liability provisions. These are market dependant as per the legislation which provides for a differentiation between the markets yet no lucid application of the regulatory principles in achieving complete regulation by separating the application of the regulatory provisions. It is submitted that a multi-staggered approach had to be followed in drafting the 2008 Bill. It is argued that the review of regulatory principles was not on the table or even considered and that the aim was to provide for regulation in one Chapter of the promulgated Act. After conjoining the regulation of the markets, the impact of each and every definition applicable, as well as each section, had to be considered in providing for the differentiation to go beyond the conjoining by means of merely providing for conjoined regulation, but also to provide for compliance of conjoined regulation to each and every section in Chapter 4 and to the principles and common law as applicable. The problem resides in the basis of disclosure as regulatory mechanism and the fact that disclosure is market dependant with different disclosure and liability provisions.

It is submitted that the genesis of enforcement failure concerning Chapter 4 regulation is with conjoined regulation of the two markets. It will be aimed to provide suitable recommendations to separate the regulatory provisions in a logical fashion, as to consider the principles of regulation and not merely effect an approach of dissociating the regulatory regimes.

Secondly, flowing from such a considered separation, recommendations will be made concerning the concept of an offer as applied to a separate regulatory model, especially concerning the primary market sale. In this respect, the definitions as delineating parameters in determining the scope and application of the regulatory provisions will be aligned along the principles of offer regulation as well as transactional relativity. Thirdly, recommendations will be made to provide for suitable exemptions to the concept of a public offer, as to exclude the possibility of a non-public common law category. Fourthly, recommendations concerning liability provisions will be made, followed by recommendations concerning the prospectus.

#### 6. **Appraisal of position in South Africa**

Regulation of capital markets is a given, not only from a historical but also a public interest point of view; the two concepts so intrinsically entwined that it is not possible to separate same as it has become policy that *ex ante* regulation is a requisite. It is submitted that the conjoined regulation of the primary market and secondary market is not a problem *per se*. There is no magical formula that prohibits such a regulatory model. At its core, offer regulation is the *ex ante* regulation of transactions where the *merx* of the underlying contracts is immaterial, i.e., a security. The regulation in respect of the two markets differs due to the difference in the principles of contract law as applicable to the respective transactions. It is submitted that conjoined regulation will have an effect on efficiency where the regulatory aspects of each, intervenes with the

other, creating confusion in the application of the requisite regulatory provisions. Where the scope of application of each set of regulatory provisions inhibits the other, a problem arises. This is evident where definitions are incorporated to provide for the one or the other or both, and the application of each is not limited to the specific market, creating an overlap and negation of application. The subject matter of regulation is transactional in nature, i.e., offers for subscription of securities in a company or the sale thereof, insofar as a primary market sale is concerned, together with the regulation of secondary market sales. The problems concerning conjoined provisions with different scopes of application have been highlighted. Also the relevance of section 101 in our law has been highlighted with the deduction that it has outlived its usefulness, especially in light of structures such as in the UK and US which provide sufficiently enough for the regulation of such transactions. Dual regulation is not a problem *per se*; it is where there is an overlap in terms of regulation which caused ambiguity, especially if the definitions are not up to par.

It is submitted that the 2008 Act is a step back in the evolvement of offer regulation and investor protection. The main concern with the Guidelines is that it failed in its objectives to provide for company law in South Africa, in respect of offer regulation. This has been shown throughout this thesis. The vision of the Guidelines in providing for company law which promotes the competitiveness and development of the economy by encouraging entrepreneurship, promoting innovation and investment in domestic markets and companies through flexibility and an effective and

predicable regulatory market, has not been achieved in respect of the subject matter. As a result thereof, the purposes of the 2008 Act, as per section 7 thereof have not been achieved and are currently at risk of failure.

Little change has occurred in terms of offer regulation and the changes that were effected, were only changes to the structure of the regulatory regime without due consideration of the substantive aspects thereof. The main reasons for same may be found in the developmental aspects which gave rise to the 2008 Act juxtaposed to that of the 1973 Act, highlighted by the differences between the Guidelines and the Van Wyk de Vries Report, both of which gave rise to the respective Acts.

Chapter 4 offer regulation should be aimed at the regulation of distributions and primary market sales. As Chapter 4 does not provide for underwriting constructions as section 146 in the 1973 Act did, apart from the ostensible distinction of a sale in section 95(1)(h), and cognisant of the problems envisaged with said definition on its own as well as if read together with secondary market sale regulation, it would serve the regulatory regime well if section 95(1)(h) is revised to provide for an invitation and construction following the precepts of the 1973 Act's definition, *sans* the differentiation between a sale and a distribution. It follows that Chapter 4 would then also include the definition with presumption which provides for underwriting transactions. The secondary market will be dealt with in terms of regulation as outlined by means of following the principles of the US and UK regulatory models, with

adaptations thereto. The inclusion in Chapter 4 of secondary market regulation which should have been aimed at the prevention of the unscrupulous sales of securities in the secondary market, has created an overlap in regulation which, based on incomplete definitions in section 95 constitute a regulatory nightmare, especially when enforcement thereof *ex ante* or liability either criminally or by means of civil enforcement *ex post* needs to be enforced. The problem with dual regulation which may have an overlapping effect, is evident from the liability provisions. It is submitted that the main causes of incomplete law in respect of Chapter 4 are the definitions in section 95 which must efficiently delineate the scope and application of Chapter 4. The definition of an offer must be revised in order to provide for the common law in respect of the underlying transaction. The definitions, read with section 101 and the provisions for secondary market regulation, create an untenable regulatory regime. Section 101 has evolved from the regulation of share hawking to full blown secondary sale regulation which severely impacts on the regulatory regime in the primary market. It is submitted that the position in the UK and US is more in line with reference to providing effective regulation in respect of secondary market sales of unlisted securities, without granting it the same status in respect of primary market sales. Following the principles of the Guidelines and section 7 of the Act, it is submitted that the Legislature should have opted for a regulatory regime akin to that of the UK and US in respect of the provision of regulating all offers of any securities, unless certain exemptions apply. It would have been easy enough to provide for regulations aimed at securing investor protection,



where reliance is placed on an exemption of secondary market sales of unlisted securities, following the example of Rule 144 in the US. At this stage, it is submitted that the Rule 144 route would benefit the regulatory regime locally whilst the infrastructure is created to provide for the exemption of registered dealers or exempt traders, with the provision that same may deal in secondary market sales of unlisted securities, following the UK system. The two systems as outlined are compatible and it is submitted that Rule 144 together with the selected provisos from the US system will benefit South Africa as our regulator is not pro-active, relying on the Courts to enforce the regulatory provisions *ex post*.

#### 6.1. Offer

In respect of the South African disposition, it is submitted that the genesis of offer regulation is the concept of an offer. In respect of same, the relevant capital market of application is important, as is the requirement for unambiguous regulation applicable to the relevant offer in a specific market. Flowing from it is the definition applicable to the concept of an offer, which is the first determinant in deciding whether an offer to the public of securities is made, thereby triggering the disclosure requirement. Secondly, the South African offer regulatory landscape is influenced in respect of efficiency by the concept of public as applied to the three determinant factors. Lastly, liability can be curtailed if it does not provide for application to a regulatory framework in a market or for an appropriate remedy, thereby influencing the deterrence value of *ex ante* regulatory provisions.

In terms of offers, the focus of Chapter 4 regulation is who must disclose, when to disclose and the extent of such disclosure, depending on the nature of the market applicable to the underlying transaction. The basis of establishing an offer, is by means of attempting to apply the definition in section 95(1)(g). An offer as the first determinant as defined in section 95(1)(g), refers to the action by the addressee and not the action by the company.

Due to the fact that offer regulation in terms of Chapter 4 is in essence the *ex ante* regulation of transactions in the capital markets, it is important to consider the contractual principles applied to these transactions. In the primary market, the offer is intended for the conclusion of a contract for subscription. In other words, the acquisition of unissued securities. The securities are unable to be sold via a purchase and sale agreement because they are not in existence as of yet due to its nature as an incorporeal and will only come into existence after allotment and issue thereof. This is juxtaposed to a contract of purchase and sale.

The company does not offer the securities in the primary market because it is unable to do so. It issues an invitation to investors who then make offers to the company. The company accepts these offers and allots them prior to issue thereof. In the law of contract, an offer is a declaration of the will of one party, which is of such a nature and in such form, that acceptance thereof will be sufficient to constitute an agreement.

An invitation to do business or to make an offer, is not an offer and it is used by the party making the invitation, to exercise a choice in respect of

the counter-party and also to communicate additional terms to the other party prior to concluding the contract.

The company can accept offers from investors for fewer shares than that offered by the investors, if there is an over-subscription. It is for this reason that a company issues a public invitation for an offer to subscribe for securities by means of an invitation, instead of an offer.

If an offer was made by the company instead of an invitation, subject to the condition that acceptance by the addressee of the number of shares will be adjusted at the discretion of the company, the acceptance by the addressee will be a counter offer, extinguishing the offer of the company. For this reason, the Van Wyk de Vries Commission reported that the common law definition of an offer was not wide enough in respect of company law subscription contracts and an invitation was incorporated in the definition of an offer. In this respect, section 142(1) of the 1973 Act provided for a distinction between an offer for subscription and an offer for purchase and sale, the latter reference to underwriting constructions.

Section 95(1)(g) differs fundamentally in respect of the underlying contractual principles as well as the evolvement of company law. It refers to an offer as being an offer for the acquisition, for consideration, of securities. This purportedly, albeit ambiguously, includes subscription and sale, not differentiating between primary market and secondary market transactions or underwriting constructions, to be read as all three being applicable. It also does not consider the exposition of offer and invitation as referred to above. An invitation is not included. The invitation for

subscription by the company will therefore not be an offer as defined in the 2008 Act or under the common law. The definition also implies that it is the investor making the offer and not the company making an invitation for the subscription to an offer. The PO and IPO are also excluded as the investor is not the party extending the offer of securities. There is a vast difference between an invitation and an advertisement, as provided for in section 98 read with section 1. Section 98 refers to an offer as defined and section 98 regulates the offer if it is made by advertisement, and not if the advertisement is an invitation. Section 95(1)(m), refers to the secondary market offering and means “...an offer for sale...requiring either a registered prospectus or a written statement.” The problem of course with section 95(1)(m) is that it defines a secondary offer for sale to the public, of any securities of a company, made by or on behalf of a person other than that company. This will entail an underwriting agreement and read with the term “sale” in section 95(1)(h), the scope for an overlap is clear. The use of offer as defined is wide enough to create an overlap of regulation in respect of the markets, where the definition of an IPO is read with the secondary market offering for sale.

## 6.2. Primary market sale

Sale in this context only refers to the underwriting constructions. It has already been alluded to that the primary market is the first distribution. The shares are made available to investors by the company, the parties consisting of the former and latter. Necessity however, dictates the need

for a company not to conduct the distribution itself and to utilise the services of a third party.

In some instances, a third party is utilised in an agency relationship to distribute the shares on behalf of the company, with the company the principal. This relationship may be with or without additional obligations and agency principles dictate that the “distribution” is by the company as principle and is in essence “best-efforts” underwriting. The third party can also acquire the securities in the company in terms of section 40 and then, as per the agreement with the company, “distribute” the securities to other investors. These “undistributed” shares, as acquired by the agent, remain the property of the agent prior to the “distribution” thereof. This denotes “firm underwriting.” The principle in both instances is that the ultimate two parties to the contracts are the company who acquires the consideration for the securities and the eventual investor who acquires the shares directly or indirectly. Such transactions will be in the primary market and will manifest as a “sale.” South African company law does not recognise these transactions as “underwriting” and views it as “old-fashioned” underwriting, which is akin to insurance. This entails that an outside party undertakes to take up the undistributed shares, and, for which the company pays a premium.

This is evident in the difference in transactions concerning “subscription” and “sale,” as per section 142 of the 1973 Act, which regulated the two capital markets in separate chapters. The secondary market comes into the fore where the investor who has acquired, by whatever means as

expounded on above, the securities and wishes to sell them. This subsequent transaction is a contract of sale and it occurs in the secondary market. This transaction has no relevance for the company. The primary and secondary markets operate in strict numerical order as per the nomenclature. It is thus physically and legally impossible for the secondary market to exist, prior to the primary market in respect of both the formal and informal secondary markets.

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 contract for subscription and not a contract for purchase and sale (as would be relevant in the secondary market), is because of the fact that the security, as an incorporeal, is not yet in existence before the issue thereof and can therefore not be sold. The company does not offer the shares for subscription, it issues an invitation to investors, who then make offers to the company. The company then accepts the offers to the extent that securities are available, and allotment and issue follows. When an offer to investors is an offer by an underwriter (in other words a primary market underwriting transaction), and when it is a *bona fide* secondary market offer seems to be problematic. In the 1973 Act, section 146(2) created 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.

In the primary market, offer regulation is substantial and the company must disclose by way of a prospectus, with substantial prospectus

requirements. In the secondary market, the seller must disclose, and the extent of disclosure requirements is limited due to the fact that the seller does not have access to all the financial information. The importance to differentiate between the two markets insofar as regulatory purview and requirements are concerned, is evident.

Primary market sales in the context of Chapter VI regulation, referred to section 146. The 1973 Act envisaged two situations, firstly where a company allots shares to an issuing house, bank or mining house with a view to such intermediary subsequently making a public offer. This underlying assumption of the role of the intermediary in floating the shares of the company constituted one of the main differences between the purview of section 146 and 141.

Secondly, it was envisaged where a company allotted and issued shares, not with the object of those shares being offered to the public for sale, but the shareholder concerned, in co-operation with the company later offers them for sale to the public, and his offer for sale is accompanied by the stated intention of the company to apply for their listing of those shares. In the spirit of the evolution of offer regulation, the applicable principles thereto had to be adjusted in order to accommodate changing strategies.

By way of background, in England the Greene Committee considered offers for sale. The structure of offering for sale through an intermediary, had in many cases been adopted to circumvent the strict requirements of the law pertaining to prospectuses, with the result that the public had been deprived of the intended protection. The recommendation had been

accepted and section 38 of the 1929 Companies Act rendered the provisions of the Act, relating to primary market offer regulation by means of a prospectus applicable, also in the case of offers for sale for the purchase of shares or debentures which a company had allotted or agreed to allot “with a view to all or any of those shares or debentures being offered for sale to the public.”

In South Africa the Lansdown Commission pointed out that primary market offer regulation, by means of mandatory merit disclosure requirements, might lead to an increase in the practice of allotting securities to another company or individual for offer to the public, in order to evade primary market regulation. A recommendation was made for the inclusion of the equivalent of section 38 of the English Companies Act of 1929, qualifying certain sales as primary market transactions.

In these circumstances, a prospectus was required, clearly differentiating between section 141 secondary market regulation and Chapter VI primary market regulation even though reference is made to a contract of sale transaction. The differentiation does not exist in the distinction in designation between offer for subscription or offer for sale, but rather in the nature of the designated underlying transaction and regulatory principles to be complied with, which were ultimately reflected in the 1973 Act.

In terms of the underlying construction of the transaction, it may be necessary for the company to not do the distribution itself but to utilise the services of a third party. In such a case, agency principles dictate that the



distribution is by the company and not the third party (regardless whether any obligations manifest as to the shares not distributed). A second scheme is where the “undistributed” shares are acquired by the agent and therefore he remains the owner (firm underwriting). The common principle is that in the above situations, the ultimate two parties to the contracts are the company who acquires the consideration for the shares (directly or indirectly) and the investor who directly or indirectly acquires the shares and therefore this is a primary market transaction, termed sale for purposes of distinction.

As Chapter 4 does not provide for underwriting constructions as section 146 did, apart from the apparent distinction in section 95(1)(h), and cognisant of the problems envisaged with said definition on its own as well as if read together with secondary market sale regulation, it would serve the regulatory regime well if section 95(1)(h) is revised to provide for an invitation and construction following the precepts of the 1973 Act’s definition, *sans* the differentiation between a sale and a distribution. Chapter 4 would then include the definition with presumption which provides for underwriting transactions. The secondary market will be dealt with in terms of regulation as outlined by means of following the principles of the US and UK regulatory models, with adaptations thereto.

### 6.3. Secondary market and secondary market sale

Section 141 of Chapter V in the 1973 Act regulated secondary market transactions, i.e., sale of shares. The section placed a restriction on the offering of shares for sale to the public without a statement. An offer of

shares to the public either orally, or in writing was prohibited to be issued, distributed or published where the denoted material in its form and context were calculated to be understood as an offer, unless accompanied by a registered written statement which complied with the requirements of section 141(5).

Specifically excluding the application of the section to primary market transactions is subsection (2)(e) which dictated that the provisions of subsection (1) did not apply where the offer is accompanied by a prospectus registered under Chapter VI of the 1973 Act.

The prohibition extended to an offer or invitation whether made orally or in writing (including any newspaper advertisement, or any electronic advertisement) and to the distribution or publication of any material which in its form and context is calculated to be understood as an offer or invitation. It also extends to debenture stock or debenture bonds or any other security of a company.

It follows that the field of application differs from Chapter VI transactions, being aimed at the unscrupulous selling to the public of issued shares of a company. The essence is the requirement of disclosure of information material to any intending purchaser's decision as whether or not to enter into the transaction, safeguarding the true market value of the shares and all matters affecting it.

The investor who acquired shares in the primary market by whatever means, may want to sell the shares and this transaction is reserved for the

secondary market, the transaction having no direct relevance for the company. The primary market and secondary markets operate in strict numerical order as per the nomenclature and it is physically and legally impossible for the secondary market to exist prior to the primary market.

The reasoning for the importance of this distinction is that in the primary market, the company must disclose by way of a prospectus and the extent of the disclosure is substantial. In the secondary market, 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.

The contextual difference is to be found in the context of information available to effectively disclose in meeting the principles of offer regulation. The less comprehensive system which was in place in terms of section 141, enabled both offer regulation as well as compliance thereto, by a seller who did not necessarily have all the information available which was needed for a prospectus. The system was therefore less onerous than that of primary market regulation.

Due to the confusion between the provisions of offer for subscription and for sale in the primary market and offer for sale in the secondary market (two sets of sale transactions with different context to each), confusion reigned in applying the provisions applicable in the 1926 Act. Due to this, the Van Wyk de Vries Commission recommended that the provisions be in different chapters in the 1973 Act.

## 6.4. Prospectus

If an offer is an advertisement as defined in section 98, it must comply with section 100. Section 95(1)(g) does not provide for a written requirement concerning the offer and a verbal offer can accompany the prospectus as contemplated in section 99. If however an invitation as per section 98, the offer must be registered as such. Section 99 provides for a registered prospectus to accompany an offer but does not state, read with section 95(1)(g), that the offer be in writing. Reading and applying section 98, it is not clear whether the prospectus is the offer or the document that must accompany the offer.

## 6.5. Securities

Currently, an offer is defined in Chapter 4 defines so as to acquire securities for consideration, envisaging two transactions, ergo the IPO and PO. The *merx* of the transactions are securities as exhaustively defined in section 1. The problem with an exhaustive definition is that any instrument not falling within this definition is incapable of being offered, therefore being able to be assailed in terms of *ex ante* regulatory provisions. Following the tenants of case law and application thereof in other jurisdictions, it follows that the definition of a security is not in need of identified transactions of securities in determined markets. The definition is required to be inclusive of the underlying transaction i.e., of a secured debt and/or claim against the property of the issuer.

## 6.6. Public

The third and last determinant is the most problematic, mainly due to its scope of application in respect of offer regulatory provisions. An offer to the public is defined in section 95(1)(h). The main problem is that this definition provides for the concept of an offer of securities to the public, to include an offer of securities to be issued by a company, to any section of the public. This does not provide for transactional relativity as it is not the company which makes the offer but an investor in response to an offer for subscription. The use of the word “includes” in the definition may denote that there are one or the other different meanings attached to it. This is however unlikely as the “includes” merely refer to subsections (aa) to (dd), serving as a causal link with the words “whether selected.”

The second biggest current problem is that the definition, together with the exemptions and application of precedent, infers a common law non-public offer. Due to the *Gold Fields* case and the new Chapter 4, especially section 95(1)(h), there is a rational connection between an offer and the characteristics that set the group where the offer is aimed at acquiring specific private property apart, where it is only capable of acceptance by the owner of the property if addressed to the owner in this capacity, having the effect of not being an offer to the public or a random selection thereof. In absence of applying the principles of Rule 506 of the SEC as basis of determinant whether an offer is non-public or not, the premise of complete law calls for an inclusive definition or list of exemptions and it is submitted that the law be amended to due effect, or in the alternative that Rule 506 be incorporated into section 96. The same

principles are used to determine who the public is in terms of section 95(1)(h) and 96; the secondary offer can still be public because it is in a different category. Therefore, the primary market transaction can be structured around one of the exemptions in section 96, and the limited disclosure of the secondary market can be applied where disclosure might be required due to the nature of the redistribution. In terms of the concept of a public offer, it is important to note the definition of a public offer, together with the exemptions, and to determine the scope of the exemptions in terms of whether the definition of a public offer is exhaustive or not. Public is not defined and thus ordinarily understood and in terms of section 95(1)(h) expanded to include a selection thereof. The scope of the definition allows that section 96 is to be read as a safe harbour in its application, which together with the application of the dictum in the *Gold Fields* case, lends itself to a non-public common law category. A transaction can therefore fall outside the scope of section 96 and will thus be a non-public offer falling outside the regulatory purview of Chapter 4. It is submitted that an inclusive definition be provided and it is submitted that such a definition should be as follows:

Offer to the public: and any reference to offering securities to the public, meaning any offer of securities to the public and including an offer to any section of the public, whether selected in any other manner and will only exclude an offer made under the circumstances as contemplated under section 96.

## 6.7. Purposive Interpretation

In order to avoid disorder which will amount from a literal reading of Chapter 4, it was proposed in chapter 5 part A that the basis of a purposive interpretational framework be laid, as the 2008 Act provides in section 7 for purposive interpretation. The gist of purposive interpretation follows the premise to avoid literal application by means of a “dictionary” application in preference to an interpretation that allows for the intent, subject matter, scope and purpose as well as background of the legislation. The problem is that the highlighted interpretative problems concerning the delineation of Chapter 4, are not confined to ambiguity towards a “dictionary fortress.” At the core of the interpretive problems are definitions that fail to consider transactional relativity and company law, as well as conjoined regulation of the secondary market in respect of public offers to the public. Chapter 5 part A, has laid the basis for the Courts to attempt to interpret Chapter 4 in a purposive manner, however even with clearer definitions and premises of law, the 1973 Act caused confusion and was interpreted wrongly by the Supreme Court of Appeal in the now infamous *Gold Fields* case. Applying the train of thought in said case, in reference to the context of Chapter 4, it is submitted that there is no certainty or clarity as to how the law will be applied. Furthermore, purposive interpretation can only be available where law is ambiguously stated. However, the situation exists in terms of Chapter 4 as it reads, that the law is so patently incorrect that it is not ambiguous but clear, albeit erroneous. This is the problem occasioned where the common

law and transactional relativity as well as the principles underlying offer regulation were not applied in the review and development of Chapter 4.

#### 6.8. Summary of position in South Africa

The 1973 Act defined an offer as: “*offer in relation to shares, means an offer made in any way, including by provisional allotment for allocation, for the subscription for or sale of any shares, and includes an invitation to subscribe for or purchase any shares.*” The definition distinguished between a contract for subscription in the primary market and a contract of purchase and sale. Chapter VI of the 1973 Act was intended to operate in relation to the raising of capital by a public company by means of an approach to the public, which is a primary market transaction and not akin to the secondary market transaction envisaged in section 141 of the previous Chapter V.

To this extent Chapter VI at section 142 contained a specific set of definitions applicable to the primary market transactions to be regulated therein. The definitions in section 142 commenced with the words: “*In this Chapter (VI),*” and the definitions could therefore not be used for the secondary market provision of section 141 in Chapter V.

Although offer as defined, included an invitation to subscribe for or purchase shares, this fundamentally differs from the secondary market transaction envisaged in section 141.

In the context of Chapter VI, purchase did not mean the purchase of issued shares acquired by the offeror or his principal, but the acquisition



of shares in a new issue. The aim of Chapter VI was the protection of investors by prohibiting offers to the public by a company, unless there was compliance with the provisions.

The application of primary market regulation underscores a fundamental difference from secondary market regulation in terms of the basis of regulation and disclosure required. Based on the risk profile of these types of offers, as well as the ability of the company to provide sufficient information, more stringent regulation applies to these transactions.

The divide between the types of regulation between the markets fundamentally resides in the type of transaction and the regulation thereof. It is submitted that it follows that the divide between regulation in terms of Chapter V and Chapter VI transactions, is to avoid confusion and thus the possibility of assailing the more stringent Chapter VI regulation for Chapter V regulation. In the absence of confusion, legal clarity is obtained ensuring efficient compliance to regulatory principles.

#### 6.9. Liability as case in point

The problem with dual regulation which may have an overlapping effect is evident from the liability provisions. Prospectus liability for untrue statements follows the structure of the 1973 Act. Persons who authorise the issue of the prospectus are liable to pay compensation for any loss or damage sustained by any person who acquired securities on the strength of the prospectus, as a result of any untrue statement in the prospectus, or any report or memorandum appearing on the face of, issued with, or incorporated by reference into, the prospectus. Section 104 provides for

liability in respect of untrue statements in a prospectus despite the securities being offered to the public for subscription or sale. This entails that secondary market offers will be excluded from section 104 liability. Section 101, which specifically deals with secondary offers and disclosure in terms thereof, either by way of a prospectus or a written statement, does not contain liability provisions for a written statement. In essence, a choice is provided as to which instrument of disclosure may be used. Different levels of disclosure and liability ascribe to each instrument. In specific instances, a defendant would have to resort to the common law. Section 77 provides that a director of a company would be liable for any loss, damages or costs sustained by the company as a direct or indirect consequence of the director having signed, consented to, or authorised the publication of a prospectus or a written statement contemplated in section 101 that contained an untrue statement as defined in section 95. In terms of this, liability of the director is extended only towards the company. Although this section provides for the written statement as basis of establishing liability in the secondary market, only the company can use it and not investors. The problem with liability in terms of this subsection and the written statement, is that it would seem that the director of the company is liable even if the director is not the seller of the securities. Liability in the sense of proper secondary market constructions rest on the capacity of the seller and not the capacity as the director, and it is not relevant under section 77. Liability towards the company is not possible as the company is not involved.

A secondary offer must not be made to the public unless the offer satisfies the requirements of section 101 of the Act. Given the definition of an offer to the public in section 95(1)(h) which refers to securities being issued, it would appear that the section 96 exemptions do not apply to the secondary market, *sans* section 95(2). If a written statement contains an untrue statement, it is an offence in terms of section 214(1)(d). However, such an untrue statement will not attach statutory liability in terms of the prospectus provisions, as the relevant provisos only refer to liability for untrue statements in a prospectus. Liability will therefore only be under common law for the delict of misrepresentation. There is however no statutory criminal liability if a written statement is required in terms of section 101 but it is not issued. It would therefore be better not to issue a statement under section 101, rather than issuing one which contains an untrue statement.

Chapter 9 of the Act provides for offences and penalties under Part A thereof. Specifically, section 214(1)(d) makes it a criminal offence where a person is a party to the preparation, approval, dissemination or publication of a prospectus or a written statement that contains an untrue statement as defined and described in section 95.

Section 214(3) provides for an offence where a person fails to adhere to a compliance notice issued in terms of the Act, unless the Commission, the Panel or the exchange has requested a Court, in terms of section 171(7)(a), for the imposition of an administrative fine.

## 7. Position in the United Kingdom

Market regulation in the UK seems at first to be complicated, yet it is not. In the UK, the regulation of offers is occasioned by means of the Prospectus Rules, through the Prospectus Directive and the FSMA. The Prospectus Rules provide the first stop of offer regulation, read with the FSMA. Both these are influenced by the European Prospectus Directive. Offer regulation is provided for in terms of prospectus requirements and prohibitions to trade in terms of any offer, as well as seeking listing without an approved prospectus. The Prospectus Rules and the FSMA provide exemptions to these requirements. Trading of unlisted securities is provided for under the FSMA and a Statutory Instrument concerning Financial Promotion. Criminal and civil liability is provided for, with the scope of applicability attached to the prohibitions against offering and listing, which also provides for the prospectus requirement. It is submitted that regulation of offers to the public, as well as the liability provisions coupled thereto, do not differentiate between dissimilar regulatory regimes where the one has lesser disclosure or liability and where ill-conceived legislative drafting provides an overlap between the two regulatory regimes. Two important aspects concerning offer regulation in the UK are of relevance for South Africa. The first is the general prohibition and prospectus requirements as per section 85 of the FSMA. The second is how the UK regulates the trading of unlisted secondary market securities. Section 85 provides for when a prospectus will be required. A prospectus is required prior to the offering or the request for admission to trade. Section 85 is to be read with section 86 which

provides for suitable exemptions. The basis of regulation is not confined to be coupled to market related transactional definitions such as an IPO and PO. Ostensibly these two definitions in Chapter 4 of the 2008 Act, aim to provide for regulation of listings which are to follow the primary market offering. These transactions are succinctly provided for in the prohibitions in section 85(1) and (2). Under the Prospectus Rules, any offer whether in the primary or secondary market, formal or informal, will attract regulatory purview unless exempted or otherwise provided for.

The Prospectus Rules and the FSMA seek to regulate offers of securities to the public and it is submitted that there is a clear divergence in UK law from a double standard type of regulation, i.e., as present in South Africa, where regulation of offers, of securities to the public, are sought in accordance with principles which differentiate the type of regulation of offers, between two markets. This type of differentiation, originally found its way into UK legislation to provide for the hawking of shares in order to regulate same as per section 356 of the English Companies Act of 1929. It found its way into South African company law by means of section 80*bis* of the 1929 Act. In the 1973 Act, it was incorporated in Chapter V as to avoid confusion with primary market sales which provided for underwriting constructions in our law. Following the dictum in the *Gold Fields* case, the confusion due to the provision in the definition of an offer to the public in Chapter VI of the 1973 Act, was not avoided entirely. Without much consideration, section 80*bis* with variations, found its way into Chapter 4 of the 2008 Act as section 101 denoting an evolvement

from anti-hawking provision towards full blow regulation of secondary market resales.

Under English law, section 356 was replaced by section 12 of the Prevention of Fraud (Investments Act) of 1939 and had a short run prior to the Legislature replacing the regulation of hawking of shares by the 1983 Act with the same title, providing for the regulation of unlisted secondary market transactions by means of registered or exempt traders or intermediaries. These provisions were ultimately replaced and are now catered for under the FSMA which provides for Financial Promotion in section 21, read with Statutory Instrument 2005 Number 1529: Financial Services and Markets.

By extending the validity of the prospectus to 1 year, the UK uses the provision that a company is obliged to register and file a supplementary prospectus in respect of any material changes or errors, to its full extent. Furthermore, the disclosure obligations in the Companies Act of 2006 provide for up to date financial information concerning the company, which will enable secondary market traders to obtain information where and when needed.

The UK does not rely on definitions to arbitrarily set out and provide for a regulatory system and also caters for the limited applicability of unlisted secondary market sales by means of providing for suitable trading conduits. Of relevance are the application of regulatory purview to transactions and the regulation of trading of unlisted securities.

**8. Position in the United States**

Regulatory purview in the United States covers any trade, in any type of security, and provides that it must be registered with the SEC. Registration provides for a prospectus and suitable disclosure, unless an exemption is available. Under the persons subjected to the registration requirements is a broad list of applicable definitions which interacts with the exemptions. The US also does not rely on defining transactions such as an IPO and PO or in providing for separate regulation between primary market distributions, sales and secondary market resales of unlisted securities. The Securities Act does not rely on definitions to cover the scope of applicability towards regulatory purview concerning types of transactions, or apply different sets of regulatory rules to transactions. What is evident from an overview of the United States, is the thematic approach of the SEC and the Courts in interpreting the respective legislation. Adherence to the underlying principles of offer regulation and the spirit of the 1933 and 1934 Acts together with the public interest, takes precedence. It is submitted that although the principles and philosophy underlying Chapter 4 differ from the established principles, the fact that Chapter 4 is merely a version of Chapter VI of the 1973 Act, provides for the interpretation thereof together with section 7, in terms of the promotion of compliance with the Bill of Rights; promotion of the South African economy; creation of optimum conditions for the aggregation of capital and spreading of economic risk as well as predictable and effective legislation for the efficient regulation of companies towards the thematic approach as per the United States, i.e., towards the principles, spirit and

public interest as served by offer regulation. This is a risky interpretive approach and only recommended in the absence of legislative amendment.

The US provides for a more definition-based regulatory system with section 5 to be read with the definitions in section 2 as well as the exemptions in sections 3 and 4. Of importance to this study is the application of the concept of offer for sale, which provides that it shall include every contract of sale or disposition of a security or interest in a security for value, including every attempt or offer to dispose of, or solicitation of an offer to buy a security or interest, in a security for value. The definition provides for the common law construction of an invitation to offer for the purchase of incorporeals insofar as subscription construction is applicable. Furthermore, the definition does not aim to provide for a specific type of contract i.e., subscription, sale in terms of underwriting or resales of unlisted securities (or listed securities for that matter). It provides for any contract regardless, which widens the scope of application towards an all-encompassing regime, dependent on the exemptions, not to determine whether an offer is public or not, but to determine the scope of application in terms of securities and/or transactions.

The US does not rely on a divide between primary market subscriptions and primary market sales as it provides explicably for underwriting constructions, bringing same under regulatory purview akin to that of the issuer. The US also provides for hawking of shares by means of the



inclusion of underwriters and dealers in terms of the definitions reliant on the regulation of an offering.

Section 2 provides broad definitions in terms of an issuer, an underwriter and a dealer. Of importance is the interaction of the definitions with the exemptions in section 4. Section 4(1) exempts transactions by any person other than an issuer, underwriter or dealer. Section 4(1) must be read with Rule 144 which provides for guidelines to be adhered to, prior to the safe harbour being in effect (provided that the seller is not a dealer, underwriter or issuer).

Section 4(2) provides for private offerings. Of importance is Regulation D which provides guidelines in terms of how to structure a transaction in order for the safe harbour to be applicable, *sans* the safe harbour outside of Regulation D, must be used i.e., section 4(2) denotes a type of common law non-public category and as such an exemption which must be used in deciding whether an offer is public or not. Section 4(3) excludes transactions by a dealer and underwriter (no longer acting as an underwriter) after the expiry of statutory time limits and section 4(4) exempts broker transactions in the formal secondary market.

The test in *SEC v W.J. Howey Co.*,<sup>5</sup> in differentiating whether a particular construction will denote a security or not, especially where investment contracts are of concern is to be implemented, together with an inclusive definition of a security which apart from identifying the instrument, is required to identify the transaction and the effects thereof.

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<sup>5</sup> *SEC v W.J. Howey supra.*

Lastly, it is submitted that broad anti-fraud provisions applicable to offer regulation *in toto* as per section 10b-5 should prove valuable if the reach thereof is also extended towards civil liability.

Of relevance will be the interaction and definition of underwriter to that of offer, as well as the exemption available under section 4(1) as this will enable recommendations for legislative reform.

## **9. Recommendations for legislative reform**

### **9.1. Subject matter of regulation**

The subject matter of regulation is transactional in nature, i.e., offers for subscription of securities in a company or the sale thereof insofar as a primary market sale is concerned. The regulation of secondary market sales are also of relevance. The problems concerning conjoined provisions with different scopes of application have been highlighted. Also, the relevance of section 101 in our law, has also been highlighted with the deduction that it has outlived its usefulness, especially in light of structures such as in the UK and US which provide sufficiently enough for the regulation of such transactions.

The major issue is incomplete law in respect of Chapter 4. This is due to two major failures. In the first instance, the concept of an offer, as applied in terms of company law, fails to provide for the common law construction of an invitation which is then offered on in terms of the acquisition of incorporeals. Therewith is the application of the concept of an offer to the public and the application of the two transactional

constructs of an IPO and a PO to regulatory relativity. In the second instance, is the existence of two sets of regulatory provisions, applicable to separate market constructs. A review of the United Kingdom and the United States has revealed that the primary and secondary markets can be regulated together. It is submitted that the main problem is that section 101 is not concerned with the regulation of secondary market transactions *in toto* but with the hawking of shares. It is submitted that there are simpler constructs available to provide for these types of infractions. It is not conjoined regulation, but the differences in application concerning disclosure and liability and the overlap of the definitions, which serve to cause problems in simultaneous regulation as is evident in section 101 and section 99 of Chapter 4. The recommendations for legislative reform will cover these issues.

## 9.2. Policy considerations

Due to the potential effects of enforcement failure, either by means of *ex post* enforcement through the Courts or *ex ante* by means of the provisions which fail to act as deterrent, and the effect it may have on the South African economy as well as the impact on individual investors, public interest requires that Chapter 4 be brought into alignment with international trends in terms of offer regulation, as well as for the provisions to comply with the principles of regulation and the common law as to constitute complete law. For this reason, it is prudent to remark briefly in terms of constitutionality and Chapter 4. Fundamental rights

entrenched in the 1996 Constitution,<sup>6</sup> which may be limited by market failure or enforcement failure, are sections 25 and 34. In terms of section 25, every citizen has the right not to be deprived of property except in terms of law or general application; law may permit arbitrary deprivation of property. It is submitted that section 25 in terms of property, relates in the first instance to where Chapter 4 fails to act as deterrent or as safeguard and an investor parts with his or her consideration in the acquisition of an incorporeal property. Not only will the acquisition be forfeited when Chapter 4 fails, the acquired property will also be arbitrarily deprived of its value which denotes a capricious deprivation. In terms of section 35, everyone has the right to have any dispute that can be resolved by the application of law, decided in a fair public hearing before a Court or, where appropriate, another independent and impartial tribunal or forum. It follows that *sans* the concept of complete law, incomplete law, as is evident from Chapter 4, will inhibit the application of the law in the resolvment of disputes. Secondly, where liability provisions fail to provide for relevant circumstances, the right to have a dispute resolved is also curtailed.

Section 36 provides for the limitation of rights where the constitutionality of the limitations to the fundamental rights may be curtailed and adjudicated upon. The limitations are to be permissible in terms of laws of general application, to the extent that the limitation is reasonable and justifiable, taking into account all relevant factors. The relevant factors include the nature of the right, the importance and purpose of the

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<sup>6</sup> The Constitution of the Republic of South Africa, 1996, Act 108 of 1996.

limitation, and less restrictive means to achieve the purpose. Fundamental rights are generally not absolute and the rights of others and the legitimate interests of society set their boundaries. Fundamental rights are not only interconnected, but also have a limiting effect on each other and must as such, be balanced.<sup>7</sup>

It is submitted that in terms of the raised rights and their application, no justifiable limitation exists. Read with section 7 of the 2008 Act, it follows that Chapter 4 is at a constitutional crossroads. In terms of the constitutional issues raised, it is submitted that the goals of the Guidelines were laudable. The implementing thereof, in terms of the overhaul process which led to the 2008 Act, constitute the problem as it is evident that insofar as offer regulation is concerned, international trends were not reviewed and implemented.

### 9.3. Recommendations for legislative reform of regulatory model

It is proposed that all regulatory provisions relating to section 101 regulation of secondary market sales in the informal market, be deleted. This will include references in definitions in section 95. In terms of the regulation of such transactions, the US model may be followed by the provision, in terms of the concept of an offer and offer to the public, for all offers or sales to fall under regulatory purview. Under the exemptions in section 96, an exemption similar to section 4(1) of the 1933 Securities Act may be created, referring to appropriate regulations which will incorporate the wording of Rule 144 of the SEC. Similarly, section 95 will

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<sup>7</sup> De Waal J Currie I & Erasmus G (2001) *The Bill of Rights Handbook 4<sup>th</sup> ed* Lansdowne: Juta 147, 154.

provide for the definition of an underwriter and the inclusion of underwriter transactions as sales, retaining the “insurance” type underwriting in South Africa, but extending the application of a primary market sale explicitly to underwriting constructions. An appropriate time limit may be coupled to the definition of an underwriter, coupling all sales within said time, to regulation in terms of Chapter 4. The presumption of 18 months in section 146(2) of the 1973 Act will suffice. It will be for the seller, which relies on the exemption on secondary market sales of unlisted securities, to provide in the notice to be filed with the CIPC, that the transaction is not an underwriting transaction. Following the construction of Rule 144, it will cover sales of unlisted securities, by any person for his own account and sales of unlisted securities by any other person for the account, of another. The Rule 144 equivalent will provide that adequate information must be available concerning the availability of financial information about the company. An affirmative statement confirming the lodgement of annual financial statements for the past 3 years with the CIPC will be deemed sufficient. Secondly, a holding period is to apply, of at least two years, in respect of the seller. This requirement is coupled with a volume limit in respect of selling too many securities, too fast. The securities are to be sold by a broker and lastly, a notice must be filed with CIPC, disclosing the particulars of the transaction and compliance with the requirements, the identity of the parties concerned and a statement concerning the legality of the offer. In order to allow for listed securities to be exempt from the improved definition of an offer and offer to the public, an exemption will apply in respect of section 96,

applicable to the exchange and exchange regulated securities. It is further submitted that the wording of Section 21 of the FSMA under Financial Promotion, read with Statutory Instrument 2005 Number 1529, be incorporated into our law by means of regulations to the Financial Markets Act of 2012, read with the definition of section 1 “advice” and section 5(1)(a), to provide for financial promotion in terms of the “Rule 144” regulations as to be adopted into the regulations of the 2008 Companies Act, providing that secondary sales of unlisted securities are to be occasioned by means of a broker. With a simultaneous listing, it is proposed that the UK model be followed, as per section 85(2) of the FSMA which provides for a prohibition to trading unless a prospectus has been approved (filed), coupled with the provision that compliance to disclosure per the Listing Requirements will exclude a prospectus, but liability in terms of Chapter 4, would still apply. This would form part of the general prohibitions and disclosure requirements to be inserted in section 99.

#### 9.4. Recommendations for legislative reform: definitions to Chapter 4

It follows that the extent of regulatory purview is based in the first instance, on the definitions applicable to the subject matter, expounded on above, in determining the scope thereof. In furtherance of the recommendations above, and in line with the principles of regulation in aligning same towards the *Grundnorm*, the definitions as per section 95 would have to be revised.

## 9.5. Offer

As Chapter 4 does not provide for underwriting constructions as section 146 did, apart from the apparent distinction in section 95(1)(h), and cognisant of the problems envisaged with said definition on its own, as well as if read together with secondary market sale regulation, it would serve the regulatory regime well if section 95(1)(h) is revised to provide for an invitation and construction following the precepts of the 1973 Act's definition, *sans* the differentiation between a sale and a distribution. Chapter 4 would then include the definition with presumption which provides for underwriting transactions. The secondary market will be dealt with in terms of regulation as outlined by means of following the principles of the US and UK regulatory models, with adaptations thereto.

In the first instance the definition of an offer needs to be revised. It is submitted that the definition in section 95 of the Act be replaced *in toto*, together with the definitions of an IPO and PO. In regard to an offer, the definition in the 1973 Act section 142, with the necessary provision for the acquisition for consideration are to be used, together with the relevant provisions for the term security *in lieu* of a share:

Offer: in relation to securities, means any offer made in any way, including by provisional allotment or allocation, with respect to the acquisition for consideration of any securities, and includes an invitation to subscribe for or purchase any securities as well as every attempt or offer to dispose of, or



solicitation of an offer to buy, a security or interest in a security.

The use of the word “any” prior to “offer” in the first sentence is borrowed from the definition in section 2(3) of the 1933 Securities Act, together with the inclusion in the last sentence of “every attempt or offer to dispose of, or solicitation.”

#### 9.6. Underwriter

As South Africa has a different view to underwriting agreements, it is submitted that it is kept, but that the definition provides for same. It is important for this definition to provide for direct or indirect control and it is submitted that the definition in section 2(11) of the 1933 Securities Act is followed. The definition should include a time limit applicable to the construction.

The recommended definition referred to an underwriter as any person which obtains securities with the aim to distribute it to the public, whether a contractual relationship between the company and the underwriter exists or not.<sup>8</sup> The definition had to contain a presumption similar to section 146(2), denoting that in the case of any distribution prior to the expiry of 24 months, such a person would be regarded as an underwriter.<sup>9</sup>

Based on this it may be recognised that underwriting transactions are those where the securities are obtained with a view to distribute them. The artificial differentiation in the definition of an offer between a sale and a

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<sup>8</sup> *Ibid.*

<sup>9</sup> *Ibid.*

subscription would be negated if underwriting constructions are provided for as outlined above. It follows that such a provision would include a presumption of primary market distribution and sale.

9.7. Recommendations for legislative reform to operative clause

It is submitted that section 99(2) and (3) be amended and reformed towards the prohibitory and requirement of disclosure clause, as per section 85 of the FSMA, which provides succinctly for a prohibition on an offering unless a prospectus has been filed, as well as for admission to a regulated market unless a prospectus has been filed. As per section 85(3) and (4) of the FSMA, criminal and civil liability are to be included in the section. It is submitted that this will sufficiently deal with what was purported to be provided for by the inclusion of the definitions of PO and IPO, in addition to specific liability rights.

9.8. Recommendations for legislative reform in respect of “public offer”

In terms of the concept of a public offer, it is important to note the definition of a public offer, together with the exemptions, and to determine the scope of the exemptions in terms of whether the definition of a public offer is exhaustive or not. Public is not defined and thus ordinarily understood and in terms of section 95(1)(h) expanded to include a selection thereof. The scope of the definition allows that section 96 is to be read as a safe harbour in its application, which together with the application of the dictum in the *Gold Fields* case lends itself to a non-public common law category. A transaction can therefore fall outside the scope of section 96 and will thus be a non-public offer falling outside the

regulatory purview of Chapter 4. It is also submitted that an inclusive definition be provided. It is submitted that such a definition should be as follows:

Offer to the public: and any reference to offering securities to the public meaning any offer of securities to the public and including an offer to any section of the public, whether selected in any other manner and will only exclude an offer made under the circumstances as contemplated under section 96.

#### 9.9. Recommendations for legislative reform to exemptions

In light of the above changes, secondary market transactions are to be exempted in terms of section 96. It is submitted that the provisions in the Securities Act of 1933, sections 4(1) and 4(3) and 4(4), be incorporated, with necessary adaptations into the provisions in the Regulations to the 2008 Companies Act. It is submitted that the Regulations provide for reference by incorporation, of section 5 of the Financial Markets Act of 2012, in respect of “Financial Promotion” and the Regulations thereto in the Regulation of the Financial Markets Act, following section 21 of the FSMA read with the Financial Promotion Order. The Regulation to the Companies Act will also provide for similar provisions to Rule 144 of the SEC. This will allow for regulation of secondary market transactions of unlisted securities, and also prohibit the hawking of shares, read with the underwriting provisions, which will constitute a clearer method of regulation.

It is further recommended that the language applicable to the exemptions be amended as to provide for an inclusive list of exemptions; it is also recommended that the language of Regulation D of the SEC be adopted in an exemption, in order to provide for exempted secondary market transactions of unlisted securities and to exclude specifically common law non-public offers, not falling within the exemptions and/or Regulations.

9.10. Recommendations for legislative reform: liability provisions

The majority of concerns regarding the effectiveness of the liability provisions will be negated by implementing the deletion of section 101 regulation. In terms of liability and the problem with breach of contract, where the shareholder might be able to claim for the loss of the expected profit on the securities, is the difficulty that the processes of allotment of shares and entry in the register entail a complete novation. In the UK, per section 655 of the Companies Act of 2006, the rule that a shareholder cannot recover damages against the company unless the allotment of shares is also rescinded has been abolished. Insofar as section 104(d)(ii) is concerned, this section entails the company, and it is preferable to also hold the company liable, in addition to the directors. A similar amendment in our Companies Act would negate difficulty in enforcing section 104 against the company.

It is recommended that liability provisions be reformed as to include an anti-fraud provision similar to section 10b-5 of the 1934 Securities Exchange Act.

9.11. Recommendations for legislative reform: prospectus

Apart from extending the period of validity to 1 year with the necessary requirements in terms of section 100(11) for correcting errors, reporting on new matters and reporting changes, considered relevant or material in terms of Chapter 4; it is also recommended that the prospectus be defined as to denote the offer or sale document; including the definition in the 1933 Securities Act per section 2(10), with necessary adaptations. It is recommended that the definition of a prospectus include a filed prospectus which complies with all the requirements.

**TITLE:                   CHAPTER 4 OFFER REGULATION UNDER THE 2008 COMPANIES ACT**

**BY:                       FREDERIK JOHANNES LABUSCHAGNE.  
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DEGREE:              LL D.**

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Chapter 4 of the Companies Act of 2008 aims to regulate offers to the public of securities and is reviewed against the principles which underscore the regulation of offerings. An overview of the historical development of the company which is parallel to the regulation of securities shows the crystallized principles which are compared against the development and enactment of the current regulatory regime. The concept of “complete law” as key element to effective regulation is discussed and applied in the review of Chapter 4 determining the effectiveness of the dispensation. The three determining concepts of regulation: the “offer,” “securities” and “public” are studied against the definitions which determine regulation and the inclusion of secondary market regulation of unlisted securities. Serious shortcomings in the process are identified. These errors, together with the practical problems of defining and regulating the secondary market in Chapter 4 read with the remainder of the delineating definitions, concludes that the current system is not in line with the principles of regulation and the *Grundnorm* of fraud prevention, resulting in Chapter 4 falling under the concept of “incomplete law” resulting in a high probability of enforcement failure and inefficiency. A comparative overview related to the jurisdictions of the United Kingdom and the United States follows with recommendations aimed at amending Chapter 4 relating to the regulatory regime *in toto* as well as the regulation of unlisted securities in the secondary market.

TITEL: **REGULERING VAN DIE PUBLIEKE AANBOD IN TERME VAN HOOFSTUK 4 VAN DIE 2008 MAATSKAPPYEWET**  
DEUR: FREDERIK JOHANNES LABUSCHAGNE.  
PROMOTOR: PROF. DR. P.A. DELPORT.  
DEPARTEMENT: HANDELSREG.  
GRAAD: LL D.

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Hoofstuk 4 van die Maatskappywet van 2008 het ten doel die regulering van aanbiede aan die publiek van effekte en word ondersoek aan die hand van die beginsels wat aanbod regulering onderskryf. 'n Oorsig van die historiese ontwikkeling van die maatskappy wat parallel is aan die regulering van effekte word gebied waaruit gekristalliseerde beginsels identifiseer word, welke vergelyk word met die ontwikkeling en daarstelling van die huidige regulerende bestel. Die konsep van “volledige reg” as bepalende faktor tot effektiewe regulering word bespreek en aangewend in die ondersoek van Hoofstuk 4 ten einde die ware stand van regulering te bepaal. Die drie determinerende konsepte van regulering welke die “aanbod,” “effekte” en “publiek,” word ondersoek aan die hand van die definisies wat regulering bepaal jeens die insluiting van sekondêre mark regulering van ongelyste effekte. Ernstige tekortkominge in die proses word identifiseer. Hierdie foute tesame met die praktiese probleme wat met die definisies en regulering van die sekondêre mark in Hoofstuk 4 manifesteer is die gevolgtrekking dat die huidige bestel nie in lyn is met die filosofie van regulering en die *Grundnorm* van bedrog voorkoming nie. Dit het direk tot gevolg dat Hoofstuk 4 val onder die konsep van “onvoltooide reg.” Die gevolg is dat die ondermyning van die bepalings en die afdwinging daarvan, die een ten gunste van die ander mag manifesteer. 'n Regsvergelykende oorsig met betrekking tot die jurisdiksies van die Verenigde Koninkryk en die Verenigde State van Amerika volg. Aanbevelings word aan die hand gedoen, gemik op die wysiging van Hoofstuk 4

met betrekking tot die regulerende bestel en dan ook die regulering van ongelyste effekte in die sekondêre mark.



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