Primary market sales and Chapter 4 of the Companies Act 71 of 2008

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OPSOMMING

Regulering van inskrywings en verkope ingevolge Hoofstuk 4 van die Maatskappywet 71 van 2008

Hoofstuk 4 van die Maatskappywet 71 van 2008 reguleer die publieke aanbod van effekte in primêre en sekondêre markte. Die aanbod om inskrywing en verkoop van effekte in die primêre mark ingevolge Hoofstuk 4 word ondersoek teen die agtergrond van die ontwikkeling en betekenis van onderskrywingstransaksies en die regulering daarvan in Suid Afrika. Die relevante omskrywings word uitgelig en gekontrasteer met die gemenereg asook ontwikkelinge in die maatskappyereg. Daar word aangetoon dat die huidige omskrywings van toepassing in Hoofstuk 4 tekortskiet. Primêre markinskrywing en -verkope word vergelyk met sekondêre markverkope alvorens probleme uitgelig word rakende die gesamentlike regulering van die twee markte in die lig van onderskrywingstransakies. Die aanwending en regulering van onderskrywing in die Verenigde State verskaf ’n regsvergelykende basis. Die gevolgtrekking is dat regulering van effekte in die primêre en sekondêre mark blootgestel is aan gebreke in die toepassing en afdwinging van die regulerende bepalings, veral met betrekking tot onderskrywingstransaksies.

1 INTRODUCTION

Chapter 4 of the Companies Act provides for public offer regulation. Once an offer of securities to the public is envisaged, mandatory disclosure requirements together with increased liability provisions apply in an attempt to exert *ex ante* regulatory control through the enabling and deterring principles which underlie offer regulatory laws.[1] Public offer regulation of securities in South Africa follows a system of mandatory merit disclosure, with disclosure as basis subsequent to merit requirements which prescribe the extent of disclosure, depending on which market the transaction occurs in.

1 Enabling principles denote mandatory disclosure by means of a prospectus (or written statement) providing details of the public offering so as to enable an investor to exercise his or her choice in either taking the risk of investing or passing the offer by. Deterring principles aim to deter unscrupulous offerings or untrue statements in the disclosure documentation, at risk of liability in excess of common law fraud or misrepresentation. See also Labuschagne *Chapter 4 offer regulation under the 2008 Companies Act* (LLD Thesis UP 2014) 116.

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It is common cause that the capital markets are divided into primary and secondary markets with the primary market subscription and sale as underlying transactions and the purchase and sale agreement applicable to the secondary market. Typically, there must be an offer to the public of securities prior to regulatory purview attaching to a transaction. The basis of Chapter 4 public offer regulation is in the definitions[2] 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, dependent on the primary market or secondary market. The market designation also influences the extent of liability exposure. 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. Sale in the context of the primary market refers only to the underwriting constructions, other than direct allotment and distribution. In the primary market construct, the securities are made available to investors by the company, the parties being the former and latter.[3] In the secondary market, the seller must disclose to the buyer but 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.[4]

Chapter 4 is reviewed in respect of its application to capital market transactions with a specific focus on the regulation of primary market sales and the impact of the regulatory dispensation brought about by the 2008 Act. The disposition of the United States of America is reviewed to establish how their legislation deals with primary market sales and secondary market resales of securities.

The question may be posed as to the efficacy of offer regulatory provisions amidst continued infractions and an onslaught on investors. 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 are provided for as a requirement for enforcement efficacy.[5] It follows that with ambiguously-stated law, that is 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 by means of the courts.[6]

2 As per s 95 of the Companies Act 71 of 2008.

3 Irrespective whether an "underwriting" construct is utilised or not.

4 In the primary market offer, regulation is substantial and the company must disclose by way of a prospectus with substantial prospectus requirements.

5 In respect of the concept of "complete law", see Xu and Pistor "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://bit.ly/1vpbXQt (accessed on 8 January 2014); Xu and Pistor "Enforcement failure under incomplete law: Theory and evidence from financial market regulation" (2004) http://bit.ly/1z1eLm0 (accessed on 8 January 2014).

6 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

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2 PRIMARY MARKET SUBSCRIPTION AND SALE

In the primary market, the offer must be intended for the conclusion of a contract for subscription (the acquisition of unissued shares).[7] The contract by which a subscriber agrees to take a number of shares and the company agrees to allot the shares to such a person is subject to the ordinary rules of contract, as modified by express stipulation of the Companies Act.

2 1 Underwriting

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 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 for disposing of the securities.[8]

2 2 Underwriting constructions

Where the third party is utilised in an agency relationship to distribute 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 of whether any obligations manifest as to the shares not distributed). A second scheme is where the "undistributed" shares are acquired in

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based on merit requirements prior to the offer becoming effective (ie 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.

7 See Delport "Offers and the Companies Act 71 of 2008" 2011 *THRHR* 280 281 (hereafter Delport "Offers" 2011 *THRHR*) and Loss *Fundamentals of securities regulation* (1988) 85 (hereafter Loss (1988) *Securities regulation*). 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 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.

8 S 146(1)(a) of the 1973 Act provided for these types of transactions. S 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.

terms of section 40 by the agent who therefore remains the owner (firm underwriting) and, as per the agreement with the company, "distributes" the securities to other investors.[9] 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. This is, therefore, a primary market transaction, termed sale[10] for purposes of distinction juxtaposed to a subscription.[11] South African company law does not recognise these transactions as "underwriting" (as they are merely primary market strategies). Underwriting, in terms of South African law, has always been considered to be "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.[12]

3 CONTEXTUAL HISTORY

By way of background, in South Africa the Lansdown Commission[13] 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 (underwriting) 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 which qualifies certain sales as primary market transactions. In these circumstances a prospectus was required, clearly differentiating between secondary market regulation of sales and primary market regulation in respect of primary market subscriptions or sales (by means of an underwriter), even though reference is made to a contract of sale transaction.[14]

It is submitted that the ambit of differentiation does not lie in the distinction in designation between offer for subscription and 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.[15] Chapter 4 of the 2008 Act is the successor of Chapter VI of the Companies Act 61 of 1973. 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 was 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

9 These "undistributed" shares as acquired by the agent remain the property of the agent prior to the "distribution" thereof.

10 See Delport "Offers" 2011 *THRHR* 281 and Loss (1988) *Securities regulation* 85.

11 Delport "Offers" 2011 *THRHR* 281.

12 *Ibid* and Delport *Die verkryging van kapitaal in die Suid-Afrikaanse maatskappyereg met spesifieke verwysing na die aanbod van aandele aan die publiek* (LLD Thesis UP 1987) 573–577 (hereafter Delport (1987) *Verkryging van kapitaal*). Old fashioned underwriting protects investors in a negative manner as it provides for sufficient capital as per the capitalising requirements.

13 South Africa Company Law Commission (1935–1936) *Report of the Companies Law Commission* (UG 45 of 1936).

14 *Ibid.*

15 *Ibid.*

from regulation by means of section 141 of secondary market sales 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".[16] To this extent Chapter VI section 142 contained a specific set of definitions applicable to primary market transactions to be regulated therein. The definitions could, therefore, not be used for the secondary market provision of section 141 in Chapter V. It follows that regulation in respect of primary market transactions was divided from regulation in respect of secondary market transactions on the informal secondary market.[17] Chapter 4 now incorporates both regulatory provisions into one chapter.

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 Chapter V. 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. The main regulatory provisions in Chapter VI were 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, under similar circumstances as section 145, provided 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. 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.[18] Section 142(1) defined an "offer" in relation to shares 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 subscribe for or purchase shares.[19] 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. 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 specifically excluded each other.[20]

16 Companies Act 61 of 1973, s 142(1).

17 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.

18 Although an offer as defined included an invitation to subscribe for or purchase shares, this fundamentally differed from the secondary market transaction envisaged in s 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.

19 Our emphasis.

20 Regulatory purview includes disclosure and liability provisions.

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 were allotted with a view to them being offered to the public[21] within 18 months of the initial allotment. The same applied if a listing was imminent 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.[22] 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 nor is an equivalent of section 146.

In respect of secondary market sales, section 141 of Chapter V in the 1973 Act regulated secondary market transactions, that is, sale of shares. The section placed a restriction on the offering of shares for sale to the public without a written 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 was 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 section 141 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. 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. The contract for a share transfer occurs in the secondary market and is a contract of purchase and sale. Generally, no formalities are required. However, there must be an offer and an acceptance. The offer is governed by the ordinary rules of contract, except where the offer is made to the public, in which case regulatory principles apply.[23] It follows that the field of application differed from Chapter VI transactions, being aimed at the unscrupulous selling to the public of issued shares of a company. 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 confusion between the provisions of offer for subscription and for sale in the

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21 S 146(1)(a).

22 Cilliers *et al Corporate Law* (2000) 258 (hereafter Cilliers *et al* (2000) *Corporate law*).

23 Blackman "Companies" 4(1) *LAWSA* (1995) para 226 (hereafter *LAWSA*). Reference is not made to Williams and Blackman "Companies" 4(1) *LAWSA* (2012) due to same not canvassing the common law disposition. It is submitted that the common law position did not change and is still applicable. Para 226 did not change between 1995 and publication of *LAWSA* (2012) as per *Current law* (2005–2008).

primary market and offer for sale in the secondary market (two sets of sale transactions with different context to each), there was uncertainty as to the applicable provisions of the 1926 Act. Due to this, the Van Wyk de Vries Commission recommended that the provisions be in different chapters in the 1973 Act.[24] It follows that the divide between regulation in terms of Chapter V and Chapter VI transactions was to avoid confusion and thus the possibility of assigning the more stringent Chapter VI regulation for section 141 regulation. In the absence of confusion, legal clarity was obtained, ensuring efficient compliance to regulatory principles.[25] The underwriting construction is evident in the difference in transactions concerning "subscription" and "sale" as per section 142 of the 1973 Act.

The 1973 Act envisaged two situations. First, where a company allots shares to an issuing house, bank or mining house with a view to such intermediary subsequently making a public offer. The 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). Second, 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 offered the shares for sale to the public, and this offer for sale was accompanied by the stated intention of the company to apply for the listing of those shares. 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.[26]

It has previously been recommended that section 146 of the 1973 Act be deleted and replaced with a definition of an underwriter, following the model established in the United States.[27] 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 *Gold Fields Ltd v Harmony Gold Mining Co Ltd*.[28] The recommended definition referred to an underwriter as any person who obtains securities with the aim to distribute them to the public, irrespective whether a contractual relationship between the company and the underwriter exists or not.[29] The definition had to contain a presumption similar to section 146(2), denoting that in case of any distribution prior to the expiry of 24 months, such a person would be regarded as an underwriter.[30] 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 subscription would be negated if underwriting constructions were provided for as

24 Delport "Offers" 2011 *THRHR* 280.
25 *Ibid.*
26 *Ibid.*
27 See Delport (1987) *Verkryging van kapitaal* 800.
28 2005 2 SA 506 (SCA). See Delport "Offer to the 'public': Even more disharmony" 2005 *SA Merc LJ* 388 in respect of the confusion.
29 *Ibid.*
30 *Ibid.*

outlined above. It follows that such a provision would include a presumption of primary market distribution.

4 CHAPTER 4 REGULATION OF PUBLIC SECURITY OFFERS

Section 95(1)(g) defines an "offer" in relation to securities, as an offer made in any way by any person with respect to the acquisition of, for consideration, any securities in a company. In addition thereto, the concepts of an initial public offering as well as a public offering are provided for in subsections 95(1)(e) and (i). An initial public offering, 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 public offering 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.[31]

The main regulatory provisions apart from section 95 which delineates 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).[32] It follows that an offer in terms of section 95(1)(g) must be aimed at bringing a particular contract into existence.[33] The difference between the public offering and the initial public offering which may determine regulation in the secondary market, is that, in the case of an initial public offering, it is an offer of securities and not an offer of securities to be issued as is the case in a public offering. Therefore, an initial public offering can be in respect of any "acquisition for consideration" as defined in "offer", but the public offering applies only in respect of issued securities. It follows that the ambit of these transactional definitions is uncertain. However, it is stated that all initial public offerings will be public offerings, but not all public offerings will be initial public offerings.[34]

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 Delport.[35] 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. 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 if all 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, therefore, will not be an offer as defined in

31 S 95(1)(m).
32 For purposes of this discussion, the liability provisions are excluded.
33 Delport "About offers of securities to the public" 2011 *THRHR* 668 669.
34 *Ibid.*
35 Delport "Offers" 2011 *THRHR* 280.

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 public offering and initial public offering are also excluded as the investor is not the party extending the offer of securities in terms of the public offering and initial public offering 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 initial public offering is read with the secondary market offering for sale.[36] 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.

4 1 Transactional relativity

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.[37] 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 yet in existence. 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.[38] 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 nature of the securities which are not yet in issue, the contract is of subscription.[39] The application for and

36 *Ibid.*

37 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, s 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. Delport (1987) *Verkryging van kapitaal* 304 and "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 (see The J v Wyk de Vries Commission of Enquiry into the Companies Act *Main report* (1970) 108 and *Supplementary report and draft Bill* (RP 31 of 1972) (1972) 97.

38 *Ibid.*

39 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*

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allotment and issue for shares commence 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.[40] To subscribe means to enter into an agreement to take shares by a formal application or otherwise, under which there is liability to pay.[41] The contract *essentialia* entail 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.[42] The subscription contract is the contract whereby the company creates shares.[43] The contract follows the basic principles of invitation, offer and acceptance.[44] 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, who 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.[45] The issue of the shares is the act which concludes 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.[46] These precepts are ignored by Chapter 4 and not provided for. Following the precepts of the law of contract, a contract is an agreement creating rights and obligations, consisting of an invitation to consent to the creation of obligations between the parties, called an offer and an affirmative response called an acceptance.[47] To constitute an offer, a declaration of

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(Hebb's Case) 1867 LR 4 Eq 9 and *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 or when it is posted, depending upon the contractual provisions. (See *Ex Parte The Master; In Re The Niagara, Ltd (In Liquidation)* 1913 TPD 38 and *Pretorius v Natal South Sea Investment Trust Ltd (Under Judicial Management)* 1965 3 SA 410 (W); also refer to the discussion and citations in Cilliers *et al* (2000) *Corporate law* 248.) The applicant may waive the right to allotment. See *idem* 257 para 16.06.

40 *Re VGM Holdings Ltd* [1942] Ch 235; 1942 1 All ER 224 CA 244. See also *LAWSA* para 199.

41 *Arnison v Smith* 1889 41 Ch D 348 (CA) 357. See also *Moosa v Lalloo* 1957 4 SA 207 (N) 219 denoting the meaning of allocation as well to subscription in terms of which contract is referred to.

42 In *Mosely v Koffyfontein Mines Ltd* [1911] 1 Ch 73 (CA) 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 moment this is subsequently followed by allotment. It is clear that the allotment of shares precedes their issue. See also *Building Material Manufacturers Ltd v Marais* 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.

43 S 35(4) and Delport *The new Companies Act manual: Including close corporations and partnerships student ed* (2011) 35 (hereafter Delport (2011) *Manual*).

44 Nagel *et al Commercial law* (2011) 47. See also Delport (2011) *Manual* 35.

45 Delport *Manual* 35.

46 *Central Piggery Co Ltd v McNicoll* (1949) 78 CLR 594 Aust HC 598.

47 Van der Merwe *et al Contract: General principles* (2012) 46.

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." Our law does not provide for an obligation to be created voluntarily by a unilateral act, as was possible under Roman law by *pollicitatio*.

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.[48] In terms of acceptance, same constitutes a declaration of will which indicates assent to the proposal contained in the offer.[49] 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.[50] It is submitted that this ought to be the objective test: have the securities been allotted with a view to offering 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 after 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 the public, section 146 of the 1973 Act would have brought the transaction within regulatory purview. If it was not a public transaction, then Chapter VI would not have applied.

4 2 Delineation of primary market sale

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. The 2008 Act does not provide for the definition of an underwriter. The 1973 Act also did not do so, although it did provide for underwriting constructions in terms of section 146. No similar provision is to be found in Chapter 4 apart from the reference to "sale" in section 95(1)(m), which defines the secondary offering. However, as the definition excludes a company or its subsidiary it is impossible for it to constitute a primary market sale.

When an offer to investors is an invitation by an underwriter (in other words, a primary market underwriting transaction) and when it is a *bona fide* secondary

48 *Ibid* 50–51.

49 *Ibid* 52.

50 S 146(1)(a) of the 1973 Act provided for these types of transactions. S 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.

market offer, an overlap in terms of the definitions in section 95 will influence the regulatory aspects of the primary and secondary markets. 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. 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. The contract for a share transfer occurs in the secondary market and is a contract of purchase and sale. Generally, no formalities are required. However, there must be an offer and an acceptance. The offer is governed by the ordinary rules of contract, except where the offer is made to the public, in which case regulatory principles apply. 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. It is submitted that for purposes of interpretation in terms of the South African context, the underlying transaction dictates the regulation thereof. The nature of the transaction dictates the market applicable. 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 muster efficacy requirements.

It is submitted 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 and had to consider underwriting transactions and avoidance of an overlap with the secondary market in respect of regulatory provisions.

4 3 Non-committal review process

Concerning the birth of the 2008 Act, see Delport[51] who 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. *South African company law for the 21st Century – Guidelines for corporate law reform* was published on 23 June 2004.[52] To fully comprehend the motivation, goals and purposes of government in embarking on this venture, one needs to look at the *Guidelines*.[53] After formulating the blueprint in the *Guidelines*, the Department of Trade and Industry consulted widely over the course of two years with various experts, also from other Commonwealth countries.[54] There is no literature available concerning the thought process that went into the preparation of Chapter 4.[55] It will, therefore, be deduced that an attempt was made towards realising the goals of the *Guidelines*. In this regard, Chapter 4 provides for a

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51 Delport "Companies Act 71 of 2008 and the 'Turquand' Rule" 2011 *THRHR* 132 132.

52 *GG* 26493 of 23 June 2004, GN 1183 of 2004 (hereafter *Guidelines*). See also Delport *Manual* 1.

53 The *Guidelines* is the only comprehensive government publication explaining the roadmap to the 2008 Companies Act in detail: Stein and Everingham *The new Companies Act unlocked* (2011) 3.

54 *Ibid* 4.

55 Juxtaposed to the Van Wyk de Vries Commission Report. However, see Sutherland "The state of company law in South Africa" 2012 *Stell LR* 157.

system of conjoined regulation in respect of primary market transactions which ostensibly include the primary market sale and secondary market sales. It is submitted that 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; the latter which gave rise to the 1973 Act and which had considered each section of the 1926 Act as predecessor of the 1973 Act, comparing same and aligning the review process towards the 1973 Act. As such, it is agreed with Sutherland[56] that many of the goals of the reform process as set out in the Guidelines were not achieved, or only partially achieved.[57] 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 cumbersome. The premise rings true that company law is complex[58] as per *Ex parte NBSA Centre Ltd*:

> "Company law is much more than the current statute which applies at any particular point in time. Like every other statute which regulates comprehensively some field of human activity, it has its own inner logic which requires to be identified and mastered. In addition, it has developed in a number of areas what might be termed, for want of a more suitable expression, its own inner common law which is not to be found in any specifically identifiable provision."

5 POSITION IN THE UNITED STATES OF AMERICA

The United States features strong capital markets with a well-developed and enforced regulatory system. At federal level, the United States opted for a disclosure-based system.[59] This regulatory dispensation provides for the regulation of any offer of any securities unless it falls under the statutory exemptions or is structured in terms of a statutory "safe harbour" which will not attract offer regulation. The position in terms of this jurisdiction shows that provision is made for the definition of an underwriter where regulatory purview is attached to same. The concept of an offer, therefore, is all-encompassing and broadly defined. Primary market subscriptions and sales are provided for as well as secondary

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56 *Ibid.*

57 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 not sufficient as the scope of this type of act and the subject matter of regulation is quite technical and detail oriented. No record exists of a refining process of these broad principles. 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. 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. The vision of the *Guidelines* has not been achieved in respect of the subject matter. As a result thereof, the purposes of the 2008 Act as per s 7 thereof have not been achieved.

58 Delport *Manual v Ex Parte NBSA Centre Ltd* 1987 2 SA 783 (T) 787 per Coetzee DJP.

59 Loss (1988) *Securities regulation* 1–3.

market resales of securities, with the exception that there is no overlapping regulation as secondary market sales (or resales of securities) are provided for under the exemptions, with requisite regulations as to how the exemption is to be applied in order for the transaction not to be considered an offer.

In terms of the Securities Act of 1933, underwriting constructions are provided for by means of section 2(11) and an underwriter will also fall under regulatory purview.[60] An "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 whose interests are 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 definition, the term "issuer" shall include, in addition to an issuer as defined, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control of the issuer. Section 2(11), therefore, provides a broad definition of underwriter.[61] "Actual issuer" means the entity against which the securities represent an investment interest.[62] 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. The definition provides for a statutory underwriter construction, even where there is not technically an underwriting construction, but the intent to distribute securities is present through direct or indirect participation in a selling effort by 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.[63]

The determination as to whether a person is an underwriter is important. Underwriters in the United States are subjected to section 11 civil liability for deficiencies in the registration statement.[64] No contractual basis is required for the relationship between the underwriter and the issuer. Delport is of the opinion 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 of 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

60 Delport (2011) *Manual* 75–86.

61 Wharton University of Pennsylvania: Financial Institutions Centre Presentation by Taliye Teleri on *The Securities Act of 1933: Registration exemptions* http://whr.tn/1GjG0gO and http://whr.tn/1wZI7Uj (accessed on 11 March 2014).

62 Greene *et al* "Getting the deal through: Securities finance in 18 jurisdictions worldwide" – United States (2014) http://bit.ly/1oeYjhv (accessed on 16 March 2014). S 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 in controlled by the issuer, or any person under direct or indirect common controls with the issuer.

63 Quinn "Securities regulation" (American Washington College of Law 2014) 43 http://bit.ly/1DZCWCH (accessed on 10 March 2014).

64 Loss (1988) *Securities regulation* 252.

bought the shares with an investment purpose or a distribution aim. This would have to be answered in terms of objective facts.

Underwriting constructions are provided for as being akin to the primary distribution from an issuer and regulation, as well as liability, attaching to the underwriter in equal parts. The "hawking" of shares, including any subsequent resales, therefore is provided for in such a manner that it 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.

The application of the definitions in section 2 of the 1933 Act is important as it shows how to delineate the structure and application of securities regulation, read with underwriting constructions as provided for. Firstly, there is the definition of the term "sale" or "sell". Section 2(3) 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. It shall include every contract of sale or disposition of a security or interest in a security for value. It follows that this is a sweepingly broad-based definition aimed at including every transaction irrespective of its 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.[65] The definition of offer to sell goes beyond the common law concept of an offer.[66] The term "issuer" is defined in section 2(4) as meaning

> "every person who issues or proposes to issue any security; except that with respect to certificates of deposit . . . the term 'issuer' means 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".

In terms of the wording of the 1933 Act, any offer for sale of securities will fall under the 1933 Act.[67] This will imply to secondary market transactions as well. However, certain secondary market transactions are exempted in section 4. The key provision to the 1933 Act is section 5[68] which imposes registration and disclosure requirements in respect of all offerings of securities. In the words of Loss, the provision covers the universe, making it unlawful to trade in securities unless a registration statement is in effect and a specified prospectus is delivered.[69]

65 "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 privacy of contract with an issuer. It is only limited to underwriters and not to dealers or brokers.

66 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.

67 S 2(a)(3).

68 Clark *Corporate law* (1986) 720 (hereafter Clark (1986) *Corporate law*). The issuing company must prepare and file a registration statement containing extensive and detailed information about itself and the offering, as specified by s 7 and Schedule A.

69 Loss (1988) *Securities regulation* 90–91. S 5 provides that it shall be unlawful for any person, directly or indirectly, to sell a security unless a registration statement has been filed. S 5(b)(1) provides that offers should be made only through a prospectus as defined in s 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 mail to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed, unless such prospects meets the requirements of s 10. S 5 was designed to place the facts before the investing public in two ways. Firstly, adequate and

continued on next page

Section 5(a) prohibits any person from directly or indirectly using instruments of communication in interstate commerce to sell a security unless a registration statement is in effect. It also prohibits using the mail 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 5 must be read as if it applied to any transacting by an issuer or underwriter in connection with a primary distribution to the public, by the 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.[70] Securities acquired in a non-public distribution may not be resold into the public without registration in terms of section 5 or unless an exemption is available either in terms of section 3 or section 4.[71]

In respect of secondary market sales, section 4(1) provides such an exemption and applies to a sale in the secondary market. Transactions by any person except an issuer, underwriter or dealer, are excluded. The definition of an underwriter will determine, insofar as section 4(1) applies, whether the registration requirements in respect of securities traded on the secondary market will apply or not, ie whether the seller relying on the exemption is an underwriter or not. *Bona fide* trades by a shareholder of his or her 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 underwriters. Sections 4(1), 4(3) and 4(4) apply to these types of transactions.[72] Section 4(1) exempts

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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 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.

70 Clark (1986) *Corporate law* 723. S 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. 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, eg, 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 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 may of the SEC's policies about desirable disclosures have been implemented.

71 Bernardo "Securities regulation: Reach of Securities Act regulation" (Harvard Law School Fall 2011) http://bit.ly/1upvtxE_ (accessed on 7 February 2014) 1.

72 Quinn (2014) "Securities regulation" 43.

trading between investors in securities already issued and not distributions by issuers.[73] Section 4(1) interacts with the definition of an underwriter in that it exempts transactions other than those subject to underwriting constructions. Read with the overly-wide definition of an underwriter in section 2(11), 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 anybody who is in a control relationship with the issuer. Control and distribution are not defined in section 2. Under the definition of an issuer, any person who is controlling the issuer falls under the definition. Rule 405 provides that control equates 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 contract or otherwise. A dealer is defined as anyone engaged in business of selling for another.[74] Section 4(3) provides an exemption to a dealer unless the securities are traded within one 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.[75] Section 4(3) exempts all transactions by a dealer. Dealer is defined in section 2(12) so as to include a broker. The 1933 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. All dealers are subject to section 5 for a minimum of 40 days after the effective date.[76]

In terms of regulation, section 4(1) is to be read with Rule 144. Rule 144 covers the sales of restricted securities by any person for his own account as well as the sales of restricted or any other securities by any other person for the account of an affiliate of the issuer of such securities.[77] Under Rule 144, if the registered offering under the initial public offering 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 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 person who might otherwise be classified as underwriters as long as certain objective criteria are met. Five conditions must be met to satisfy the Rule.[78] 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 of 1934 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 who 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.

73 Clark (1986) *Corporate law* 734.
74 S 2(a)(12).
75 *Ibid*.
76 Loss (1988) *Securities regulation* 88.
77 Rule 144(b).
78 Clark (1986) *Corporate law* 736.

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.[79] Section 4(4) is an exemption for broker transactions executed on instructions of customers on any exchange or in the over-the-counter market. In the matter of *Ira Haupt & Co*[80] it was held 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 Securities Exchange Commission 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) is what gives it to their brokers.[81]

In the United States, the focus is on distributions of securities rather than artificial transactional distinctions such as subscription, sale and the secondary market sale as evident in terms the South African nomenclature. The Securities Act provides for an effective regime in respect of primary market distributions and sales by means of statutory underwriting provisions. Instead of attempting to regulate transactions by defining same as an initial public offering or public offering and secondary offering, it provides for sweeping definitions of an all-encompassing transactional nature together with a broad prohibitory and registration requirement, ensuring regulation and disclosure. Counteracting these are exemptions under sections 3 and 4 as well as the Securities Exchange Commission's[82] Rules and Regulations. Sales are exempted provided certain conditions are met, most notably aimed towards the protection of investors, ie securing the position of *bona fide* sales from a non-issuer and/or underwriter or a person in control of an issuer. Rule 144 provides for the required compliance-based safe harbour of any person engaged in a secondary market sale of unlisted securities (sections 4(3) and 4(4) provides for the formal secondary market).

6 CONCLUSION AND RECOMMENDATIONS

Chapter 4 offer regulation should be aimed at the regulation of distributions and primary market sales and it should provide for underwriting constructions so as to avoid a regulatory overlap with secondary market sales of unlisted securities. It is submitted that the main causes of ambiguity 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

79 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).

80 In the matter of *Ira Haupt & Co* 23 SEC 589 (1946). See also Clark (1986) *Corporate law* 735.

81 Clark (1986) *Corporate law* 735.

82 The Securities Exchange Commission which is the regulatory authority in the United States and fulfils its role as pro-active regulator juxtaposed to South Africa where the Commission for Intellectual Property and Companies acts only as administrator. The result is that enforcement will be reactive by means of the court as enforcer/regulatory. It is for this reason that the provisions in Chapter 4 should be as clear and unambiguous as possible.

for the common law in respect of the underlying transaction, in including an invitation. 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, but *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 a presumption which provides for underwriting transactions. Ideally, secondary market regulation should be deleted *in toto* and be provided for under the exemptions in section 96, with relevant qualification as to how the exemption may apply (akin to Rule 144 regulation in the United States). Due to the fact that the enforcement of Chapter 4 provisions are to be occasioned *ex post* by means of the Courts as reactionary enforcers (juxtaposed to an *ex ante* pro-active enforcer such as is evident in the United States), it is essential that the *ex ante* regulatory provisions of Chapter 4 adhere to all applications of the law, without errors, and be capable of being interpreted unambiguously. This is currently not the case.