The Legal Conceptualisation of Investment Securities in the Nigerian Capital Market: Challenges and Opportunities

A thesis submitted to the University of Bolton for the Degree of Doctor of Philosophy in the School of Law

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# List of Contents

Abstract .................................................................................................................. 7

Declaration ................................................................................................................. 8

Copyright Statement .................................................................................................. 9

Dedication .................................................................................................................... 10

Acknowledgment ........................................................................................................ 11

List of Figures ........................................................................................................... 12

Table of Statutes ........................................................................................................ 15

Table of Cases ........................................................................................................... 19

List of Abbreviation .................................................................................................. 22

**Chapter 1**: General Introduction ........................................................................ 23

1.1 Background .......................................................................................................... 23

1.2 Statement of Problem .......................................................................................... 25

1.3 Research Questions .............................................................................................. 25

1.4 Aim of Research .................................................................................................. 26

1.5 Objective ............................................................................................................. 26

1.6 Focus of Research ............................................................................................... 27

1.7 Research Methodology ....................................................................................... 27

1.8 Contribution ........................................................................................................ 29

1.9 Why Nigeria? ....................................................................................................... 30

1.10 Challenges to the Research ............................................................................... 31

1.11 Structure of Thesis ............................................................................................ 31
Chapter 2: Securities in Context (Theoretical Framework)

2.1. Introduction (Part 1) -----------------------------------------------33
2.2. Basis of choice of Literature and Markets for this study -------------------35
2.3 Uncertainties in defining securities ----------------------------------------37
2.4 Existing Conceptual Framework of Securities Law -----------------------------44
  2.4.1 Negotiability and Liberty -----------------------------------------------51
  2.4.2 Legal relations and interference with circularity ------------------------54
  2.4.3 Power-Liability relations and Privilege – No right relations and circularity pursuant to rule of law -----------------------------------------------56
  2.4.4 Power and its capacity to change legal relations ---- 59
2.5 Fashioning a new Conceptual Framework from pre-existing framework --- 61

PART 2

2.6 Statutory Formalism Approach as rational institutional practices ---------------71
2.7 Statutory Functionalism Approach as rational institutional practices -------------82
2.8 Judicial or Court Centred Context-Sensitive Functionalism -------------------90
2.8 Purposive implications by tracing out the philosophies that shape the economic or social arrangement and ordering/philosophy -----------------------------------------------108

Chapter 3 Research Methodology ------------------------------------------------122
3.1 Ontology ---------------------------------------------------------------------122
3.2 Epistemology -------------------------------------------------------------------123
3.3 Research Approach -------------------------------------------------------------124
  3.3.1 Formalism ---------------------------------------------------------------124
  3.3.2 Functionalism ------------------------------------------------------------125
3.4 Chosen Research Approach ------------------------------------------------------126
3.5 Research Strategy -------------------------------------------------------------128
3.6 Research Methodology

3.7 Research Methods

3.7.1 Research Method

3.7.2 Research Tools

3.7.3 Sample Size

3.7.4 Justification of Sample Size, Sampling Technique and Triangulation

Chapter 4 Securities in Nigeria: Fashioning a Framework Part 1

4.1 The Regulatory Model/Concept Applicable in Nigeria

4.1.1 Statutory Formalism in Nigeria

4.1.2 The Origin/History and reason for Statutory Formalism in Nigeria

4.2 Identify and discuss how the contradiction in ISA 2007 creates confusion and limits products development and invariably the expansion of securities market in Nigeria

4.2.1 Bonds

4.2.2 Debentures

4.2.3 Other debts

4.2.4 Share

4.2.5 Rights or Options in respect of Shares, Bonds, Debentures, Stocks and Notes

4.3 The Practicalities of the language structural incoherence

4.3.1 Language

4.4 Political Economy and Impact on Nigerian Securities Law

4.4.1 Colonial experience: Political class and the law

4.4.2 The Military Regime and the Law

4.4.3 Ethno-rivalry and the Law

4.4.4 Religious incursion, a new Political Class and the Law
Chapter 6 General Conclusion and Recommendation .................................205

6.1 Securities under wraps ........................................................................205

6.2 Conflicts and Tensions in Conceptualisation .......................................208

Chapter 7

7.1 Introduction .........................................................................................216

7.2 Findings of this research ......................................................................216

7.3 Original Contribution to literature .......................................................219

7.3.1 Conceptual Onion: Implications and Recommendations for Research, Policy and Practice ---- 223

7.3.2 A Glimpse into the future of securities regulation in Nigeria with the Conceptual Onion ----224

7.3.3 Implications and Further Recommendations .................................227

7.4 Conclusion ..........................................................................................229

References ..............................................................................................230

Appendix .................................................................................................248
ABSTRACT

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The Legal Conceptualisation of Securities in the Nigerian Capital Market: Opportunities and Challenges

Ikpenmosa Uhumuavbi 2018

Tensions created by continuous disruption in the financial landscape leading to increased market convergence have suddenly rekindled the age long philosophical dispute between ‘form’ and ‘function’ as it relates to the conflict between indigenous and received legal traditions. This research tests these competing theories in the conceptualisation of securities. The formalist explanation considers the degree of institutional influence a sole reliance on legal texts play in achieving statutory coherence and utility; such as applying the strict interpretation of legal letters to reduce the uncertainties of contexts. By contrast, the functional explanation captures the limitation of legal texts without an examination of contexts. Therefore, statutory design and definition must seek to operationalise the outcomes of historical, political, economic, and socio-cultural contexts in its formation. This research raises the hypothesis that formalism places significant constraints on the language of statute to optimise products development, while functionalism enables the aggregation of legal and non-legal themes to create products. It goes further to tests these hypotheses on critical literature review and on a data set of regulatory agencies and market participants in Nigeria. It explores the conflicts created and how they continuously erode the underlying conceptual structure of securities. The research finds strong support for the functionalist context sensitive explanations. Therefore by developing and proposing a functional court-centred context-sensitive model as solution, this research suggests that formalist structure contributes to definitional incoherence of securities and places significant constraints on the capacity of language to optimise securities laws for increased product development in capital markets.

The research further stresses the usefulness of real world semantics within language philosophy in shaping representionality of legal texts by providing a basis for the context sensitive conceptualisation. Through the use of focused group case study research technique, the thesis identified the legal obstacles to the conceptualisation of securities in the Nigerian Capital Market. It clarifies the place of negotiability, transferability and circularity components within the context of securities concepts of rights and duties. This is with a view to unearthing the legal nature of negotiable risk that sits at the core of securities. The research proposes a context sensitive definition of securities for the Nigerian Capital Market to replace the current definition in Section 315 of Investment and Securities Act 2007.
DECLARATION

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DEDICATION

To my wife Ejemen Isi Uhumuavbi, and my sons Eromose Sean Uhumuavbi and Efeosa Jayden Uhumuavbi for their support and understanding all through this journey
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LIST OF TABLES, FIGURES AND CHARTS

Chapter 2: Securities in Context (Theoretical Framework)

Figures -

2.3 The cellular structure of a security © – Figure 1 -----------------------------42
2.7 IOSCO Conceptual Model © – Figure 2 ------------------------------------------89
2.9 Diagrammatic Representation of the Process of Pooling © – Figure 3 ---------113
2.9 The United States Conceptual Model of Securities © – Figure 4 ...........117
2.4 Jural Opposite © – Figure 5 ---------------------- 49
2.4 Jural Correlative © – Figure 6 ---------------------- 49
2.4 Definition of the eight Jural Concepts © – Figure 7 ------------------- 50
2.5 Deontic Logic – Figure 8 ------------------------------- 63

Source: Mullock (1972)

2.5 Venn diagram showing logical disconnection of concept – Figure 9 --- 67

Source: Mark Andrew (1983)

2.9 Comparison of Wals v Foxhill and SEC v Howey on application of Investment Contract Test © - Figure 10 ------- 114

Chapter 3 Research Methodology

Figures -

3.4 Linking research framework to choice of research approach © – Figure 11 ---------------127
3.5 Other legal research not used in this thesis © – Figure 12 ---------------128
3.7 Research Methods
3.7.3 Research Sample size © – Figure 13 --------------------------------------130
Chapter 4 - Securities in Nigeria: Fashioning a Framework – Part 1

Figures:

4.3 The practicalities of the language structural incoherence

4.3.1 Multifaceted Framework for the Categorisation of Securities © – Figure 14 167

4.3.1 Representation of responses to practical application of Section 315 ISA 2007 ©– Fig 15 172

4.3.1 Analysis of chart 1 © – Figure 16 173

Chapter 5 – Securities in Nigeria: Fashioning a Framework – Part 2

Figures:

5.1 Cross-section of interviewees © – Figure 17 184

5.3 Responses from Focused Group Structured Interview

5.3.1 Responses from interviewees on the Look Through provision, context and Transferability/Circularity © – Figure 18 189

5.3.1 Table of questions asked © – Figure 19 189

5.3.4 Data addressing Judicial Context Sensitive Functionalism and legal treatment of borderline instrument and whether it promote or constrain transferability and circularity © – Figure 20 193

5.4.1 Data on No Look Through provision and Transferability/Circularity © – Figure 21 194

5.4.2 Data on how Form versus Function dispute resolves the property law versus contract divide in securities conceptualisation © – Figure 22 195

5.4.3 Data on whether operating word within provision enables or constrains transferability © – Figure 23 196

5.4.4 Data on to what extent context sensitive judicial functionalist conceptualisation and legal treatment of borderline instrument promote or constrain transferability or circularity © – Figure 24 196

5.5.5 Data on to what extent context sensitive judicial functionalist definition and legal treatment of borderline instruments promote or constrain transferability/circularity © – Figure 25 201

5.3.2 Chart disclosing data on whether securities is property or contract – Figure 26 190

5.3.3 Chart disclosing data on impart of judicial context-sensitive functionalism in furtherance of circularity (data on approaches) © – Figure 27 191

5.3.3 Disclosing data on sectorial responses to above question © – Figure 28 191
Chapter 7 – Original Contribution to Literature

Figures:

7.3 Conceptual Onion © – Figure 30 ..........................221

7.3.2 Conceptual Web © – Figure 31 ..........................226
Statutes

Argentina Capital Market Law (26, 831), 2012

Bank and Other Financial Institutions Act, 1991, Nigeria

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MiFID II /MiFIR 2018 - EC

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16
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LIST OF ABBREVIATION

NASD – National Association of Securities Dealers

OTC – Over the Counter

SEC – Securities and Exchange Commission

IOSCO – Internal Organisation of Securities Commission

CSCS – Central Securities and Clearing System

FMDQ – Financial Market Dealers Quotations

ISA – Investment and Securities Act

CAMA – Company and Allied Matters Act

FSMA – Financial Services Market Act

NSE – Nigerian Stock Exchange

MiFID I & II – Market in Financial Instrument Directive
Chapter 1 –

1.0 General Introduction

1.1 Background

There is clearly no small irony as markets continuously grapple with the consequences of the financial crisis caused by complexities of financial instruments. These fundamental pieces of inconveniences have often been waved off in a dignified fashion as investors contend with new and unexpected occurrences. Tensions between indigenous and received legal traditions as they relate to the battle for form or coupled with technological exploitation of the gaps, now unsettle the underlying dimensions of securities function and erode their post-crisis regulatory achievements. These conflicts are creating webs of uncertainties and capitalising on the complexities of securities as a concept. Indeed, the conceptualisation of securities has been extremely controversial. This is because of its unprecedented scope and limited understanding. Its fluid nature both at domestic and international levels is a subject of immense debate within institutional circles. On the part of investors, there is inertia in exploring new horizons partly because of regulatory hurdles created by these conflicts. Even market operators are now wary of innovative schemes to mobilise saving towards investments. These broad tensions between institutions, markets and investors have created two problems. Firstly, it has created a drift in the underlying dimensions of securities which now makes its identification, classification and characterisation extremely difficult. The 2008 to 2010 financial crisis was largely traced to the complexity and poor understanding of investment products. Secondly, it has made the international investment environment more vulnerable to systemic collapse due to the absence of an agreed legally binding universal framework for the conceptualisation of these instruments. This therefore means that markets are constrained and limited to monoline plain vanilla products, designed along prescriptions of domestic regulation. The increase in these monoline products means fewer investment options, limited markets depth and strong disincentive for cross-border interactions. Even in cases where cross-border transactions are


3 Fulfilling investors objectives have never been so difficult in an environment of so much uncertainty


conceived, they are plagued by efficiencies around high compliance costs and slow pace of capital mobility. These problems have once again highlighted the need to develop a model for the conceptualisation of securities across the globe.

The call to regulate has placed significant burden on market regulator both at the global, regional and national levels for years. This is despite a decline in the powers of global and regional regulatory agencies in recent years due to gradual growth of populist movements and perception of international regulatory bodies as biased and lacking independence. ⁶ Even as national markets engage and play host to international market participants, the local regulators are caught up with the challenge of providing adequate regulation and required oversight to ensure government confidence. Traditional approaches to securities conceptualisation have failed to address the problem of meeting the expectation of diverse range of domestic and foreign market participants. Therefore, the effectiveness and efficiencies of securities at achieving its optimum is blighted. Securities can be useful at helping to mobilise savings for investment where a coherent framework and jurisprudence for its conceptualisation exist. It is therefore argued that the development of a conceptual framework would provide certain level of interpretative uniformity and coherence in the overall definition of securities. Apart from providing cross-border linkages for engagement, it will create clarity and uniformity in the application of the components that constitute securities and provide a basis for their recharacterisation.

After the 1929 market crash till date, academics and commentators have continuously questioned the rationale for a localised approach to securities conceptualisation. ⁷ In fact they raised several points to support pre-existing arguments that a globalised conceptualisation technique for securities is imperative. They argued that the measure of global technique meant that no one country is subject to the superfluous influence of other countries when it comes to trade and investment. Indeed, even when laced with the best of intentions, such views will not neutralise those myriad of regional and global institutional inhibitions that facilitate further entrenchment of nationalistic systems. ⁸ For instance, while distinct national governments maintained their national frameworks, they engaged in various forms of coordination and cooperative arrangement that gave persuasive reciprocal recognition to regional and global bodies. For this reason, national governments have the

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⁸ Amir N. Licht, ‘Games Commissions Play: 2x2 Games of International Securities Regulation’, 24 Yale J Int’l L (1999), http://digitalcommons.law.yale.edu/yjl/vol24/iss1/3 - The global inhibition to national systems include pressure on national governments to accommodate global standards as a quid pro quo for trade and investment. Even then, local politicians in a bid to retain political relevance within their constituencies are locked in a dilemma between economic priority and nationalist sensitivities. The basis of their argument was that nationalism leads to market fragmentation which carries significant inefficiencies, uncertainties and costs.
upper hand in this conflict between regional and global regulation. To this end therefore, domestic governments now solely possess the necessary internal networks needed to facilitate securities development, management and enforcement in the market. For this reason, they wield significant influence over the institutional tools that shape the concept of securities. One of those tools is the logic of language, while the other is the ownership of the interpretative philosophy that animates the legal concepts of securities. It is the case that both language and its interpretative theories facilitate the exploitation of ideas that catalyses innovation in investment securities within the market. Therefore, a study of the origins and operational nature of these interpretative theories in legislative design and implementation within the context of legal language is crucial. This thesis examines these points and argues that the history and conflict between the broad interpretative theoretical paradigms that support the construction of legislation, contribute to the definitional incoherence of securities. More specifically, this research looks at how the misapplication of these tools has created the problem of definitional incoherence and conceptual ambiguities in the Nigerian Capital Market.

1.2 Statement of Problem

The Nigerian Capital Market has underperformed from its inception in comparison to similar markets worldwide. This has been traced partly to legal contradictions which culminate in limited product availability to meet diverse investment preferences. Lack of strategic fit between legal model and non-legal themes like political economy and socio-cultural dispositions have accentuated the problem. These internal problems have external dimensions in terms of effectiveness of cross-border transactions and willingness of investors to take a long term outlook of the market. This has led to a critical inquiry by seeking answers to the following research questions:

1.3 Research Questions

1. Whether the absence of a universally accepted conceptualisation framework for legal concepts in securities contributes to their definitional incoherence and in turn affect product development in markets?

2. Whether the tensions between formalism and functionalism in their conceptualisation of legal concepts in securities contributes to the definitional incoherence of securities and places constraints on poor understanding of securities and prevents product development in markets?

3. Whether the adoption of similar statutory design on the basis of historical nexus is sufficient to guarantee similar legal outcomes without the necessity of requiring strategic fit between design of legal concepts of securities and non-legal themes in the conceptualisation of securities?

Avgouleas E. (2012), ‘Governance of Global Finance Markets: The Law, the Economics, and the Politics’ Cambridge University Press. There are however tensions between domestic regulation and global technological disruption which is in effect eroding national control of securities management and enforcement. This has raised questions of legitimacy and acceptability. Even both tools are in constant conflict because tensions between indigenous traditions and foreign practices
1.4 Aim of Research

This research seeks to develop a model that will enable the understanding and conceptualisation of securities. Apart from providing a basis for the contextual definition of securities, the model will also help in the application of the concepts of securities for the purpose of investment product development to meet diverse investment objectives.

1.5 Objectives

In view of the absence of a holistic and globally accepted framework for conceptualising securities, there is need to highlight the risks to market and market participants. The impact of poor global coordination especially where it fails to capture the multi-sectorial and multi-dimensional nature of securities is also highlighted. This research goes further to demonstrate that non-legal factors like philosophy, politics, economics, history, social and cultural themes play a major role in shaping the nature of securities creation and regulation. Given these myriads of dynamic forces, any attempt at entrenching a global institutional form will most likely be incapable of addressing the divergent concerns of various interests. Therefore to achieve harmony across all spectrum of investors’ expectation, a flexible framework is needed to cater for the multi-lateral networks of interests. For instance, common measures of mutual recognition are needed to incentivise participation and create contextual access to more product development. To achieve far-reaching discussion, this research seeks to explore structures that could enhance practical product development when applied across market segments to enhance market growth and development.

To achieve the stated aim, the research adopts the following objectives:

1. To show that there is a problem with the definition and conceptualisation of securities within the Nigerian Capital Market which is inhibiting poor understanding of investment products and their development in the market for the purpose of increasing investment.
2. To show that this problem partly results from the conflict between formalist and functionalist legal philosophies.
3. To show that this conflict is impacting and continuously eroding the concepts and components of securities even as the structure of these products are evolving and changing at a fast pace due to technological disruptions.
4. To show that this problem still persists
5. To explore other legal barriers to investment product development within the Nigerian Capital Market.
6. To develop a practical legal model that is national in approach but with structures to suit the Nigerian Capital Market’s proposed engagement with cross border activities. This model seeks to achieve the following:
   a. Harmonise the concepts, components and theories of securities
   b. Show areas of alignment upon which to create a coherent network of concepts, theories and components
   c. Provide a basis for the development of a coherent jurisprudence for the conceptualisation of securities and better understanding of the product for increased development and investment in the Nigerian Capital Market.
1.6 Focus of this Research

This research focuses on Nigeria with literature review of major markets in North America, South America, Europe, Asia and Africa. The scope of this research addresses four functional categories in the definition of securities:

i. The definition of securities and concepts
ii. The structure of the definition and concepts
iii. The use of language operators and effect on concepts
iv. The interpretative model adopted and effect on concepts

1.7 Research Methodology

This cross-sectorial study investigates the regulation of equities, debts and derivatives from multiple directions. It considers the concept of securities regulation from a legal standpoint by examining legal theories, components, concepts and approaches. This is viewed from a national prism in relation to regional and global perspective. The research assesses this subject from epistemological standpoint of contextualism. Contextualism is grounded on constructively functional epistemology that sees reality as an amalgam of legal and non-legal contingencies laced in political and moral values.

a. Research Philosophy

This research adopts the contextualist tool because it addresses social and legal phenomena within the capital market by deploying multidisciplinary framework with the ultimate objective of emancipating functional realities. Since the researcher’s view cannot be distinct from the research, the data must be interpreted based on his insight and influences. Contextualism seeks to push ideas and frameworks to their limits by identifying contradictions and exploring the subjective meaning of legal rules. This stimulates responses and elucidates realities behind actions. On the basis of the aforementioned, the tool appropriate for this study. Contextualism seeks to understand the subject reality of legal subjects within the capital market by exploring their actions in response to the construction of laws, regulations, responses, motives and actions.

b. Research Design and Method

The research design indicates the manner in which research is to be carried out in line with the contextualist tool as a vehicle to explore functionalist instrumentation of language in legal design to achieved pre-set objectives.

i. Data Collection Method

A researcher administered unstructured interview is used to measure the impact of current law and regulation on ability to develop new investment product in the market. That is whether the Investment and Securities Act 2007, Companies and Allied Matters Act 2004, Securities and Exchange Rules, Corporate Governance Code, Chartered Institute of Stock Brokers Rule and Nigerian
Stock Exchange Rule. This interview method intends to capture the concerns and contributions of practitioners within the industry. The interview will be conducted with senior members, middle management and employees/practitioners that are responsible for products development, regulation and enforcement in the market. This would involve lawyers and in some cases judicial officers.

The self-administered unstructured interview method will be applied in Chapter 4 to discuss the current legal environment in the country. This will be followed by a third method of participant personal observation to understand the manner in which standards setting, cross-border market approach, mutual coordination and sharing of regulatory experiences are achieved in the market. The usefulness of this mixed approach is to identify likely gaps between the views of practitioners within the industry and actual realities on ground. It may as a matter of fact, also identify other variables outside the legal environment that currently contributes to the problems. This could include socio-political structure/disposition, economic realities; technological situation and environmental issues.

ii. Sample Selection

This research proposes to study ten (10) organisations within the Capital Market. Five (5) of these organisations will be drawn from the Capital Market Operators and investors’ segment, and Five (5) from the regulators segment.

The operators segment will be sub-divided into local and foreign operators. This research seeks to select four (4) out of (5) operator organisation within the Nigerian Capital Market. These include Broker-Dealers, Market Makers, Investment Management Company, Issuing Houses, Trustees, Investment Advisers (lawyers, accountants), Securities Clearing and Settlement Companies. Within this group, the research proposes to apply a combination of personal observation of the Nigerian Capital Market working environment and unstructured interview of an estimate of two (2) senior members each of the legal and enforcement team or Chief Executive Officer of these organisations.

Also Three (3) of the Five (5) regulators will be chosen from Nigeria. This includes the Securities and Exchange Commission and the Nigerian Stock Exchange, NASD OTC and FMDQ OTC. Within this category, the researcher intends to personally observe the operations of the Nigerian Stock Exchange and the Securities and Exchange Commission and engage at least One (1) senior member each of the legal and enforcement team, preferably the head of the team in an unstructured interview. In all these cases, the middle management and lower staff will also be personally observed (disclosed and undisclosed), accompanied with unstructured interviews.

iii. Analysis Method

Current literatures identify two main research methods (quantitative and qualitative methods). While the quantitative method analyses numerical data from questionnaire and structured interview to achieve scientific outcomes, qualitative method is used in interviews and observational data analysis to achieve social realities.

This research which adopts the doctrinal method utilises the qualitative approach because of the nature of the research. Qualitative method makes it possible for researcher to explore the social contradictions within legal theories.
The doctrinal method which represents a systematic set of procedures for developing theory from data is considered useful in measuring the regulatory effectiveness of national laws/rules in the development and management of securities.\textsuperscript{11} This will be particularly useful in Chapter 5 where qualitative analysis of legal models of Nigeria is assessed against conditions applied to specific products available in those markets to understand their respective outcomes. While utilising qualitative analysis through doctrinal method, the researcher will deploy grounded theory tools such as theoretical sampling, coding and comparison drawn from laws, contracts in Nigeria at national level and thereafter compared with the respective regions.

With this choice method of analysis, the outcomes expected are a modification of existing theories to fit into data.

1.8 Contributions

The idea of multiplicity of conceptualisation frameworks by different countries may be seen as attractive today because of the possibility of cooperation and mutual recognition. However, this approach has its demerits. Firstly, it creates significant compliance burden on countries as they try to navigate, interpret and justify similarities or differences between every aspect of financial instruments. Secondly, the fluid nature of securities and increasing technological disruptions by Digital Ledger Technologies and Crypto-Instruments makes it difficult to anticipate the scope of these instruments. Thirdly, it is also the case that whilst nations are caught in the dilemma of either preserving historical traditions to retain uniqueness or embracing foreign traditions to ensure economic growth, significant tensions is created in the underlying structures and understanding of securities. This conflict is militating against cross-border coordination and harmonisation efforts. The danger of increased market fragmentation has left regional regulators with the option of increasing the threshold of compliance and/or raise standard of membership in regional blocks or groupings. Even though this may possibly present short term positive results, the long term disadvantages may lead to loss of competitiveness at the regional level as a result of potential arbitrage opportunities inadvertently created for non-members.

To address these concerns, this research argues and firmly makes the point that formalist approach to the conceptualisation of securities is insufficiently equipped to accommodate the various contexts that constitute securities as a concept. By so doing it makes the following contributions:

a. Looks to fill the vacuum and initiate debate on the conceptualisation of securities in Nigeria and the selected countries.

b. It stresses the usefulness of real world semantics in language philosophy as it shapes representionality of legal texts by providing a basis for their context-sensitive conceptualisation.

c. Through the use of focused group case study research technique, this thesis identified the legal obstacles to the conceptualisation of securities in the Nigerian Capital Market

d. Proposes a suitable national definition of security by attempting to clarify and harmonise the inconsistencies in the concepts of securities in the Nigerian Capital Market.

\textsuperscript{11} Saunders et al (2012) supra
e. Development of a model for the clarification and harmonisation of the components and concepts of securities (The Conceptual Onion). It demonstrates the capacity of the model to clarify the place of negotiability, transferability, circularity within the context of securities and its concepts of right and duties.

This research is an original contribution to knowledge as it clarifies the yawning inconsistencies in conceptualisation of equities, debt and derivatives. By exploring pre-existing researches to identify gaps in the understanding of investments and analysing concepts, this research develops the Conceptual Onion Model for the categorisation of securities.

The Conceptual Onion is established on the basis of a multi-layered exploration of national conceptualisation models of different countries. It will expand existing frameworks of national regulation in several ways:

a. It shows the cyclical interactions of the concepts of securities by clarifying uniformities in legal relations with parties. These circular networks are both at the levels of the instruments themselves and their derivatives.

b. It facilitates the understanding of the concepts and their likely cooperation with regards to enforcement in regulated markets within and outside national boundaries.

c. The model shows that comparative and contextual studies of structures and approaches adopted by different countries provide a framework for standard setting, and create the basis for combination of regulatory theories and practical application in these countries.

d. By putting the courts at the heart of conceptualisation, the model demonstrates its capacity to galvanise the development of a coherent jurisprudence while setting out criteria for the determination and weaving together of legal and non-legal contexts.

Apart from these contributions to knowledge, the researcher is also inspired by the role of securities in enabling the capital market to deliver economic growth and development. The challenges faced by regulators in their quest to mobilise savings for investment, lower financing costs, facilitate equitable wealth distribution, can only be addressed by increased product availability in the market. Therefore, it is imperative to explore the practical and theoretical elements that support the development of investment products in markets.

1.9 Why Nigeria?

Nigeria is an attractive choice for a study of this nature because of its unique position on the continent of Africa and the world. As undoubtedly the largest economy in Africa, its Capital Market is the second largest on the continent. This underperformance has been traced to limited product availability to meet diverse investment preferences. The impediment to product development is a result of internal incoherence in the definition and application of concepts that constitute securities and lack of strategic fit between legal and non-legal themes.

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12 The Nigerian Capital Market Master Plan – 2015 to 2025 (CCMP)
1.10 Challenges to research

Lack of understanding of securities at a conceptual level made the sourcing of data within the market difficult. This was also made worse by the fact that no literature currently exist on this aspect of securities in Nigeria and Africa at large.

To address the problems and challenges highlighted above, this research is structured into chapters.

1.11 Structure of Thesis

**Chapter 1** sets out the background of this research to show the damaging effect of the philosophical divides that have perpetuated this definitional incoherence of securities in capital markets.

**Chapter 2** considers the definition of securities (equity, debt, derivative and various hybrids) with a view to understanding their nature and propriety for specific regulatory models. It presents a general overview of the essential and universally accepted component of securities. It identifies the competing theories, concepts and approaches to securities categorisation. The chapter further highlights the merits and demerits of these various approaches as a window to distil the best normative approach to achieving definitional coherence and by extension product development in the capital markets in Sub-Saharan Africa/Nigeria. This chapter concludes that the formalist conceptualisation contributes to the definitional incoherence of securities and limits their economic functions. While acknowledging the preponderance of weak institutions as a likely risk to the successful implementation of the recommended functionalist judicial context-sensitive approach, this chapter demonstrates how the US has adopted this approach to overcome similar challenges in its history as it fashioned a coherent framework for the conceptualisation of securities. This has led to increased product development and market growth.

**Chapter 3** details the research methodology and justifies the choice of research strategies.

**Chapter 4** identifies statutory and administrative formalism as the model/concept at play in Nigeria. It presents the historical origin and demonstrates its contribution to the weak mechanisms that sustains definitional incoherence and poor product development in the Nigerian capital market. It goes further to identify and discuss through empirical data the limitations, confusions, contradictions and negative disruptive implications of formalist language structure that have shaped securities legislation and negatively impacted the development of Nigerian capital market. It assesses and analyses collected data against the main thrusts of the framework developed in chapter 2. Such analyses should either support the views that formalist approach places significant constrains on the effective conceptualisation of securities and product development in the Nigerian Capital Market. The chapter also identifies and explores non-legal themes (socio-political and economic factors) that have shaped the definitional/language crisis and perpetuated a cycle of under-development of market products. It concludes that the difficulties experienced in the Nigerian capital market are traceable to the definitional incoherence of securities borne out of strategic misalignment between legal and non-legal themes.

**Chapter 5** examines the legal issues within the model against Nigerian Investment laws (as captured in chapter 3) and data. Through hypothetical case study this chapter explores relevant provisions within the Investment and Securities Act, SEC Rules, CAMA and Clearing Rules to practically show
how functionalism (contextualism) can improve the functioning of market through contextual application of laws. The results achieved are further assessed to produce recommendations.

Chapter 6 Summarises the research and makes suggestions

Chapter 7 Captures the findings and contributions to theory, policy and practise. It also addresses the epistemology of the contribution and implications
2.1 Introduction

For reasons captured in previous chapter above, the broad literature and jurisprudence on the conceptualisation of securities is fraught with fundamental gaps, contradictions and dilemmas. Hudson identifies these as a source of definitional incoherence and threat to global financial stability. This view seems to enjoy wide support from a cross-section of market participants who have long advocated for a coherent framework for global application of securities law. For the most part this research reflects a strong consensus on four unique and interconnected points.

a. First, the absence of a coherent jurisprudence and framework for the conceptualisation of securities has given rise to multiplicity of interpretative approaches of securities instruments and increased market fragmentation. Ever increasing differences in national laws and their interpretation have continuously widened the gaps in understanding and worsened investors’ dilemmas. The desire to ensure free movement of capital across borders for purposes of trade and investment is inhibited by difficulties in achieving mutual recognition and/or equivalent status. A major source of this controversy essentially, is the conflict between the formalist and functionalist interpretative philosophies.

b. Second, apart from gaps and lack of uniformity in the interpretation of securities, the absence of a definitional framework for the characterisation of the specific concepts within negotiability that make up securities, further deepens its incoherence. This creates tensions in markets as participants fashion out how best to achieve mutual recognition and/or equivalent status for the purpose of cross border transactions.

c. Third, the absence of uniform application of these concepts in the conceptualisation and characterisation of securities across all jurisdictions contribute to its definitional

14 Joanna Perkins; Joshua Mangeof; Malavika Raghavan; Richard Hay; Maria Chan; Daisuke Tanimoto; and Paul Mortby, Coordination in the Reform of International Financial Regulation: Addressing the causes of legal uncertainty, Financial Market Law Committee (FMLC) Discussion Paper, February 2015. The failure in the successful implementation of the G20 core recommendations on strengthening global financial stability held in Pittsburgh in 2009 led to this discussion and identification of challenges to such implementation. These include overlaps, inconsistencies and conflict in national rules, legal frameworks and regulation. The question of interpreting the main components of securities has been a major ideological battle ground between the formalist and functionalist philosophical schools. These components are Proprietariness (ownership), Negotiability and Transferability. Their conflict is not restricted to the global or regional jurisdictional levels. It also pervades and has since created tension between institutions within national levels for instance, national legislatures enact securities law to adopt divergent paradigm, while court centred case laws adopt a convergent paradigm. The difference in this structure creates internal tensions that stand I the way of effective conceptualisation of securities. Jurgen Baselow, ‘The Europeanisation of Private Law: Its Progress and its Significance for China; Chin J Comp Law (2013) doi:10.1093/cjcl/cxs001
15 The Singapore IMF Report on IOSCO Implementation of Core Recommendation and Principle for Securities Regulation
incoherence. Some of the causes of this include inherent limitations in language and linguistic interpretation of legal texts,\textsuperscript{16} the promotion and protection of legal traditions. It also include the poor institutional capacities of certain nations to accommodate changes to new legal regimes or take full advantage of changes imposed by the adopted (new) legal traditions.\textsuperscript{17}

d. Fourth, the inadequacy or lack of definition of the specific financial instruments is traceable to the desire to perpetuate dogmas. There are practical dangers in the failure to provide a definitional framework to delineate the contours and scope of these instruments.\textsuperscript{18}

e. Fifth, the agreements in paragraphs (a) to (d) above make a strong case for the development of a flexibly robust context sensitive functionalist model for the conceptualisation of securities to address these challenges.\textsuperscript{19}

To resolve the above challenges, this research addresses the two main parts of legal philosophy. The first being the development of a theoretical framework of legal studies and the second, the examination of legal concepts such as rights, duties, liabilities, immunities etc. as they relate to private law and contract. These concepts and theories are explored within the context of ‘meaning’ in language philosophy on the one hand, and reference implications propositions as embedded in context on the other hand.\textsuperscript{20} An investigation of this nature is essential to shape the philosophy in the area of securities regulation.

Part 1 of this chapter attempts defining securities and explore the theoretical framework so as to serve as the conceptual framework for the review of literature on the structure of securities. The chapter adopts the functionalist/contextualist approach as a window to examine how language and the use of its concepts like ‘means’ and ‘context’ constrains or support the understanding of securities, its component and concepts. The choice of judicial context sensitive functionalism to frame this perspective is borne out of the multital legal relations of securities and the need to capture its nominal essence. Hence this approach helps to amalgamate several theories and concepts to create the needed focus point for structuring this review.

\textsuperscript{17} The lack of uniformity in the application of operating words and phrases in legal texts is a major source of incoherence in most formalist jurisdictions
\textsuperscript{18} Hudson, Alastair (2013) Securities Law, Sweet and Maxwell; Frederick H.C Mazando supra page 33
\textsuperscript{19} This is necessary given the current wave of technological disruption of the financial market and emergence of the Digital Ledger Technology and Crypto-Currencies/Instruments. There is the increasing need for a framework to delineate the contours of these ever dynamic instruments for purposes of clarity and investor protection.
\textsuperscript{20} Reference implication propositions and truths
Part 2 on the other hand examines new ways of thinking about securities, its definition and the concepts in practice. It indeed explores how the courts have been used as an instrument to weave together all the theories, concepts and legal relations in fashioning a holistic jurisprudence for securities.

2.2 Basis of choice of Literature and Markets for this study

This review seeks to identify the gaps and contradictions in the conceptualisation of securities in major markets of the world, explain the effect of those gaps and propose solutions. To achieve this, the review relies on case law, statutes, seminal works, journals and newspaper articles on securities law in major capital markets of the world. This research explores the inner workings of concepts of securities and underlying components. It examines the themes that influence and are influenced by these concepts in such a way that they shape market behaviours, attitudes and knowledge of concepts within the markets.

Therefore the literatures of choice are foundational and contemporary in that they explore these investment products internally to understand the laws in practice and how they reinforce negotiability, transferability and circularity. By concentrating attention on these categories, it is possible to identify the contemporary legal arguments borne out of conflicts in interpretative systems that participants are constantly confronted with in the market. This is with a view to unearthing how these interpretative structures either militate or support the seamless movement of title within the market. This literature review covers legal issues emanating from disputes about product categories, types and legal effects. The focus is not on the activities of participants and regulation with respect to investment. Rather it is on how legal issues within these rules shape the activities of respective participants and regulation as they relate to their choices in the market. This is with a view to focusing on how legal rules promote and constrain the conceptualisation of securities towards achieving circularity. In deliberating on negotiability, transferability and circularity, emphasis is on the network of concepts like rights and duties captured by language operators within securities that guarantee circularity in the market.

The same is true of the choice of markets. Brummer identified the dominant influence bigger securities markets have on smaller one within regional blocks as it relates to their legal structure and securities regulation.\textsuperscript{21} Considering the need of this research to explore the legal effects created by conflict of philosophies, the identification of the major markets within sub-regional blocks in every continent was explored to understand the interpretative philosophies in operation. Therefore this choice of markets was informed by size, legal sophistication and regional influence. With this in mind, it becomes imperative to state that distinctiveness of markets only exist at the mercy of their interconnectedness. The US

\textsuperscript{21} Chris Brummer, Post American Securities Regulation, 98 CAL. L Rev 327 (2010), http://scholarship.law.berkeley.edu/californialawreview/vol98/iss2/2
securities market has global appeal because of its size, legal sophistication and influence within the NAFTA trading block. Germany, France, Italy, Spain, United Kingdom are influential on the one hand because these countries are major markets within the world’s largest trading block (the European Union). On the other hand, these countries still maintain some form of influence over the legal and financial systems of their former colonies. Hong Kong and Singapore are explored because of their regional influence in Asia, sophisticated legal regime that captures the cultural variations of the region and also membership of the common wealth. This is important now that the common wealth is increasing gaining importance in the wake of BREXIT. Japan is studied because of its size, influence and sophistication. Finally, the choice of South Africa, Kenya and Nigeria is borne out of their sub-regional influence as the continent moves towards a single trading bloc under the recently signed African Free Trade Partnership in Kigali Rwanda (also known as the 2018 Accord).

**PART 1**

The legal jurisprudence (whether general or particular), as in this context represent the study of securities and their uses. By securities, we refer to traditional instruments and synthetics. With respect to their uses, reference is made to how they are conceptualised and applied to transactions. At the core of securities is its representative character. Aside exceptional cases, the definition of securities have been couched with cognisance of their purport and coherence. To interpret these definitions within the context of transactions require analysis of their representative contents and grammatical structures. In achieving this study the language concept of ‘means’ and ‘context’ are explored against those legal concepts that underlie securities. These include negotiability/transferability which is better described as a bundle of rights within instruments that guarantee their unhindered or uninhibited transfer, exchange of values and storage of the said values within regulated markets. The identified rights in themselves are both paucital and multital and therefore form the basis of this research to understand their nature and function and impact of legislation on their function.

Do we really need a definition of securities?

The question of examining securities on the basis of its component like negotiability seems particularly attractive these days. This is partly due to the difficulties faced in different jurisdictions as relates to arriving at one that captures the very essence of these products and the conceptual difficulties faced in understanding rights as a concept. These problems are both internal and external. The internal issues relate to lack of consistency in the conceptualisation approach of these products which is borne out of differences in legal
regimes, language philosophies, cultural and economic priorities. The external factors relate to the attitude of governments, politics and the ideological dispositions of the framers of the laws.

Hart in his concept of law identified working models as the only way to present different standards of legal systems in place of definitions.\(^{22}\) To him, practical life clarity can only be attained by understanding concepts from the way they function in particular linguistic and logical frameworks. Without jettisoning the real essence of definitions as reducing complexities and drawing attentions to key criteria, word construction in this sense has the potentials to perpetuate dogmas. To this end, it is important to adopt multiple approaches in the analyses of securities as a concept. This will include atomism, real essence and nominal essence.\(^{23}\) Although these logical analysis methods are treated distinctly in practice, they are not mutually exclusive. Wollheim criticised the real essence analysis model as lacking in their elucidation of meaning, provision criterion of validity of law and schema of legal system validity. He however advocates for nominal essence model.\(^{24}\) Freeman disagrees with Wollheim when he cautioned that words and their construction within legal texts have potentials of improving or constraining legal validity. These tensions are reflected in the unease and uncertainties in defining securities.

2.3 Uncertainties in defining securities

Achieving an all-embracing definition of securities has not been easy. Legal systems all over the world have struggled to surmount definitional challenges by adopting different strategies.\(^{25}\) The first strategy is about the structure of the definition, the second strategy is definition on the basis of institutional ideologies, the third strategy is on the basis of the underlying component of securities and the fourth approach is definition on the basis of practical criteria.

The first strategy is broken into three sub-strategies. This includes definitions:

a. Supplanting definitions by listing broad categories of products commencing with the word ‘Context’ or ‘Means’

b. Another sub-approach adopts a highly restrictive technique of categorising securities on the basis of their resemblance to pre-existing instrument (UK)

c. The third sub-approach is one that fashioned a definition through the creation of theories and tests through a court system (USA).


\(^{24}\) Freeman page 13

The second approach is more of institutional attempt to define securities based on the ideological positions. Statute and courts tend to tow uniquely similar yet conflicting lines when it comes to defining securities. In the US for instance, statutes adopt the formal divergent view of securities as distinct pieces of contractual instruments with lives of their own, the courts explores the functional convergent approach of looking at the rights and obligations emanating from the labels parties give to their contracts. This therefore highlights the tensions that currently exist. For other countries, their statutes have played significant roles without a supporting jurisprudence from the courts. The outcome of this statutory approach has been mixed. In some jurisdictions, it heightened the level of uncertainties and created risk aversion. In others, it has contributed to the low level development of investment products in those markets because investors factor in the strength of supporting institutions in their decision to invest. The meeting point for both views should rest on the importance but salient identification of the linkages in the governing variables that constitute securities and more fundamentally, their conceptual nature.

For the third approach, some writers have attempted to ascribe securities to some classification systems which include criteria like currency denomination, ownership rights, maturity, liquidity, tax treatment, income payment, credit rating, industry types, sectors, market, region and country. The difficulties in these generalised classifications stem from inconsistencies in the choice of application criteria, universality of a particular system of classification and the lack of certainty as to the methods to be applied at a given situation or circumstance.

The fourth approach to defining securities explores theories to understand the true nature of securities and their dispersal within the market. Attempts have been made to identify some basic constituents of securities which consist of terminologies like ownership, ownership.

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26 Section 2(a)(1) of the Securities Act 1933 and Section 3(a) Securities Exchange Act 1934
27 This is the case with the United States which has developed a comprehensive jurisprudence around the conceptualisation of securities.
28 These jurisdictions in Europe include Germany, France, Spain – Dick Diane Lourdes, Confronting the Certainty Imperative in Corporate Finance Jurisprudence (25 October, 2011), Utah Law Review, No.4, p 1; Seattle University School of Law Research paper No. 11-26; Joanna Perkins, Legal Certainty and the Role of the Financial Market Law Committee (2007), Capital Market Law Journal, volume 2, number 2, page 155
29 Dick Diane Lourdes (supra) page 38
30 The governing variables in this case includes laws, state of affairs, the logic and the underlying philosophy
relationships; rights to ownership and negotiability. These terminologies have however not been explained to provide clarity.

IOSCO through its 35 Principles for the Regulation of Securities identified negotiability/transferability as the essential component of securities. Without providing a definition for the term, a community reading of the entire principles indicate that transferability as the characteristics of negotiability so that where instruments are capable of moving freely within a regulated exchange, they are deemed negotiable. The fact of unhindered movements of assets within a market does not resolve the question of what is transferred, its nature and capacity to confer binding title on the other party. Therefore and as a first point, questions of ownership which has suffered dispersion over the years to great masses of shareholders who clearly do not have control over their shares, was not addressed as a way of clarifying the component. Secondly, the clear departure from property law of ownership that emphasises control has been left unattended. Thirdly, the legal definition of ‘relationship’ has suffered disruptions especially within the context of right of ownership and beneficial ownership as they relate to law and equity.

From the foregoing, it is clear that authorities are divided on the true nature of securities. The debate is a product of historical understanding of the uses of products and various regulatory definitions. Importantly, three broad classifications exist in summing up the interest they elicit. Firstly, there are arguments as to whether securities are properties (therefore subject to property law Lex Situs Rule). A second group argues that securities are mere contractual rights, while a third group argue that they are neither property nor contract but investments of a special kind that is created by the law to circulate in a regulated exchange. These distinctions have far reaching effect on tax laws, property laws, corporate accounting principles as applied to securities and their tradability in the market.

Benjamin in a bid to define security interests distinguished it from securities by stating that they are different and any attempt to bring them together is a legal risk. Such a view may not hold especially with the dematerialisation of property interests and increased

33 Michele, Eva; Hudson; Paech Philipp; (supra) pages 23 and 33
34 The purpose of this study is to achieve some level of certainty as to the true nature of securities in order to identify the appropriate laws that should regulate various competing interests in the market.
36 Gilmore Grant (1968) ‘Security Law, Formalism and Article 9, Neb Rev 47, 659
complexities in the world of intermediation. Even in the 1990s when such positions were held, the underlying rights conveyed by a certificate were essentially intangible and could have existed separately as investments. What she seems to suggest by that position is that interest in a share certificate for instance could be characterised as an instrument of payment or investment. What is however unclear is whether both payment and investment can exist simultaneously on the same securities. If the answer is in the affirmative, then there must be a basis for their demarcation. Conversely, in cases where the concept of ownership is inferred in both securities as payment and investment, then is there basis for separation must be apparent.

For this research the word security is a legal construct. It is descriptive in character and exists in the word of function rather than form. Securities in one sense are the conceptual embodiment of rights (entitlements) and interests in an investment on a subject matter that is either tangible or intangible. These rights create obligations. While these rights are self-preserving, the subject matter invested in forms the fulcrum on which the value of these interests are measured and re-assigned. In other words, while providing a protected entitlement for investors, it also enables a claim against itself for the sustenance of pre-agreed obligations.

The definition of securities by listing a set of items does not cover sufficiently the extensiveness of the concept. Bonds, shares and derivatives do not constitute securities in themselves but serves as mere descriptive devices of rights and obligations that are created through contracts that securities represent. This explanation is more relevant in the capital market where price movements form the basis of investible obligations. Such obligations become payable in line with the underlying contracts that sustain their exchanges. Therefore, securities constitute a bundle of legal entitlements captured within contractual devices that exist to protect itself and obligations within it for the purpose of substituting or reallocating values. The extent to which these rights are punctuated by intermediation and their specificity in the face of multiple layers of intermediaries are important considerations. This is useful in the determination of whether these rights are effectual if not specifically tied to identifiable individuals or groups.

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40 Gullifer Louise and Payne Jennifer – Intermediated Securities, Legal Problems and Practical Issues
41 This seems to be a major problem in the validation of right captured in those contractual devices. To this end, the UK adopted the Trust model to create that link. The community effect of US Article 8 and 9 of the Uniform Code provides that these rights are effective even where they are not specifically tied to named individual; it raises further questions as the conceptualisation of these rights.
Therefore, securities are better known as instruments that do the following:

a) Guarantee protection of investors’ asset by providing a form known and recognised among the three identifiable variants (equity, debt and derivative). The distinction between equity and debt is consistently blurred by the frequency of debt – equity conversion within the market.\(^\text{42}\)

b) Provision of exchangeability for value and negotiability. Securities as an existing medium of transferability of recognisable transferable rights of value for value between the transferor and transferee.

c) The modicum of un-hedged risk.

The above conditions constitute the sum total of the nature of securities which significantly finds more expression in function it performs rather than the form it exists in. Its structure which better explains its definition is captured in the diagram below.

\(^42\) This is also referred to as contingent capital which exists to limit liquidity risk. The percentage and type of debt to equity conversion is determined by the nature of the default anticipated and the amount or type of asset involved. For example conversion from debt to preferred stock could even involve various derivatives. Others are the increasing use of voting rights by bondholders in the US State or Delaware is another example of that bridge.
Figure 1 above represents the microscopic structure of a security showing the characteristics and function of securities. It basically demonstrates that a security is nothing more than a bundle of tradable rights which are intricately interwoven and in constant communication. Under prescribed rules which allocate powers that create and reinforces rights and duties, this indicates how these concepts rely on one another to exist and function. The square diagram shows that the rights themselves perform dual functions of wealth creation and storage. This empowers the holder to wield control and influence. They create wealth by facilitating easy transferability, tradability and convertibility of risks. These rights are a store of wealth by providing opportunity for capital appreciation, retrieval and monetisation of itself. The ability to protect values, guarantee safety and security of stored values are special advantages.
One unique feature of securities is the fact that they are represented in contracts or contractual terms and regulated by statute. The question as to what extent statutes influence these contracts and guarantee the protection of rights created within it is the essence of registration. In other words, registration of rights created within the instruments is a means of control of the content therein.\(^{43}\) Several discrepancies exist on the question of control and the recognition of specific rights currently captured. It is inimitable to assume this on the basis of mere statutory language. Parties to a contract would question the illogic of exerting control merely on the basis of statutory language read into labels placed on their private transactions. The highhandedness that characterises absence of a democratic mandate in statutory application which in a sense carries historical and cultural significance, has led to controversies in methodological approaches.\(^{44}\)

The tensions identified above raise the following fundamental questions:

1. What is the nature of rights and obligations that constitute securities as captured within the concepts identified in Figure 1 above?
2. How are these concepts connected to create the required legal relations identified in Figure 1 above?
3. What these rights and obligations represent?
4. How these concepts identified in Figure 1 above ensures compliance to create the legal relations that guarantee uninhibited transfers.

These questions can only be answered by exploring the legal systems and content of laws regulating securities. By legal system, Fuller thinks of morals that carry internal structure and exemplary code of legality in achieving a relationship between laws and legal concepts.\(^{45}\) Raz disagrees with Fuller’s theory and believes that relationship between law and concept is possible only if a legal system can tackle the questions of existence,\(^{46}\) identity and member\(^{47}\) and structure.\(^{48}\) Identifying the relationship between law and legal concept does not guarantee compliance without establishing validity of the system. Therefore, where the various legal systems have been identified, the test for their validity will necessitate the adoption of three distinct approaches. Firstly, the behavioural approach which evinces the attitude of the legal system towards its laws and legal concepts by looking at the effectiveness as a measure of validity. The two main types of legal system under this

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\(^{46}\) Existence in this sense means distinguishing between existing legal systems and those which no longer exist

\(^{47}\) Identity and member in this sense means recognising which system a particular law belongs

\(^{48}\) Structure means identifying the particular features or patterns common to all.
approach are realism and positivism. Secondly, the socio-psychological approach sees validity from the basis of legal compliance by official and citizens of a country. Thirdly, the deontic approach which looks at logical analysis of law as a basis for its effectiveness.

One need not see the law as a standalone creation. Freeman sees it as a social continuum that is constituted by values, institutional philosophy and language of the law interacting at varying degrees.\(^49\) This is the basis upon which laws and concepts must be seen. Therefore, to properly discuss these themes within the context of securities concepts, this research adopts the four analytical categories of Robert Summer.\(^50\) He recommends four main steps to be taken in ‘engaging variety of analytical activities.’

1. Analysis of existing conceptual framework of or about the law
2. Construction of new conceptual framework with accompany terminologies
3. Rational justification of institutions and practices, existing and proposed
4. Purposive implication tracing out of what the acceptance of social purposes ‘implies in terms of social arrangement and social ordering.

This research relies on these categories in the analysis of legal concepts so as to achieve a thorough appreciation of contemporary legal philosophy of securities.

2.4 Existing conceptual framework of securities law (Formalism versus Functionalism)

In view of the universal acceptance of negotiability as the component of securities and the fact of its description as constituting rights and duties (obligations) which are created by law, there is need to explore the concept of law to discover their nature and function.\(^51\) Hart insist on the use of context and language to elucidate rules and obligation rather than disagree with Austin’s theory of definition.\(^52\) To him, legal system is simply comprised of social rules derived from varied experiences which operate regulate, provide guidance and promulgate standards upon which conducts are measured and criticised.\(^53\) Hart believes that these social rules are made of rule of law (which create obligations and make certain conducts obligatory) and rules of morality (which is also known as systematic quality, mediates primary duty imposing rules and secondary power conferring rules). To Mullock, secondary (power conferring rule) provides the legal basis for contracts and allocate powers through rules to courts, legislature; securities regulators as well as prescribe their composition.\(^54\) The primary rules on the other hand impose duties. Hart recognised the unique relationship between primary and secondary rules as determinative of the texture of

\(^{49}\) Freeman supra page 25
\(^{50}\) Summer Robert (1966) 41 New York University Law Review 861, 865-877
\(^{51}\) Hudson, Alastair (2013), ‘Securities Law’, Sweet and Maxwell
\(^{52}\) H.L.A Hart supra page 145
\(^{53}\) M.N. Smith (2006) 12 Legal Theory 265
a legal system, but stated that the basic differences between legal systems and standards for acceptability are predicated on three categories of secondary rules:

1. **Rules of adjudication** which empowers officials in the course of legal enforcement to pass judgment. This is in cases where either the regulation or courts or both are allowed to act in judicial capacity.

2. **Rules of change** empower official bodies to enact laws which have the ability to change legal relations between individuals to achieve specific ends. As in this case, legislature to enact Securities Act.

3. **Rules of recognition** which prescribes the criteria for validity of these rules. So that a legal system is said to exist where valid rules that regulate behaviours in accordance with the system’s criteria of validity exist. In addition, these rules of recognition, change and adjudication must be accepted as common prerequisite of behaviour by parties and officials. This is because the absence of these rules makes concepts like power and system of adjudication ineffectual thereby limiting the operational effects of legal and moral obligations.

Therefore, Hart hinges his Systematic Quality on the normativity of law as reflected in human attitudes and actions towards law. He emphasised the relationship between moral influences to obey laws based on internal conviction as to its validity and the understanding of the significance of effect of human actions to self and society when they are obeyed or disobeyed. MacCormick identified this suasion as a product of distinctive language reflecting the critical characteristics of these social rules. Karl Olivercrona’s view seems in tandem with MacCormick’s especially on the question of the capacity of legal words to delineate, create, and determine legal relations. This means the role of linguistics is increasing becoming relevant in legal interpretation even as S. Winter maintains that the role of linguistic legal interpretation is only confined to cognitive linguistics. Freeman disagrees with the idea of cognitive linguistics exclusively without social linguistics in elucidating legal systems. Harris captures this view succinctly in voicing his support for the power of words in capturing the nominal essence of legal concepts in the determination of systematic quality and legal relations.

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55 H.L.A Hart supra pages 185-212
57 This is a term he called ‘Performative’ – Karl Olivercrona ‘Legal Language Reality in R.A Newman (ed) Essays in Jurisprudence in Honour of Roscoe Pound (1964), 151; Olivercrona, K ‘Law as a Fact’ (1939, Oxford University Press)
58 Freeman supra page 1463
60 Freeman page 27
“Followers of this approach seek insights into the nature of legal concepts by careful attention to all the subtle variations of language comparing their uses inside and outside the law”

This is what Bentham refers to as Deontic Logic.\textsuperscript{62} Tarski’s discussion on the variations of language in achieving representionality confirms Harris’ and Bentham’s views.\textsuperscript{63} He formulated the theory of formal language (formalism) which divides language and its uses into two broad sets. The first is the ‘Meaning-Proposition’ which sees representational legal and language concepts from their usage as a function of attitude as distilled from truth condition of the initiator. This according to him is borne out of his state or predetermined end and not from a considered collaborative exchange of mutual representionality. In other words, ‘means’ as it is used in statutory definition is meant to coerce outcomes. According to Tarski,

“\textit{The epistemic counter-factual and modal positioning of formal language is not intentional in the sense that the object of their truth are not based or determined by reference to their parts}”

Therefore ‘meaning’ is not distilled or referenced from ‘sub sentential constituents’

The second view which is the ‘Possible World State’ (functionalism) as popularised by Saul Kripke considers representionality from the situation of how the world would look like ‘if the set of basic proportions with which they are defined where true’.\textsuperscript{64} This view which operates within the realm of context is conceived on the basis of four related premises.\textsuperscript{65}

1. \textit{A world state which is metaphysically impossible but epistemically possible}
2. \textit{A world state which occupies inquiry-relativity spaces within theories}
3. \textit{A world state which encapsulates apriori knowledge}\textsuperscript{66}
4. \textit{A world state which is either known by its self-description or a product of empirical or indexical views}

These assumptions that place representionality of legal concepts within the realms of context have been criticised as insufficient. Saul Kripke,\textsuperscript{67} Richard Montague,\textsuperscript{68} David

\textsuperscript{62} D. Lyons, ‘In the Interests of The Governed (1973)
\textsuperscript{66} This is particularly relevant and used in the Scandinavian functionalism like Sweden, Finland
Lewis,\(^{69}\) Robert Stalnaker\(^{70}\) and David Kaplan described Tarski’s formal language (formalism) as lacking in the underlying features of natural language which includes context sensitivity, intentionalities and logical truth. They see formal language as too weak to determine meaning and truth assigned to sentences. While jettisoning Tarski’s formal language technique, world state proponents advocate the Tarski’s style theory of ‘truth to context of utterance and possible states of the world’ also known as ‘Possible World Semantics’. The ‘Possible World Semantics’ provide a more robust approach to unpacking language by incorporating modal concepts that tend to capture context and natural language. Conflict between the ‘Meaning-Proportion’ and the ‘Possible World State’ constitute a major conceptual challenge for the philosophy of language and stand in the way of rationalisation of legal system, legal rules and concepts.

**The Conflict between Formalism and Functionalism**

**Formalism** is essentially hinged on the Meaning- Proposition. It sees no transcendent conception of legal rules outside their literal or textual content.\(^{71}\) It argues that law is rationally determinate, autonomous, comprehensive and logically ordered.\(^{72}\) Therefore application of legal rules should be purely from mechanical deductions to produce single correct outcome instead of engaging in functionalist approach that manipulate legal rules through the lenses of political influence, moral views and personal biases. The fundamental ideals of the law in relation to society is deduced and conveyed by their statutory structure and language. To this end, formalism generally attempts to preserve legal tradition and control through the adoption of statutory structure that guarantees certainty in interpretation without the need for judicial support.\(^{73}\)

**Functionalism** revolves around the Possible World State. Functionalism disagrees with the formalist views that ascribe personal and societal prejudice in legal interpretation as prejudicial to legal purity and essence.\(^{74}\) It argues that purity of the law is achieved by

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\(^{72}\) Frederick Schauer, Formalism, 97 Yale LJ 509, 510-14 (1988)


looking beyond legal texts to understand the state of affairs that regulate the objectivity of legal texts and subjectivity of its interpretation to clarify underlying phenomena. As a normative theory, it distances itself from the rigidity of formalism by embracing creativity in interpretation of legal text to ensure law serves the end of society through the entrenchment of good public policy, promotion of social justice and human rights improvement. It questions the logic in ascribing resolution of coordination problems in society to the coercive existence of law. Functionalism argues that law operates in letters and spirit which capture the prevailing state of market functioning. By so doing, it incorporates norms and various contexts into its legal design. Unlike formalism, the functionalism believes in the limitation of statutory language and therefore promotes the need for theoretical contextual frameworks through case law or empirical data to guarantee relative stability in a highly fluid market. In the final analysis, functionalism (unlike formalism) is illuminating not merely from the point of context, but also of function; therefore contextualising the process of interpreting statutes help in not just looking at the meaning of words but also their uses.

This divergence in the mode of understanding the law is fundamental and far reaching. One major casualty of this dispute is the component of securities (negotiability). The vital question is whether the Meaning-Proposition or the Possible World State best elucidate this component to achieve representationality? This is a question that goes to the construction of

1. The nature of legal system as it relates to relationship between social rules and their capacity for elucidation of legal concepts.
2. The content of the law/rule as it relates to the desire to achieve systematic quality
3. The interpretative approach to guarantee compliance or obedience

Therefore, negotiability of a document is essentially affected by

1. The statutory formalities and language used in its making
2. Proper Endorsement or Delivery and the legal/language construction of what constitutes endorsement and delivery
3. The legal/language construction of transferee’s right of ‘Holder in Due Course’ within the context of representationality

Worthington describes negotiability as right within the rules that allows the passing of ownership from one party (transferor) to another (transferee) by endorsement or delivery.

As a creation meant to substitute money within an exchange, it requires that the transferee is assured of its payment and also protected from the actions or defect of the transferor. The fact that a document is negotiable insulates the transferee from the transferor’s attempt to assert any legal defence against any transferee. This means the ability of an instrument to effect a transfer free of legal defences.

The capacity to deliver this is a function of various rights captured within primary and secondary rules. This is why negotiability has been defined as legal aggregation of rights guaranteed by statutes and rules conferred on instruments to ensure their unhindered transfer within a regulated exchange. Hohfeld attempts to elucidate the nature of these rights. He defined rights as an aggregate of eight jural relations with other people. He believes that these eight jural relations constitute the lowest common denominators of law and the lowest generic conception of which any legal quantities may be reduced. Arthur Corbin agrees with him when he called the relations ‘fundamental’ because they are constant elements into which all of the variable combinations can be analysed. He however decomposed the eight concepts into two recurring themes of ‘power and duty’ and posited that using power and duty, one may arrive at the remaining six concepts definitely quickly. Goble however disagrees and thinks the basic legal concept is ‘power’ and that all others are derivatives of power, while Kocourek characterises the entire concepts as ‘claim’ and ‘power’. Morse insists that the entire system is based on ‘rights and duties’. Whichever way it goes, it is clear that particular and correlative relations exist between parties which need elucidating.

Hohfeld breaks down rights into eight distinct concepts which are right, duty, privilege, no-right, power, liability, immunity, disability. To eliminate ambiguities he defines these terms relative to one another by grouping them into four pairs of

### Jural Opposites – Figure 2

<table>
<thead>
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<th>(1)</th>
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<tbody>
<tr>
<td>Right</td>
<td>Privilege</td>
<td>Power</td>
<td>Immunity</td>
</tr>
<tr>
<td>No – right</td>
<td>Duty</td>
<td>Disability</td>
<td>Disability</td>
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### Jural Correlatives – Figure 3

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<tbody>
<tr>
<td>Right</td>
<td>Privilege</td>
<td>Power</td>
<td>Immunity</td>
</tr>
<tr>
<td>Duty</td>
<td>No - right</td>
<td>Liability</td>
<td>Disability</td>
</tr>
</tbody>
</table>

78 Hohfeld, W.N. Fundamental Legal Conceptions as Applied in Judicial Reasoning, Yale: Yale University Press 1964 (1913) 23 Yale Law Journal
79 Corbin, Arthur, ‘Legal Analysis And Terminology, 29 Yale, LJ 163, 164, 167 (1919)
80 Goble, A Redefinition of Basic Legal Terms, 35 COLUM. L. Rev 535 (1935)
81 Kocourek, Basic Jural Relation, 17 ILL. Rev. 515 (1923)
By achieving these pairing, concepts that correlate are easily distinguishable from their opposites in determining legal relationships. The importance of achieving pre-determined legal effect is philosophical. Hohfeld posits that the use of words like right and privilege for instance, corresponds respectively to concepts of claim right and liberty right so that rights held and duties owed across all of these relationships disclose the degree of liberty.\(^83\) Therefore, there is a need to allocate these concepts in such a way as to derive the expected results within a system. Collision; Andrews define the concepts as seen in the Table 3 below:

**Figure 4 – Definition of the eight Jural Concepts**

<table>
<thead>
<tr>
<th>Jural Concepts</th>
<th>Description</th>
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<tbody>
<tr>
<td>Right</td>
<td>This is one’s affirmative claim against another</td>
</tr>
<tr>
<td>Duty</td>
<td>This is one’s affirmative obligation to another</td>
</tr>
<tr>
<td>Privilege</td>
<td>This is one’s freedom from the right or claim of another</td>
</tr>
<tr>
<td>No-right</td>
<td>This is the absence of any obligation from another</td>
</tr>
<tr>
<td>Power</td>
<td>This is one’s affirmative control over a given legal relation as against another</td>
</tr>
<tr>
<td>Liability</td>
<td>This is one’s affirmative subjection to the control of another in a given relation</td>
</tr>
<tr>
<td>Immunity</td>
<td>This is one’s freedom from the legal power or control of another as against legal relations</td>
</tr>
<tr>
<td>Disability</td>
<td>This is the absence of any legal power or control of another as regards some legal relation</td>
</tr>
</tbody>
</table>

An individual would be considered to have perfect liberty if it is shown that no one has a right to prevent the given act. Hohfeld argues that there is nothing like right against a thing (right in rem), and that legal relations can only be had between persons.\(^84\) Therefore since securities is neither property (subject to right in rem) nor contract but instrument of a special kind created by law with liberty (negotiability) to circulate in a regulated market, the extent of its liberty is controversial.

Therefore questions have been asked as to:

1. Whether negotiability can really guarantee the liberty it professes?
2. Whether it can really be said that there is no interference with the choices made by parties within a regulated exchange?
3. Whether the correlatives constitute one such interference with choice?
4. Whether and to what extent both transferor and transferees are imbued with choice and control over choices?

These questions can be answered by examining the practical operations of negotiability.

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\(^83\) Hohfeld supra page 49
\(^84\) Hohfeld defines correlatives in terms of the relationships between two individuals which he described as complex and needed to be broken down into simpler forms.
2.4.1 Negotiability and Liberty

The importance of liberty cannot be over-emphasised because it guarantees control over choices and actions. Liberty in this sense is defined as an absence of both right and duty. In the case of negotiability, it is defined as freedom of title to pass in exchange for value in a regulated market. That means a transferee is free to take title without fear of prior adverse title because he is under no obligation to recognise any reserved right from transferor or third party. But this does not in any way prevent the transferee from recognising transferor’s right under certain moral considerations or benefits to the third party. In such situation, the third party may have a right against transferor to enforce duty. Therefore, it is inconceivable to expect the existence of liberty from correlatives of rights and duty between two people who are limited by their choices to act outside legal and moral confines. This means that freedom or liberty does not really exist. The right of the transferor and transferee within a regulated market are in personam and as such guided by terms upon which title can be exchanged for value and circulate within the market. This locks in preserved rights and obligations that are enforceable between specific parties on an interconnected basis. Property rights on the other hand are quite distinct and arguably not within this purview.

A property right is multital or (in rem) because a property owner has a right to exclude not only a specific person from his property, but the whole world. If this is the case, can a lawful title pass in the market without some form of exclusion applied against third parties not privy to the in personam rights between transferor and transferee? If exclusions do exist, to what extent can it be said that there is liberty and title is freely transferable within the market? It must be suggested however that in personam right can also exclude others not privy to it which in a sense convey some kind of proprietariness and enforceable (like property law breaches) through civil action. These are conceptual issues with significant legal effects which continuously throw up the following questions:

1. Are legal relations governed by civil liability solely?
2. Are legal relations governed by rules of positive law solely?
3. In terms of securities, are legal relations governed by both civil liability and positive law or by property law (lex situs)?
4. Are the legal relations between parties regulated by contract law so that parties are only restricted to rights and duties and civil liabilities arising therefrom?

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87 That is recognising the third party including the overriding purpose of the regulated exchange to promote circularity
88 Clearly, this is not the case because securities are essentially a creation of law and rules administered principally by a regulator. There are clearly grounds for relief from the regulator’s or parties' exercise of powers outside the rules.
89 In other words, does the legal system operate the tyranny of law within the regulated Exchange?
The first two questions are answered by first addressing the concepts as they reflect the goal of society (sometimes referred to as social policy). So that the interpretation of whether legal relations are governed by civil liability or positive law is a question that goes to the heart of how they are constructed.\(^9\) This is where a determination is made as to whether social policy gives rise to rights. Understanding the nature of these rights and duties that emanate from relations in a regulated exchange remains important. Secondly, the influence of social policy positioning on the system of law and the approaches adopted in applying the concepts, implicates their purpose and the importance of words in the creation.

To address the last three questions above, positive school which Collison says informed the Hohfeldian concepts is of the view that duties arise from the rules of positive law.\(^9\) This means principles of contract may have no say; a view that seems to contradict Anderson position where he identifies the existence of civil liability or remedy borne out of a duty.\(^9\) To say that the transferor has power as against the transferee to make the transfer solely on the basis of positive law, speaks to the attitude of the rule of law. This raises questions as to the representionality of a law that give no room to other considerations. While positive law provides for remedy irrespective of defects in positive law, the legal realist sees such law as unrepresentative. They therefore advocates for a law which includes inputs from non-legal themes so that where transferor or transferee fail under their duties in a contract due to unanticipated natural occurrences, their rights are protected.\(^9\)

Despite arguments from the realist, positive law still remains attractive in regulating securities in many markets because of the need to enforce unhindered circularity of instruments. For instance, the rule of positive law ensures that legal duty exist where the law would make a person liable for inaction. So that in the case of transfers within the market, the rule of civil liability makes the transferor liable to transferee only where a duty exist which preclude withholding such transfers. This duty even extends to the courts either at first instance or appellate where they are obliged to stick to precedents. However, courts in certain circumstances, depending on the social philosophy would base their decisions on duties which do not arise from pre-existing positive law. The question therefore will remain as to whether and to what extent this furthers circularity. For example:

“If the defendant is liable for the plaintiff’s losses, not because the rules of law make him liable, but because (in our opinion) it is socially or economically desirable that he bear the loss rather than the plaintiff”.

Question will be raised as to what extent social philosophy furthers unhindered circularity of values within the regulated Exchange. Although the presence of social philosophy that

\(^9\) That is whether they are constructed for public good or to perpetuate the wealth of a few.
\(^9\) Anderson supra
informs this fact that the courts are allowed to exercise discretion outside positive law is one of the distinctive features that demarcate legal system, the extent to which discretion can be exercised outside laid down principles, tests the extent to which social philosophy are subject to prevailing state of affairs. This is especially important when viewed against the degrees of variability of context and its likely effect on consistency in the exercise of discretion. It then becomes a major consideration as to whether legislature is willing to include the courts in the process of securities regulation.

Another possible demarcation is the effect of a decision reached by a superior court on the lower courts’ exercise of discretion. Once the case is decided and liability imposed, the doctrine of precedent is used to impose liability on people who do what the initial defendant did. It is unclear whether this liability places a duty on lower courts to follow judgment. This raises questions of context and the possibility of achieving clear cut similarities in all cases. So that where for instance the context and nature of transaction between transferor and transferee are different, the issue is whether the court would rely solely on the form of transfer without the substance and legal effect it creates in the determination of rights and duties. One of such areas where the courts are particularly active in deriving a duty not expressly captured within positive law is in dispute involving issues like the duty of vigilance. The question is whether the transferee owes a duty of vigilance and whether such duty extends to the regulator of the exchange?

While it is now accepted that the transferee owes a duty to the transferee in the above sense, the next question is whether such duty create corresponding liability or privileges with respect to the parties or third party or the exchange? These are not questions that can easily be answered by statute because of the practical difficulties of statute to envisage every scenario. The inputs of the court are necessary in many regards. This is so that where instruments are transferred in the market with the expectation that the transferee can take subject to the transferor’s defects in title, this does not excuse the transferee of his duty to take reasonable steps to verify the transferor’s title before acceptance of the instrument.

The duty of vigilance on the part of the transferee is one of such that emanates from positive law which are non-hohfeldian because they do not arise from liability. It is merely a duty to mitigate damages and ensures corrective and distributive justice. Another non-hohfeldian duty is one which arises from positive law that places a duty on officials, participating entities and their employees within the market. This is a duty to ensure or show that these bodies have taken reasonable steps to vet market participants and staff of regulators in the market. The court is expected to be active in this area as it tries to balance the need of market credibility with the logic of circularity.

2.4.2 Legal relations and interference with circularity

The question of how to guarantee certainty through non-interference with seamless flow of values within the market given the ever changing context in legal relations is a difficult one. Hohfeld used the term duty as the basis of the logic of legal relations between pairs of specific people with respect to an act. Without defining what it really means, he identifies its practical use in inter-party transactions. For instance, when used in specific ways, duty should include one who owes the duty and one to whom the duty is owed. The exchange and network of these duties arising from the rules of liability, forms a basis for the logic of circularity in the market.

In the case of a regulated exchange, the transferor might owe a Hohfeldian duty to transferee but he cannot owe such a duty to himself. This duty owed to transferee pursuant to the powers conferred by law comes from transferee’s right to receive and corresponding liabilities on the transferor which may inhibit or facilitate such transfers. Therefore, if under the rule of law, the transferor is liable for failure to make a transfer, it therefore means the transferor owes a duty to do it. The same is true where transferor’s liability extends to 3rd party. In this case however, transferor owes a separate duty to third party because his liability to third party is separable. While these ensure the weight of duties is evenly spread by promoting unidirectional flow of duties amongst market participants and multidimensional rules of liability, such unidirectional flow inadvertently creates privilege – a no-right relation which reduces the efficacy of the rules of liability. For instance pursuant to power/liability relations guaranteed by rule of law, transferor might owe two separate duties to transferee and third party but cannot owe the same duty to both. This creates privilege no-right relations which provide a basis for the promotion and destruction of seamless circularity.

Another possible interference with circularity is the fact that liabilities emanating from the transferee’s exercise of the non-Hohfeldian right of non-interferability may promote circularity but transferee’s duty of vigilance disrupts the logic. This is because that duty creates corresponding rights on the transferor that could impinge the transferee’s right to receive. In other words, the contingency placed on transferee’s right to receive by the duty of vigilance, defeats the logic of uninhibited circularity of values within the market. There are also instances where power to create future rights can impose correlative duties on the transferor or transferee which may inhibit seamless circularity. The same is true of the effect of a possible rule that empowers the exchange to underwrite present and/or future

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96 Cullison, Alan page 563-564
97 Husick, ‘Hohfeld’s Jurisprudence, 72 U. PA L. Rev 263 (1924)
98 Mullock, Holmes on Contractual Duty, 33 U. PITT. L. Rev 471 (1972)
100 Their causes of actions are also separable
risks within the market in the event of losses.\footnote{This clearly is inconceivable in view of the fact of moral hazards. Also the likelihood that such a hedge removes the risk element from the market inhibiting capital formation and price discovery} Therefore, the effect of transferor’s duty to transferee is really about how the rule of law would treat both parties if it happens that there is a breakdown in legal relations on grounds of non-compliance. The conflicting nature of the consequences of non-compliance also poses significant test to the logic of circularity and risk to the unhindered flow of values within the market.

The other concepts also have similar challenges and inhibitions to the circularity principle. For instance, transferor’s legal right is perceived as a duty from transferee’s perspective.\footnote{Cullison supra page 564.} This makes the right and duty correlatives.\footnote{Corbin, ‘Jural Relations and Their Classification, 30 Yale L.J 226 (1921)} It also means that where the transferee is seen to be owed a duty either emanating from power/liability relations, he has a right to demand it. The result from this therefore is that the entitlements of the transferor and transferee are coterminous to the extent that changes occasioned by power - liability relations do not tilt the balance in favour of one party on grounds of social or economic philosophies. The purpose for such equality is to promote circularity. This is shown in a particular case of transferor’s duty not to deprive transferee of his right to receive those instruments as much as the transferee’s right against the transferor to demand for the said transfer and actions of the rule of law to create liabilities for non-compliance. There are however conditions that could impede this flow of values between parties. The transferor might decide to invoke the power of abandonment of the duties owed to transferee on the ground of transferee’s failure to fulfil his duty of vigilance. This could create uncertainties especially as to whether such power invalidates the transfer or whether the transferor can legally be mandated to make such transfer nonetheless. Where such transfer has already been made, it raises questions as to the capacity or effectiveness of ‘Holder in Due Course’ to pass valid title where such appears to be defective. Adam disputes this scenario on the basis that while failure on the part of transferee’s duty of vigilance may invalidate transfer where title is defective, it does not foreclose transferee’s right to receive.\footnote{Adam J Macleod (2015), ‘Property and Practical Reason’, Cambridge University Press} There indeed negative implications in putting forward ‘Holder in Due Course’ principle as part of the economic philosophy of circularity without the concept of distributive justice. Remedies for wrong arising from practices made express and not by power of abandonment could deal a major blow to the principle of circularity and negotiability as a whole.

In addition the Hohfeldian Privilege – No-right relations that arise to exculpate transferor or third party from the rule of liability, this rule may not also apply to reinforce circularity at the expense of justice. While privilege does not mean absence of right – duty relations, it however refers to lack of accountability for actions or failure to act. There are reliefs in respect to or from the operations of power – liability relations to remove possible lack of accountability. So that failure on the part of either party or third party to account for their
rights or obligations cannot go untested.\textsuperscript{105} It is however unclear in the real sense how the law can sustain privilege – no-right relations within a unidirectional flow of values which is sustained by right – duty relations.

2.4.3 Power – liability relations and privilege – no-right relations and circularity pursuant to rule of law

The vital question is whether power has the capacity to create privilege – no-right relations within a right and duties relation? The answer may be based on the rule of law and the extent to which it accommodates party autonomy.\textsuperscript{106} That is if positive law will create liability against transferor for failure to transfer, then transferee could safely assert that transferor owes a duty not to interfere with transferee’s access to the instrument by withholding it, refusing to transfer or making transfer substantially different from that which is agreed. Although this principle remain clear as its effect on circularity is likely to be positive, there are however several uncertainties. Firstly, the presence of condition precedents to the validity of a transfer could be interpreted as interference. In other words, the very existence of a privilege – no-right relation is a direct curtailment of the potency of right – duty relations. So that it is not really about the transferor having a privilege against transferee’s right of non-interferability, or the transferee’s no right to interfere with or question the transferor’s enjoyment of his privilege. It is more about how positive law would not make the transferor liable to transferee for denying transferee’s access to his instruments without remedies. This is the basis of questions as to how this furthers the essence of unhindered circularity.

Secondly, that the transferee’s has no right against transferor and the fact that transferor cannot deny transferee access to instrument may be construed as a privilege in favour of the transferor to further the principle of circularity. It is also the case that this privilege may be seen as obstructing circularity because transferor can decide not to comply with transferee’s demand for the instrument. Such action could impede circularity. This is not to be interpreted to mean that transferor is under a duty not to deprive transferee of the instrument, but on whether the transferee has instant right against transferor for failure or refusal to transfer.

In effect, Hohfeld’s schema merely explains paucital relations between two or more persons that give effect to the performance or refrain from performance of certain acts.\textsuperscript{107} This so that where duty exists pursuant to power of rule of law, liability follows, but where duty is absent, privilege is present. Hohfeld identified the types of privilege.\textsuperscript{108} He distinguished privilege to do from the privilege not to. To him, this is a way of assessing the extent to

\begin{thebibliography}{9}
\bibitem{11} Hohfeld, ‘Some Fundamental Legal Conceptions As Applied in Judicial Reasoning, 23 Yale L.J 16 (1913)
\bibitem{105} William, Glanville (1956) ‘Concept of Legal Liberty’, Columbia Law Review, Volume 56, Number 8 pages 1129 to 1150
\bibitem{107} Finan, Presumption and Modal Logic, A Hohfeldian Approach, 13 Akkon, L. Rev 19, 26-31 (1979)
\bibitem{108} Hohfeld supra pages 710-770
\end{thebibliography}
which privilege – No-right relations further the circularity principles. Where certain liabilities are withheld from the transferor through the grant of specific privileges, the language of those privileges must be explored against the object of circularity in the exchange. It must also be ascertained whether such powers to the transferor places liabilities on the transferee that are capable of preventing transferee’s exercise of its powers and thereby impeding circularity.\textsuperscript{109}

On the other hand, where privilege exists and the transferor enters a contract with transferee to make the transfer, then he would have no privilege to make the transfer, but he will be privilege not to transfer. This also indicates a privilege with respect to his duty and no privilege against it. This means he is subject to the full right of the other parties without any form of protection from the law. So Hohfeld is of the view that the construction of rule of law determines the nature of these concepts. It is the rule that authorises the doing of an act just as it is the rule of law that forbids. Given that the rule permits the creation of the type of legal relations between transferor and transferee that is how the law forbids certain acts between transferor and transferee. This is not to say that power cannot be accountable to authority.

These show that the rule of law can bestow both on a party under certain circumstances or either. But both privileges cannot be absent in a party at the same time. This will mean a transferor for instance is liable whether he makes a transfer or not. The type of privilege as discussed which guarantees doing a thing or not doing it seems to be antithetic to the format of jural relations where one concept either correlates or is opposite to the other and not simultaneous.\textsuperscript{110} Perhaps he also wants to say that the transferor may be accountable to transferee if the said transferor interferes with transferee’s right to receive those instruments. Thus in Hohfeld’s view transferee position against transferor is a privilege not to retransfer the instrument and a right that his privilege is not interfered with. This means that the transferee’s right to non-interference with transferor’s privilege produces certain liabilities and accountability on the part of transferor. If this is the case therefore, one wonders how the element of circularity will be achieved. The exercise of that privilege will clearly occasion uncertainty in circularity within the market.

The holding of instrument by transferee itself is not a right but a privilege. Non-interferability of that privilege is a right. It is unclear if the intentions of holding a privilege could be interpreted as withholding or a right to withhold. Therefore the non-interferability of a privilege as a right comes with the question of whether the transferee can exercise this right by withholding the instrument. This raises questions as to:

\textsuperscript{109} This means he has a liability and in this sense, right is power.

\textsuperscript{110} Hohfeld supra 756
1. Whether this means that this right has to be silenced to give effect to negotiability in the market
2. Whether the concept of privilege exists within the exchange? If so, what is its philosophical and logical relevance to negotiability
3. Whether the fact of withholding an instrument without transferring it, defeats the very essence of negotiability/transferability?
4. Whether the withholding of instruments by transferee and refusal to transfer, strips the instrument of its negotiability or negotiable qualities?
5. Pursuant to the right emanating from the non-interferability of a privilege, is it safe to say that this makes the holding of an instrument a right?
6. What of if the transferor decides to exercise his power of abandonment (if any) which is capable of extinguishing the myriads of relations

These questions which have legal, philosophical and logical basis are subject to multiple constructions.¹¹¹ For instance in law, when a court refers non-transfer of instrument to transferee as a right, it is merely saying the following:

1. Firstly, that a transferor has privilege to hold the instrument and not re-transfer it in the sense that he is not legally accountable if he does not transfer it to transferor or third party. In this case, non-transferability could easily be legal and the exercise of this privilege and resulting right clearly infringes the concept of negotiability
2. Secondly, the transferor’s right not to have privilege interfered with arbitrarily is sacrosanct in the sense that he will have a legal remedy if such privilege is interfered with.¹¹²

Where a court refers to holding of an instrument as a privilege, the court means that a privilege to hold or withhold instrument makes the holder not legally accountable if he does not transfer it. It also means that the privilege to hold or withhold the instrument can be withdrawn without legal remedies. This raises questions of what legal protection the law therefore gives to transferor and transferee from non-interference or non-interferability. Hohfeld responds by emphasising the capacity of power – liability relations to shape all other relationships.¹¹³

¹¹¹ Pound, ‘Fifty Year of Jurisprudence’, 50 Harv L. Rev. 557, 570 (1937)
¹¹² This therefore raises the question regarding the legal effect of having a right to non-interference without some level of accountability
¹¹³ Hohfeld supra pages 756-769
2.4.4 Power and its capacity to change legal relations

Power – Liability and Immunity – Disability relations are concerned with changes in legal relations under the rule of positive law rather than rules of civil liability. The power – liability relations especially is capable of converting jural correlatives into jural opposites. That is it converts

a. immunity – disability into power – liability
b. power – liability into immunity – disability
c. privilege – no-right into right – duty
d. right – duty into privilege – no-right

Apart from changing the legal relations of parties as seen above, power within the rule of law also has the capacity of altering the legal relations of the holder and between persons other than the holder. For example where the transferee offers to enter a contract with transferor, the transferor acquires a power to change the legal relations between both parties by accepting transferee’s offer. This means that the rule of law must provide a basis for the existence of power and its capacity to effectively change legal relations. Achieving such a feat is a matter of construction of legal texts. In relation to securities market, questions have been asked whether signing up to an exchange is an invitation to treat or an offer? Where the construction of law makes it an invitation to treat or offer, does that create a duty on the exchange and its participants to either make offers or accept his offer for the sake of circularity? If not, are the dealing members under certain privileges with respect to what to offer and accept? Has transferee got power to refuse an offer from transferor or vice versa without liability? Can they safely exercise their right of non-interference, if any? Can the transferor act under a power to revoke an offer before acceptance without liability?

Through the instrumentality of power, it must be noted prima facie that accepting the offer would under the rule of contract convert transferor and transferee’s privilege – no-right relations into right – duty relations. Where this is the case, does it therefore open the door to the application of principles of contract law? Can the power convert right – duty relations into immunity – disability relations through a party’s exercise of power of abandonment? These questions are better answered through construction of the rules. The transferee generally has the power of acceptance while the transferor has a correlative liability. So that under the rules of law that govern securities, an offer is an exercise of power conferred within the rules because of the power of revocation before acceptance. This however raises further question as to the nature an offer or acceptance takes. While it is a matter of legal construction, points have been raised whether it is at the point of signing

114 In other words, does freedom exist?
up as participant in the exchange that makes one liable to accept every offer automatically in order to promote circularity? This question may be difficult to answer without clarifying whether a party in the exchange can lawfully exercise a power of abandonment just to emphasis a certain level of liberty in furtherance with the principles of party autonomy.

The argument for liberty is not only philosophical, but also has transactional implications when explored against the need for circularity and negotiability. It is a matter for deliberation especially where the extent to which participants can freely exercise and revoke power of offer before acceptance without corresponding liabilities.\(^{117}\) This power should also be constructed in such a way the transferee is not placed under a perpetual state of disability by the excessive use of the power of revocation to the detriment of circularity. There is a follow up problem even in circumstances where offer and acceptance is effectively consummated. This plays out where the transferee accepts the offer before it is revoked by transferor thereby creating contractual right and duties relations. Such a move could be avoided so as not to precipitate a breach of transferee’s duty of vigilance. Under this circumstance, does a breach extinguish the transferee’s right and convert it into privilege – no-right relations? What is the effect of this uncertainty to the idea of circularity and the concept of distributive justice?

Legal construction of securities rules remain the only option to providing answers to these questions. This is especially true where the legal effects of these relations throw more questions with respect to participants, the exchange and third parties. On the question of third parties for instance, understanding the nature of how power allocated by securities rules impacts a trustee for investors in relation to his powers under Trust legislation and captured within a trust deed as they pertain to trust assets. The same is true of agents. The determination of who an agent is in the context of securities market is legal one. Where it is an agency, the agent analytically has at least two powers.

a. The first is the power as against his principal when acting within express or ostensible authority

b. Secondly, he has power against a 3\(^{rd}\) party where the actions of the 3\(^{rd}\) party are likely to interfere with his right, duty, privilege and power.

The principal and 3\(^{rd}\) party have correlative liability.\(^ {118}\) Therefore where a party has a good cause of action against another party, it automatically vests power in the claimant to invoke the instrumentalities of the law against another party and the other party automatically operates under a correlative liability. Apart from securities regulators, the court is one of such institutions while acting under the power of rule of law has capacity to alter legal relations through its power to grant reliefs or remedies. This means therefore that by virtue of a judgment, power – liability relation changes to other categories of legal relations to give

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\(^{118}\) Kocourek, Tabulus Minores Jurisprudence, 30 Yale L J 215 (1921)
effect to the desires of the judgment creditor and satisfy the philosophical demands of the market. Accordingly, the desire to achieve some level of certainty in the power relations architecture to ensure unhindered flow of value in a regulated exchange is not a straightforward process.

Anderson, Mullock and Finan identified these tensions and uncertainties created by the interaction of the concepts and the inconsistencies generated in the analysis of legal problems. They however suggested a logical approach to resolving them. Mullock believes that applied deontic logic of obligation can streamline the myriads of legal relations generated to identify their ultimate connections and substance. By capturing their networks and modes of operation, a pattern is identified that would help craft a seamless flow of interest from one party to another with certainty in the regulated market. They suggested deontic logic as capable of providing this certainty.

2.5 Fashioning a new conceptual framework from pre-existing framework

a. Deontic Logic

Tarski in his theory of formal language believes that the Mean-Proposition which is founded on logic holds the clues to resolving the uncertainties in interpretation of concepts. Even where Kripke attempts to develop the Real World Semantic as an alternative to Mean-Proposition, the essential concepts of that theory were premised on the Deontic Logic distilled from Tarski’s theory of formal language. For negotiability, this meant identifying the logic between right, duty, no-right, privilege, immunity, disability, power, and liability. Finan\textsuperscript{119} took the first step by dividing the concept into two principal relations:

i. Primary relations – right, duty, no-right, and privilege

ii. Secondary relations – immunity, disability, power, liability

Anderson thinks that identifying those factors that regulate the concept is the best approach to understanding and streamlining their operations. These factors are:

i. Agent – the actor which is represented with the symbol $X$. In the case of negotiability in the market it is represented as \textit{Transferor}

ii. Patient – this is the recipient of the action with the symbol $Y$. In the case of negotiability, it is referred to as \textit{Transferee}

iii. State of affairs – this is the situation which the agent is said to bring about relative to the patient. It is represented with the symbol $P$

\textsuperscript{119} Finan, Presumption and Modal Logic: A Hohfeldian Approach, 13 Akron Law Review, 19, 26-31 (1979)
To understand the logic, Finan\textsuperscript{120} and Mullock\textsuperscript{121} developed symbolic logic of the basic unit of \((X, P, Y)\). \(P\) is essentially the result of \(X\) and \(Y\) which means \(P\) is a factor of \(X\) and \(Y\) relations. To show the relationship between constituents of the basic unit, Anderson devised other symbols.

iv. \(+O\) – indicates the relationship between \(X, P, Y\) as Obligatory
v. \(–O\) – indicates not obligatory. This means it is permissive
vi. \(+H\) – indicates the governing state of affairs. This means \(+H\) governs \(S\).

\(H\) however is difficult to define because it is a product of the combined effects of contexts and non-legal influences. One would expect the factors that constitute and govern the state of affairs given their fluidity to be outside the realms of logic, but Anderson tries to painfully fit it in and argues that \(+H\) determines who creates the state of affairs \(P\); i.e whether it is \(X\) or \(Y\). Therefore, where \(+H\) decides that \(X\) will \textit{do} \(P\) for \(Y\) or that \(X\) will \textit{create} \(P\) for \(Y\), both creates two distinct legal relations. The negation is \(–H = X\) will \textit{do} \(P\) or \(X\) will \textit{create} \(P\). Mullock called this ‘a 3-place constant signifying the notion of social action’. In understanding within the unit \((X, P, Y)\), which party is \(X\) and which is \(Y\) at any given point in time, Mullock demarcated the respective symbols within the units to indicate these.

viii. \((+X, P, Y)\) – indicates that \(X\) is the agent
ix. \((X, P, +Y)\) – indicates that \(Y\) is the agent

\(X\) and \(Y\) can effectively define the eight concepts because the symbols show whether the relationship between \(X\) and \(Y\) are obligatory, whether the state of affairs will be created, and whether \(X\) is the agent. He answered the above questions by reducing the logical symbols into different relations while indicating their interactions. This research represents the views in Table 4 below

\bibitem{120} Finan supra page 30; Mark Andrew (1983) Hohfeld Cube, Akron Law Review, Volume 16: 3 pages 471-485
\bibitem{121} Mullock, Holmes on Contractual Duty, 33 University of Pittsburgh Law Review, 471 (1972)
<table>
<thead>
<tr>
<th>Concepts</th>
<th>Symbols</th>
<th>Interpretation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Right</td>
<td>+O +H (X, P, Y)</td>
<td>Presence of obligation, with a governing state of affairs for transferor (agent) to do or create state of affairs for transferee (patient)</td>
</tr>
<tr>
<td>Duty</td>
<td>+O +H (-X, P, +Y)</td>
<td>Presence of obligation with governing state of affairs that transferor actor (formerly transferee patient) to do or create a state of affairs for transferee patient (formerly transferor actor)</td>
</tr>
<tr>
<td>Disability</td>
<td>+O –H (X, P, Y)</td>
<td>Presence of obligation on transferor(agent) not to do or create a state of affairs for transferee (patient)</td>
</tr>
<tr>
<td>Immunity</td>
<td>+O –H (-X, -P, -Y)</td>
<td>Presence of obligation but no governing state of affairs for agent/transferor (formerly patient transferee) to do or create a state of affairs with patient transferee (formerly agent transferor)</td>
</tr>
<tr>
<td>Power</td>
<td>-O +H (X, P, Y)</td>
<td>No obligation, which means it is permissive for the agent/transferor to do or create a state of affairs for patient/transferee</td>
</tr>
<tr>
<td>Liability</td>
<td>-O +H (-X, P, -Y)</td>
<td>No obligation, which means it is permissive for the transferor/agent (former transferee/patient) to do or create a state of affairs for transferee/patient (formerly transferor/agent)</td>
</tr>
<tr>
<td>No-Right</td>
<td>-O –H (X, P, Y)</td>
<td>No obligation and No governing state of affairs which mean transferor (agent) cannot do or create a state of affairs for the transferee</td>
</tr>
<tr>
<td>Privilege</td>
<td>-O –H (-X, -P, -Y)</td>
<td>No obligation and No governing state of affairs. This means that transferor/agent (former transferee/patient) can neither do nor create a state of affairs for the transferee</td>
</tr>
</tbody>
</table>

The above table represents the underlying basis of deontic logic on Hohfeld’s concepts and shows the following:

a. On the point of correlative, it demonstrates that when X is an agent in one correlative, Y is an agent in the other correlative.

b. Immunity and disability forecloses the act or forbearance which effectively forms the very core of right and duty. This is because of the existence of reverse obligation. In both cases, the notion of obligation determines certainty represented as O. Certainty is achieved where harmony with regards the parties’ notion of ‘duty’ intersect.
c. On the part of privilege, no-right, power and liability; their point of certainty is on the notion of ‘present freedom from obligation (duty), Mullock, Finan and Corbin\textsuperscript{122} call them ‘Permissive Relations’ which is symbolised as $\neg O$.
d. The governing state of affairs which is represented as $H$ is not concerned about whether or not relations are obligatory but concern about the product of that relation which is the state of affairs. So that in the jural relations of right, duty, power and liability, the agent may or must create a certain state of affairs $= H$. Under a duty to create $H$.
e. Conversely, the jural relations or privilege, No-right immunity and disability involves situations where the agent is under a duty not to create a certain state of affairs or where the agent is free not to do so, not under a duty to create $H$.

Goble thinks that disability and immunity involves absence of power and immunity – privilege involves freedom from duty.\textsuperscript{123} Therefore these four concepts require the negation of state of affairs $= H$.

The inferences drawn from the logic are captured under four sub-heading. They are as follows:

i. Corollaries
ii. Contradictories
iii. Contraries
iv. Sub-contraries

Corollaries:

With respect to power, disability and no-right, duty and liability, and immunity and privilege, the proof is that any act or forbearance which is performed pursuant to a duty may also be done voluntarily. Therefore, if a transferor is legally entitled to demand performance from transferee, under a duty/right, then the inference is that transferor is empowered to also be able to do the same voluntarily (power).

Contradictories:

Under this category where one jural relation exists, the other must not exist. Secondly, if one jural relation is true, the other has to be false. For instance,

a. Right and no-right
b. Power and disability
c. Duty and privilege
d. Liability and immunity

\textsuperscript{122} Corbin, Legal Analysis and Terminology, 29 Yale L.J 163 (1919)
\textsuperscript{123} Goble, ‘A Redefinition of Basic Legal Term’, 35 COLUM L. REV 535 (1935)
So in practical terms, a transferor cannot possess the power to alter a legal relation and at the same time lack the ability to do so (disability). It is also the case that a transferor cannot be under a duty to act and at the same time enjoy freedom from such duty by way of a privilege.

Contraries

There are two sets of contraries which include right and disability, duty and immunities. These jural relations may be absent at the same time, but they may not be present at the same time. That is both relations may be false, but cannot be true. For example in cases of duty and immunity, transferee may neither have a present duty to act nor permanent freedom from such duty (immunity). This principle holds true for rights and disability.

Sub-contraries

Under these categories, the jural relations may be present at the same time but they may not be absent at the same time. One other unique thing about this is that both may be true, but both cannot be false. The two sub-contraries are:

a. Power and no-right
b. Liability and privilege

There are examples of interactions between power and no-right scenario under this category. These include where the transferor may not have a present duty to another (no-right), but yet have the power to create such duty in the future (power). However where the aforementioned relations are absent, it becomes extremely confusing because even where the transferor makes the transfer, he will be unable to change transferee’s legal relations because he has no power to do so. This is in effect a disability in the transferor. Also in cases where the transferor is not under a present duty (for instance to make the transfer) with respect to transferee and the same transferor is has a right (for instance to non-interferability), the presence of both present contradictory outcomes could grind circularity to a halt. It is becoming clear that present claim right and no-claim right (no-right) with respect to transfer of instrument (disability) cannot realistically coexist in the transferor at the same time if the desire of circularity is to be achieved. Therefore the conceptual basis of jural correlative is to ensure the seamless flow of interests within a regulated exchange.

The effective operation of jural correlatives in promoting circularity and negotiability can sometimes be obstructed by what Mark Andrews calls the Jural Analog. Jural Analog is a schema that discloses the possible causes of actions and likely defences to those actions so that in a transferor’s claim against the transferee based on present right, it is sufficient defence if transferee can prove privilege. The defence of privilege may not suffice if transferor can show he is empowered by law to so claim. This means that the operations of

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124 Andrew, Mark supra
power have the capacity to influence every other variable towards its goal of circularity and negotiability. The influence of power to claim (power/right) may be curtailed for instance where transferee power to create future duty on transferor is met by transferor’s immunity to change in his legal relations. It is however unclear logically how immunity relations can arise under market circumstances and the possible justification for power relations to be issued pursuant to the rules apportioning immunity. The logical analysis also predicates its effect on the actions of power in relation to other concepts without providing corresponding analysis on the checks on power relations.

One other critical area of omission in the logical analysis is the failure to illustrate the duty and no-right relation. A no-right may exist to defend an action in quantum meruit to prevent what Mark Andrew calls ‘unjust enrichment’. The transferor and transferee’s claim and counter-claim with respect to performance of respective duties, now throw up question of who between them have the power to claim right. This then becomes a matter for legal construction as to whether a claim right exist and to whom it falls. It is however doubtful whether logical connection is sufficiently equipped to capture all variables required in making this determination. For example exploring the logic between disability and immunity, or where they are reversed, the resulting design suggests that there is an ‘immediate inference’ on the side of transferor between immunity and no-right. The existence of immunity immediately implies the existence of a no-right. Thus the following statement would be valid where transferor is immune from changes to his legal relations thereby creating a disability in transferor’s power to change transferee’s legal relations. The lack of logical connection in this case, shows another weakness in the logical analysis of these concepts.

Andrews\textsuperscript{125} also tries to address these logical disconnections by analysing the concepts using the Venn diagram. It attempts to use the Venn diagram to create an image of syllogism.\textsuperscript{126} It uses the three circles to develop major, minor and middle term syllogism. The three circle overlap creating seven areas within the circles and one open area outside.

\textsuperscript{125}Andrew Mark supra page 484
\textsuperscript{126}Andrew, Mark supar page 484
From the diagram above, the circles indicate three symbols which define Hohfeld’s ideas – O, H, and (X, P, Y)

a. The concepts inside the upper circle represent those relationship that are obligatory
b. The concept that falls outside the upper circle represent relation that are permissive
c. If the agent will create the state of affairs, the jural relation appears within the lower left circle
d. If the agent will not create the state of affairs, the relation appears outside it
e. If X is the agent, then the jural relations appears within the lower right circle
f. If X is not the agent, the relation appears outside it
The basis for the development of these concepts by Hohfeld which is to clarify legal thinking and attempt at using logic to clarify their relationships with some level of certainty raises questions as to the level of success. The application of logic in the analysis of the concepts assumes that:

a. There are only eight jural relations
b. That the relationship among the concepts are well defined
c. That their relationships behave in predictable ways and therefore it is easier to analyse even complex legal questions to enable two disputing parties define unsettled questions more precisely and the courts, agency, or legislature are able to settle the same question with correspondingly greater precision.
d. Cullison suggests that with this predictability in relationships could be translated into binary language system for computers analyses using special algorithms.\(^{127}\) With such information in a program, the computer may search for all statutes which create a jural relation symbolised by \((1, 0, 1)\). This means using the following computer codes to represent the concepts: Right \((0,0,0)\); Duty \((0,0,1)\); Disability \((0,1,0)\); Immunity \((0,1,1)\); Power \((1,0,0)\); Liability \((1,0,1)\); No-right \((1,1,0)\); Privilege \((1,1,1)\).

It is unclear how Collison\(^{128}\) will assume certainty or predictability of legal relationships from the Hohfeld’s legal concepts when:

a. There is no precise definition or a mechanism for determining state of affairs and governing state of affairs
b. Secondly, the contradictions in the jural analog relations
c. Uncertainties in the key assumptions that form the basis of the logic H and S thereby defeating the very essence of the standard deontic logic. Also the relations that create absence of obligation are not contained in the logic.
d. The logic only tries to explain the concepts without showing the likely effects of the transaction or operations in practice.
e. While it attempts to show the relationship between the concepts, it assumes their relationships can only be internally determined and that there are no external influences on the relationship and changes in their structure.

The determination of what constitutes the state of affairs and that which governs the state of affairs is outside the capacity of logic. This therefore forms the central focus of this research. Even where Dyadic Deontic Logic presents an interpretative proposition for the exploration of state of affairs within the concepts and their legal relations to deliver their nominal essence, it relates to Kripke’s theory of interpretation which is the real world

\(^{127}\) Cullison supra
\(^{128}\) Cullison supra
semantics and modal logic. As noted by Collison, power provides the centrepiece in the understanding of influences within and outside the Hohfeld’s concepts especially in the crystallisation of legal relations. Firstly, power plays in a role in the philosophical understanding and interpretation of the right of non-interferability, duty of vigilance and the power of interpretation, but the prescription of logical analysis of their experiences is often insufficient to guarantee seamless circularity. Secondly, power may have created a window to the understanding of the place of authority and its philosophical appreciation in securities conceptualisation, but this is insufficient to guarantee obedience of law and entrenchment of circularity principles.

Neither Hohfeld concepts nor positive law have been able to provide all encompassing coverage of these problems which have significantly impacted representionality of the Hohfeld concepts. This makes compliance difficult. As a result of these, different legal systems have attempted to address these problems through statutory designs. The first statutory design is one based strictly on standard deontic logic. The proponents of this logic believe that the logical framing of the law makes it obligatory or permissible to comply with. Under this category, deontic logic which is a formal system that attempts to capture the essential logical features of these concepts was introduced. Therefore, when used in the development and analysis of statutory provisions, they are geared towards achieving certainty. While standard deontic logic is geared towards achieving certainty in statutory/legal analysis, it does not properly represent conditional obligations. This is because ‘deontic’ from its Greek interpretation is actually translated as ‘binding’. This infers that an operative word like ‘Mean’ was meant to achieve that certainty and binding effect.

On the other hand, a conditional operator like ‘Context’ used within statute is inserted to create conditional obligations which cannot be represented by standard deontic logic \( O(A/B) \). \( I\)-Transferor + Transferee = \( I\)- Obligation Transferor \( T_1 \) + Obligation Transferee \( T_2 \). Therefore the existence of the inference that the transferor’s obligation to the transferee only exists where certain conditions can be inferred, fails the test of representionality. This is because a unary operator like \( O \) (obligation) cannot be defined on a binary basis \( O(T_1/T_2) \). The likelihood of designing statutes on the basis of faulty underlying logic is strong with a binary conceptualisation of legal concepts and relations that govern securities. The uncertainties that follow the interpretation of the following is most pronounced

\[ O(\text{Transferor} + \text{Transferee}) \] or \[ \text{Transferor} + O(\text{Transferee}) \]

This is where definition of securities in statute makes the internal elements within it obligatory as can be seen in the first category above. Under this particular definition, the
word ‘Means’ as the operator, is used to enforce certainty in relation to other elements of
the definition of securities. This approach has been criticised as unrepresentative, coercive,
repressive and authoritarian. Its formalist structure is incapable of capturing the complex
dimensions of securities. Where transferor is under an obligation to transferee only on the
existence of certain conditions as in the second category above, the word ‘Context’ is used
as the conditional operator. To this end, instruments can only be seen as securities on the
satisfaction of certain conditions. This structure may prove difficult to manage where
context is unsupported by some form of certainty in language.

Dyadic deontic logic which is used to represent conditional operator was therefore created
to respond to this problem. Apart from the use of binary deontic operators, this logical
method combines standard deontic operator ‘Means’ and conditional deontic operator
‘context’. The notation is modelled P (Transferor/Transferee) + O (Transferor/Transferor),
represented as P(X/Y) + O(X/Y) which means it is permissive that the transferor ... (given
Transferee ...) and obligatory that transferor, (given transferee ...). By applying conditional
probability with the phrase ‘unless the context otherwise admit, securities means ...’, it
escapes the problems of standard (unary) and conditional deontic logic.

This is also subject to problems of its own. The normative attitude of the courts which is not
based on a ‘true’ and ‘false’ scenario is of particular concerns. While deontic logic analyses
normative propositions, the norms themselves and their effects left unattended in the
determination of truth. Generally, courts enter only two kinds of judgments:

a. Those granting remedy which imposes civil liability
b. Those denying remedy and imposing no liability in the case of civil liability

Those granting relief as the legal effect of an act and those granting relief as to the legal
effect of an act (privilege – no-right). Hohfeld’s right-duty and privilege – no-right relations
are fairly manageable since the number of ‘legal effect’ they refer to are limited to only two
counts remedies

a. Liability
b. Non-liability

But the principles behind Hohfeld’s power – liability and immunity – disability relations is
much the same as right and duty because they also described the ‘legal effect’ on voluntary
acts. However, these relations are not easy to manage because their effects are unlimited in
number. The legal effects involved here are changes in legal relations and there are myriads
of legal relations in the world. This has informed various statutory and interpretative
designs to capture both the logic and philosophy underlying the concept in the analysis of
legal questions. For the purpose of this analysis, this research identifies the approaches
adopted by different jurisdictions across the globe in the interpretation of securities to
create binding effects. They are:
1. Statutory formalism – which is fully reliant on standard deontic logic with the use of ‘Means’ as operator
2. Statutory functionalism – this uses the conditional deontic logic in statutory design and interpretation
3. Judicial formalism – which uses Dyadic deontic logic by utilising the principles of stare decisis very strictly as a normative criterion
4. Judicial functionalism – this is a combination of dyadic deontic logic as the statutory design and the underlying social or economic philosophy in the determination of legal effect on a context-sensitive basis. Under this system, the normative effect of stare decisis is not obligatory. This means cases are determined on the basis of their own merits.

PART 2

2.6 Statutory Formalism Approach– as rational institutional practices

Statutory formalism is fully reliant on standard deontic logic with the use of ‘Means’ as operator. This type of formalism is usually expressed within the language structure and relationship within provisions in legislative texts for the purpose of defining a term. It has been used to define securities in civil law countries that seek legal certainty and binding effect through the use of formalistic operators. Under this category, statutory powers are conferred on administrative bodies to exercise regulatory and oversight functions with little or no judicial powers. The purpose is therefore to restrict the uncertainty of independent judicial influence in seamless transferability and circularity within the market. While this approach has guaranteed predictability of rules and their application within the market, it has stifled innovation borne out of inflexibility of rules and inability to suit changing circumstances. A case in point is the attempt to define ‘Transferable Securities’ in the European Union Directives. The attempt to consolidate into a single Act all the disjointed definitions of securities during the Pre-FSAP period, has not achieved much success due to their formalist structures. Firstly, the move to unify the definitions by adopting the Pre-FSAP controlling words for all securities ‘Transferable Securities’, failed the clarity test. While these words remained undefined, they ran contrary to the language of Prospectus Directive and created practical difficulties for individual countries in terms of interpretation and application. Even with the subsequent amendment by Article 4(18) MiFID which now makes ‘Transferable Securities’ a part of the broader category of financial instruments captured within its provision, this is still largely unhelpful. Under this new provision, there

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132 77/534/EEC; Castellano page 472; The Financial Sector Assessment Program FSAP 1999-2004 is the instrument that enabled the creation of the European System of Financial Supervision ESFS framework comprising all regulatory authorities in Europe. This framework was set up to strengthen all existing regulatory frameworks including the definition of securities immediately after the 2008 financial crisis.
are challenges with delineating coherent criteria for characterising securities given their broader scope.

Secondly, by consolidating earlier slew of Directives with new ones,\textsuperscript{133} the incoherence in the definition of securities is even made worse. It all started in 2003 when an attempt was made to define securities. The Prospectus Directive 2003\textsuperscript{134} defines securities to mean:-

“They are shares in companies and other securities equivalent to shares, bonds and other forms of securitised debt which are negotiable on the capital market and other securities normally dealt in giving the right to acquire any such transferable securities by subscription or exchange or giving rise to a cash settlement excluding instruments of payments.”\textsuperscript{135}

While this definition rightly captured the conceptual ingredients of securities, it was vague in many respects. The identification of three types of instruments\textsuperscript{136} as constituting the hallmark of securities could not been seen as representative. Also, the use of the terms “negotiability” and “transferability” without stating their meanings, raised several contextual issues that left investors and regulators in a milieu. This was even exacerbated by the absence of a coherent jurisprudence to delineate the contours of statutes. It is the case that an approach that underscores an instrument as security only on the basis of transferability within the capital market, creates greater confusion especially at a time when markets clamour for certainty. The demand for clarity informed the 2004 definition of security.

Market in Financial Instrument Directive (MiFID) 2004/39 Article 4(18) defines securities as follows:

“A transferable security covers those classes of securities which are negotiable on the capital market except instrument of payment such as shares in companies and other securities equivalent to shares in companies, partnership or other entities and depositary receipts in respect of shares; bonds or other forms of securitised debt, including depositary receipts in respect of such securities. Any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement by reference to transferable securities, currencies, interest rates or yields, commodities or other indices or measures.”\textsuperscript{137}

As MiFID attempts to harmonise the principles of national laws, individual countries’ approaches to the directive remains substantially varied. The application of techniques like gold platting, subsidiarity and single passport places significant constraints of the harmonisation efforts of the directive and further reinforces the divergence in the definition.

\textsuperscript{134} The Prospectus Directive (Directive 2003/71/EC (2003 OJL 345) is implemented by means of the new listing rules effected by the FCA as of 1\textsuperscript{st} July 2005
\textsuperscript{135} This Prospectus may however be supplanted by national legislation – Prospectus Directive art 2(1)(a)
\textsuperscript{136} Shares, bond and other forms of securitised debts
\textsuperscript{137} Directive 2004/39, Article 4(18)
of securities in Europe. The key to harmonisation as argued does not rest solely on a
common approach of sticking to certain components like “transferable security” or
“negotiability”, a broader understanding of the linguistic and transactional contexts seems
to present even greater disparities. This has led to questions about the impact of MIFID’s
definition on various countries in Europe. While France and Italy apply the concept of
transferability, Spain seems to have embraced “negotiability”. The practical and linguistic
differences of both terms are still unclear. Although Market Abuse Directive emphasises
negotiability, the context for such use cannot be likened to transferability in the sense used
in MIFID. This is particularly evident where the components are explored against the
overriding purposes of the respective Directives. The MIFID for instance attempts to unify
the language of other Directives on the question of transferability and negotiability by
making its provisions the authoritative reference when it comes to defining securities.138
There are clearly difficulties in the wholesale harmonisation of contexts even though that of
language may be possible. The overlaps of legislative purposes draw a line between their
attributes especially where the linguistic interpretation of some of the components at
national level seem to be divorced from even their national understanding of the term
securities.

For countries that emphasis formalism, the strengthening of national frameworks on the
basis of local languages imposes significant pressure on individual nations to justify their
essence within the context of multi-lingualism. For instance, the translation of the term
‘securities’ in German, Dutch, Spanish, French and Italian will throw up issues on linguistic
contexts and semantics. This is partly due to their varied understanding and application of
this concept. Looking at the language specifically from a transactional context, the French,
Spanish and Italians would refer to securities as valeurs mobilières or titres financiers, valori
mobiliari (movable values or financial titles), and Valores (valuable) respectively. These will
however not fly under a rigorous etymological and contextual construction of these words
in relation to the law. A literal and contextually insensitive interpretation of these terms
would certainly lead to absurdity. On the other hand, German, Lithuania and Estonia see
securities as ‘Wertpapiere, Vaartpaberite and Verty biniai popieriai (paper value) and Latvia
also see it as parvedami vertspariri (transferable paper values). This shows the confusion
that could emerge from a literal or conceptual construction of these terms independently
and collectively. The avoidance of such impeding calamity may have informed Guilliano’s
suggestion that a combination of ‘cognitive tools that rely on a contextual linguistic analysis
that transforms legal texts into legal norms’ be deployed.139 With legal norms and context,
he meant a departure from the formalism to the introduction of the functionalism that is
capable of harnessing contexts to create binding effects.

The challenges identified in the formalism clearly cast deep light on national systems and
explores the propriety of unsupported reliance on its prescriptions. Even the language of

138 Hudson supra
139 Guillani, Castellano supra Page 457
international transaction (English) is not free from this entanglement. Therefore it has become imperative to review the legal techniques adopted in understanding securities, so as to save regional and international bodies from these yarning gaps in legislation that create arbitrage opportunities for market infractions. With changes currently taking place in the commercial world like the Digital Ledger Technologies, Crypto Currencies, Peer to Peer lending, Crowd Funding, investors now seek greater levels of legal protection as governments and regulators explore ways to guarantee continuous soundness of financial markets.¹⁴⁰

The Hungarian Real Estate crisis of 2004 and the Lehman Brother insolvency of 2008-2010 exposed the untidiness that could greet the inappropriate characterisation of securities. In Hungary, a Ponzi scheme which collapsed and triggered systemic crisis escaped regulatory oversight because the shares that constituted it were not considered as securities. At a wider level, liquidation of Lehman Brothers’ cross border assets met significant challenges because of legal and regulatory divergence on the characterisation of securities. Part of this was accentuated by the choice of law controversies as most of the instruments linked to the company were multi-jurisdictional.¹⁴¹ Therefore, this choice of law debate draws the securities definition controversy even more into the international sphere especially with regards to securities holding. While it has become relevant at regional and continental level, application of choice of law clauses themselves still carry domestic weight.

At the level of the European Union for instance, the choice of law clause becomes relevant because this is essentially regulated at continental level. The Convention on the Law Applicable to Certain Rights in Respect of Securities held with Intermediaries also known as the Hague Securities Convention was enacted to clarify and harmonise issues around applicable law for securities transaction in cases of inter-state relationship. This convention was a leap away from the lex situs rule that tended to curtail the wild intermediation opportunities inherent in indirect holding system and its associated uncertainties.¹⁴²

Apart from the question of choice of law, The Hague Convention gave insights as to what it considers as securities, when it defines same in Article 1(1) (a) as

‘Securities means any shares, bond or other financial instruments or financial assets (other than cash), or any interest therein.’¹⁴³

It is unclear how the above definition that is so loosely structured, interfaces with others likes national, regional and continental definitions. This is even after several unsuccessful

¹⁴² This obviate the need for tracing proprietary interests across property classes or jurisdictions especially given the thorny issues around fungibility of accounts, multi-tier intermediation structures, and complexities of products. Nowadays, the place of the Relevant Intermediary Approach (PRIMA) looks at the location of the intermediaries over and above location of transacting parties. Micheler, Eva (supra); Paech, Philipp (supra)
attempts have been made at the international level to influence regional and national harmonisations. The common understanding at the national level is crucial to the harmonisation effort both at the regional and international levels, but up till date national definitions have been deeply divided. In Europe for instance, two sets of definitions exist even within its seamless formalist structure. The French approach like most civil law countries is governed by Code du Commerce (Commercial Code) and Code Monétaire ET Financier (Monetary and Financial Code). Under the French system like in most civil law countries, more emphasis is placed on statutes and administrative acts over and above case law on the regulation of financial markets. This emphasis on statutes placed significant strain on interpreting both codes side by side in the determination of what constitutes securities. Apart from the intra-statutory challenge, an examination of both codes in relation to the MiFID created even more problems. To address the former, an attempt was made to unify both codes in the adoption of a suitable definition. Hence Article L228-1 Code du Commerce is now read alongside Article L221-1 French Monetary and Financial Code to get a sense of the true character of securities. The French Financial Code now reads thus:

‘Les titres financiers sont:

1. Les titres de capital emis par les societe’s par action;
2. Les titre de creance, a l’exclusion du effets de commerce et des bons de caisse;
3. Les parts ou actions d’organismes de placement collectif.’

This is similar but more comprehensive definition is provided by the German version which reads:

‘(1) securities within the meaning of this Act, whether or not represented by a certificate, are all categories of transferable securities with the exception of instruments of payment which are by their nature negotiable on the financial markets, in particular:

1. Shares,
2. Other investment equivalent to share in German or foreign legal persons, partnership and other enterprises as well as certificates representing share.
3. Debt securities;
   (a) In particular profit participation certificates and bearer bonds and order bonds as well as certificates representing debt securities.
   (b) Other securities giving the right to acquire or sell securities specified in nos 1 & 2 or giving rise to a cash settlement determined by reference to securities, currencies, interest rates or other yield, commodities, indices or measures, units in investment funds (investmentvermogen) issued by an asset management

144 Despite Europe’s formalist approach to legislation and regulation, it is deeply divided in its definition of securities.
145 This uses the term Valeur Mobilieres
146 This also uses Titres Financiers – G. Castello page 467
company (kapitalanlagegesellschaft) or a foreign investment company (investmentgesellschaft) are also deemed to be securities.

(1a) Money market instruments within the meaning of this Act are any categories of receivables which do not come under the provisions of subsection (1) and are usually traded on the money market with the exception of instruments of payment.\textsuperscript{147}

The German definition seems to have adopted the two main components of the MIFID 4(18).\textsuperscript{148} Apart from the race towards compliance with MIFID, it also demonstrates breath by capturing all categories of securities and placing them under a unique classification of “other investments equivalent to shares... and “other securities giving rights to acquire or sell securities in numbers 1 and 2”. This structure therefore seems to accommodate both traditional instruments like shares, debt, units and other borderline instruments. Italy shares similar technique with Germany, but a more coherent technique compared to France in delineating the boundaries of securities. However both\textsuperscript{149} share some semblance in terms of language.\textsuperscript{150} The challenges with the Italian approach are its listing of its instruments which share similar characteristics with that of the United States and the characterisation of securities as a subset of other financial instruments. It defines securities as follows:

‘Per valori mobiliari si intendono categorie di valori che possono essere negoziati nel mercato dei capitali, quali ad esempio

(a) Le azioni di societa e altri titoli equivalent ad azioni di societa, di partnership o di altri soggetti e certificate di deposito azionario;
(b) Obbligazioni e altri titoli di debito, compresi I certificate di deposito relative a tali titoli;
(c) Qualsiasi altro titolo normalmente negoziato che permette di acquisire o di vendere I valori mobiliari indicate alle precedent lettere;
(d) Qualsiasi altro titolo che comporta un regolamento in constant determinate con riferimento ai valori mobiliari indicate alle precedent lettere, a valute, a tassi di interesse, a rendimenti, a merci, a indici o a misure.’

The Italian model specifically stressed ‘negotiability’ as core to its characterisation. This in a sense mirrors the US approach and represent a slight departure from the European technique. There seems to be significant differences in the use of terminologies. While some countries emphasize transferability, movability, other uses negotiability. It is unclear how these terms could be made similar, with such patent differences and potential source of confusion. Apart from the fact that individual nations are empowered to legislate on

\textsuperscript{147} Securities Trading Act (WpHG) amended 22\textsuperscript{nd} of June 2011 (Federal Gazette 1 page 1126), Section 2.
\textsuperscript{148} Transferability and Negotiability” – Section 1(2) of Securities Trading Act (WpHG) Art 1 of the Act of 5\textsuperscript{th} January 2007 (Federal Law Gazette 1, page 10).
\textsuperscript{149} Italy and France definition of securities
\textsuperscript{150} Italian Securities law uses the term valori mobiliari
securities in a manner that suit their function, the definitions of these countries share certain contradictions and gaps that blur all chances of clarity. The provisions do not clarify the extent to which they operate within or outside the ambit of MIFID. Although they are expected to make reference to Directive as a guide, the scope of that guidance in relation to their function is unclear for purposes of investor confidence. The absence of that clarification also means that a slew of listed and unlisted securities which may or may not be transferable or negotiable are not catered for.

Whilst Germany addressed issues around domestic and foreign issuer, the definition was silent on the place of issue vis-à-vis the residence of issues in the determination of the nature of interest or underlying interests. France and Italy made no adequate provisions for this important qualification that has a far reaching effect on the nature of interest they possess. In addition, these countries made no effort at demarcating the nature of issuers as to whether they are governments, corporate or individuals – local or foreign. This qualification should have been necessary to properly situate their risk weighting and give insights to a larger class of investors to take advantage of available opportunities in the market. These opportunities could exist around the value chains of issue, holder-ship and in some cases transaction. These also lack sufficient clarity.

In Germany for instance, it is not certain if the said issue by German or foreign issuer has to satisfy the trading and listing requirement for it to be considered transferable or negotiable, since these components are nowhere defined in the law.\textsuperscript{151} Most countries studied in Europe have included “other investment” in their definition without clarifying what the term constitute and how they should be characterised. This has direct implication for borderline instruments outside the typical equity/debt categorisation. While the United States courts developed the Howey Test to delineate the contours of investment contracts, the formalist approach adopted by European countries make such approach impossible because of its strict reliance on statutory language that is essentially context insensitive.

The United Kingdom securities law is also caught in similar statutory cross currents.\textsuperscript{152} Hudson voiced his disappointment at the lack of coordination in the statutory framework and jurisprudential depth on the subject.\textsuperscript{153} Apart from the legislative cratering that implicates the mismatch in principle-based and rule-based regulations\textsuperscript{154} which were directly imposed by the European Union, there are also hazy interactions between private

\textsuperscript{151} Micheler, Eva (supra)
\textsuperscript{152} The United Kingdom’s securities law is essentially governed by EU Directives that are made to apply directly to the whole country including Scotland – Hudson (2014)
\textsuperscript{153} He stated that it is currently difficult to find one’s way through the legislation unless one has some close familiarity with it already. In particular, the failure to completely overhaul Part 6 of the FSMA 2000 in the wake of the implantation of the EC Directive by means of statutory instrument has meant including concepts which are comparatively unimportant.
\textsuperscript{154} The debate is currently raging with regards to propriety of the principle based approach enunciated by the Lamfalussy Report. There seems to be preference for the more recent Lariore Report that promotes the rule-based approach.
law and regulation. This confusion in the statutory layout, partly underscores a lack of success in integrating formalism which it see to adopt from the European Union by virtue of its membership and the functionalism which forms its historical core as a common law system.\textsuperscript{155}

Notably, the United Kingdom presented a more elaborate definition that captured various categories of instruments as security. Also by a stroke of legislative ingenuity, the term “transferability”\textsuperscript{156} which formed its hallmark for the determination of what constitutes security, was effectively distinguished from money market instruments\textsuperscript{157} through statutory devices. Despite the thoroughness in this approach, several transactions and activities needed to be regulated while at the same time create allowances for those classes of investors to benefit from the protection that comes with regulation without the rigours of registration. To this end, the Regulated Activities Order pursuant to the FSMA 2000 incorporated three categories of instruments as securities. Firstly, those instruments which have been specifically enumerated by MiFID 2004.\textsuperscript{158} Secondly anything that have been or maybe admitted on the Official List and thirdly, “anything in relation to credit agreement or a consumer hire agreement, a mortgage, charge, pledge, bond, debenture, indemnity, guarantee, bill, note, or other right provided by the borrower or hirer or at the implied or express request of the borrower or hirer to secure the carrying out of the obligation to the borrower or hirer under the agreement.”\textsuperscript{159}

These statutory definitions in their expansive and elusive nature have by no means addressed the prevailing concerns arising from the incoherence in the characterisation of securities. Even where the UK definition is unclear with regards to whether RAO 2000 applies only to categories of instrument specifically captured in Art 3(1) RAO only. This is of particular concern because the concept of transferable security only applies to instruments covered by the RAO 2000. Therefore other categories of instruments not within the scope of RAO need not be ‘Transferable’. In other words, transferability is not a central theme that runs across all instrument categories. This lack of consistency in approach is a challenge in terms of compliance cost for investors and operators in the market. In addition, there is limited clarity with respect to instruments covered by the RAO because of the absence of a coherent framework on what amounts to ‘Regulated Activity’.

\textsuperscript{155} This is a constant reminder of the conflict between the Anglo-American system and the Civil law system. Unlike the Anglo-American common law system, the Civil law approach places highly premium on statutory provisions over and above case law.
\textsuperscript{156} Section 1173 of Companies Act 2006 describes the term “Transferable” by reference to the “Market in Financial Instrument Directive 2004/39 art 4(18); Section 102B FSMA 2000
\textsuperscript{157} Under Section 102 A(3) FSMA 2000, money market instruments for the purpose of the directive means instruments with a maturity of less than 12 months
\textsuperscript{158} These instruments have been provided for in Art 76 to 89 of RAO. They include (a) shares (art 76), (b) debenture (art 77), (c) alternative debenture (art 77A), (d) government and public security (78), (e) warrant (art 78), certificate representing certain securities (art 80), (f) unit (art 81), (g) stakeholder pension scheme (art 82(1), (ga) personal pension scheme (art 82(2), (h) right to or interest in investment in paragraphs (a) to (g)
\textsuperscript{159} Art 60 L of RAO
Although Section 22 of the FSMA defines Regulated Activities to encompass those activities identified in Schedule 2 FSMA 2000, the identified activities have no common theme to suggest the basis for their inclusion.⁶⁰ Even the courts are also at crossroads on this issue because of the absence of coherent criteria. An attempt was made to explain Regulated Activities from the purview of business by requiring an interpretation of the phrase ‘Carrying on Regulated Activities by way of Business.’⁶¹ The definitions of ‘business’ and ‘activities’ are inconclusive from the statutory and judicial standpoint;⁶² also the attempt by the court to manufacture the Test of ‘Quality and Sophistication of Investment Choices’ is also not clear.⁶³ It is not settled whether the general prohibition under Section 19(1) of FSMA 2000 applies to all categories of instruments or exclusively to instruments covered by the RAO 2000.

The contextual basis for exclusion of certain instruments as securities and absence of a uniform criteria or jurisprudence for delineating securities remains a major challenge. Apart from the gaps highlighted above, more obvious lacunas have been identified. Section 22(1) FSMA and Schedule 2 Paragraph 2-9 of FSMA explains the element of securities to include that: (a) financial instrument must be issued by a public company through a public offer; (b) financial instrument must be traded in a regulated securities market, (c) financial instrument must be negotiable and transferable. It however failed to clarify if the category of instruments for trading excludes those not listed by public company through public offer. The definition also failed to clarify to what extent the instrument expressly excluded as securities pursuant to Schedule 11A of FSMA 2000 and Section 85(1) – (5) FSMA 2000, can function as securities if traded in the market even though not specifically recognised as securities under the legislation.

These challenges of clarity seem to be pervasive across all continents even as catalogues of repetitions and imprecisions that characterised the statutory definition in the European countries seem to have also played out in South America and Africa. Historical factors may have played a significant role in this. In some sense, these countries have tried to incorporate the United States and European technique and in the process created definitions that are conceptually confused. Their definitions essentially do not carry recognisable themes upon which to base one’s judgement on the likely conceptual

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⁶⁰ The seven categories of regulated activity which are identified in Sch 2 to the FSMA 2000 are – dealing in investment, arranging deals in investment, deposit taking, safe keeping and administration of asset, managing investment, investment advice, establishing collective investment schemes, using computer based system for giving investment instructions. The category of investment provided in Schedule 2 - paragraph 10 to 24 includes – securities, instrument creating or acknowledging indebtedness, government and public securities, instrument giving entitlement to investments, certificate representing securities, units in collective investment schemes, options, futures, contract of difference, contract of insurance, participation in Lloyds syndicates, deposits, loans secured on land, rights in investments.

⁶¹ Treasury Regulation further to Section 419 FSMA; FSMA (Carrying on Regulated Activities by way of Business) Order 2001 Para 3; Morgan Grenfell v Welwyn Hatfield DC (1995) 1 AER 1

⁶² R v Wilson (1997) 1 AER 119
approach adopted. This is especially so where the word ‘meaning’ precedes their definitions without operating words to prescribe the philosophical and conceptual underpinnings.

Japan’s\textsuperscript{163} technique, however, seems to follow the South American and Kenya’s technique by commencing their definition with the word ‘means’. This is followed by a list of items that are referred to as securities without clearly stipulating the controlling word or central theme for the determination of products that fall outside the categories expressly listed. The Argentina Capital Market Law\textsuperscript{164}, Mexico Securities Market Law, Brazil, Kenya, is useful cases in point. The Argentina law defines securities in Section 2\textsuperscript{165} as follows:

‘When used in this law and regulations hereunder, the following terms shall have the meaning set forth below – securities issued both in certificated and book entry form, including in particular any negotiable instruments or instruments evidencing claims, shares of stock, mutual investment fund quotas, debt securities or certificate of participation in financial trusts or other collective investment vehicles, and in general any homogenous and exchangeable securities or investment agreements or receivable instruments issued or grouped in series and which may be traded in the same manner as and with effect similar to securities, and which on account of their nature and transfer requirement may be traded on a general and impersonal basis in financial markets’

‘Also, the term securities include futures, options and derivative contracts in general when traded in authorised markets, deferred payment checks, admissibility time deposit certificates, invoice payment commitments, certificate of deposit and stock warrants, promissory notes, bill of exchange and any other securities admitted to trading in secondary markets’.

The Argentina approach went pretty close in its qualification to a point of description. Apart from generalising the products on the basis of negotiability which appears to have been common to South American countries,\textsuperscript{166} it also drew on their classification based on the physical nature of the instrument (certificated or book entry). What was however untouched, like its Mexico counterpart is the omission beneficial or underlying interests. This is very much unlike Brazil\textsuperscript{167} and even Japan that covered both direct and underlying interest leaving little or no room for doubt as to its formalist character thereby obviating the need for judicial incursion. While Argentina’s definition is inclusive enough to include derivative contracts, which makes it stand out of other South American countries, little clarity currently exist with regards to its classification on fractional interests, investment agreements and certificate of participation in financial trust. It also makes frequent use of

\textsuperscript{163} Financial Instruments and Exchange Act (Act No. 25 of 1948) Article 2
\textsuperscript{164} Argentina Capital Market Law 26, 831 27th December, 2012
\textsuperscript{165} Argentina Capital Market Law 26, 831 27th December, 2012
\textsuperscript{166} South American Countries like Brazil, Mexico
\textsuperscript{167} Article 2 of Brazil Capital Law
the word “or” without indicating whether it is conjunctive or disjunctive. This is clearly a source of confusion and uncertainty for investors.

Mexico clearly identified detailed components for qualifying securities to include negotiability, registered, and unregistered, trading whether domestic or foreign. This is absent in Brazil and Argentina. Partial reference was made to the Financial Markets, Authorised Markets and Secondary Markets under the Argentina definition without clarity on whether it refers to domestic markets only. There is also doubt as to the bases of differences in description of the same market. One wonders if it was deliberate and whether it intends to convey a message. While Mexico is certain on the question of market which it termed “...exchange recognised by their securities law”, there are challenges with regards to proper demarcation of instrument which may have foreign content. There could be situations where either resident or non-resident investor issues a listed instrument under a foreign law for instance, a global depositary receipt, or where a resident lists a stock and places it in the third segment of the market which essentially makes the instrument non-transferable. Both situations could present practical problems for this formalist definition.

The approach to local or foreign Government Issue is somewhat different and could present conceptual problems for this definition. This therefore makes it imperative for judicial intervention to delineate the contours of statutory language in order to provide clarity.

The functionalist approach believes in the insufficiency of statutory language and argues that the nature of securities as an amalgam of history, politics, socio-cultural and economic tool cannot be achieved by mere statutory design. The context should govern the characterisation of these instruments. This section explores countries that have adopted this approach to see how it has helped achieve statutory intent and developed their markets.

It is the case that most countries with this approach have the leading Capital Market in their respective regions. The reasons for this could be traced to the capacity of investors to weigh on the flexibility that the markets present. The United States, South Africa, Hong Kong, Singapore are very good example of systems with this functionalism. Although this technique has been criticised for using contradictory terms, this is in a sense deliberate. The word “means”\(^{168}\) and the phrase “unless the context otherwise requires”\(^{169}\) are opposites. While the former attempts to provide some level of certainty, the latter is conditional and calls for an exploration into the unifying principle or philosophies that shape the underlying component of the provision and their legal effect. This is the basis for the need for statutory functionalism.

\(^{168}\) The word ‘mean’ as described by the Etymology Dictionary is ‘intend, hand in mind’, - Old English maenan ‘to intend, signify; - Germanic mainijan (source also of Old Frisian Mena ‘Signify; Old Saxon menian ‘to intend, signify, make known); but Germanic meinen – think, suppose; Old Church Slovanic Meniti – to think, have an opinion; Old Irish Mian – wish, desire” – http://www.etymonline.com/index.php?term=mean

2.7 Statutory Functionalism as rational institutional practices

Statutory functionalism uses the conditional deontic logic in statutory design and interpretation to avoid the ideological trap that creates the incoherence in formalism. This practice operates on the premise that the framework and statute seek that ultimate truth not only within the texts, but also beyond it. This means exploring contexts through the constant creation of meaning from words in statute. There are wide advantages within this approach. Firstly, it empowers the regulator to exercise both administrative and judicial powers in implementing statute. While this has the tendency to speed up the process of resolutions, it may be open to abuse. Secondly, the presence of context opens the door for flexibility in product innovation due to the less rigid implementation of provision and the likelihood of working around themes that could occasion hardship. To this end, various countries have adopted this approach. A case in point is South Africa. The country has only recently amended its Securities legislation to adopt statutory functionalism after years of statutory formalism.

The South Africa provision is very detailed on the question of qualification of instruments themselves and the controlling component. It defines securities as:-

‘….. unless the context otherwise admit, … Securities means –

(a) Listed and unlisted –
   i. Shares, depository receipt and other equivalent equities in public companies, other than shares in a share block company as defined in the shares Block Control Act, 1980 (Act No.59 1980)
   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 Scheme Control Act, 2002 (Act No 45 of 2002), and units or any other form of participation in a foreign collective investment scheme approved by the Registrar of Collective Investment Scheme in terms of Section 65 of that Act; 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 purpose of this Act.
(e) Rights in the securities referred to in paragraphs (a) to (d),
But excludes

i. Money market securities, except for the purpose of chapter iv/ or if prescribed by the registration as contemplated in paragraph (d);

ii. The share capital of the South African Reserve Bank referred to in section 21 of the South African Reserve Bank Act, 1989 (Act No. 90 of 1989); and

iii. Any security contemplated in paragraph (a) prescribed by the registrar;\(^\text{170}\)

Apart from the use of the term “context”, it clearly identifies “listed and unlisted” as essentially the basis for its characterisation of securities. The definition also provides limitations and clear cut demarcations of what rights are covered. Share Block Control Act 1980 (Act No. 59 of 1980) clearly restricts the scope of equities, while certain classes of issuers demarcate debt instruments. Other participatory interests, units, forms of participation in foreign collective investment schemes are circumscribed by the Collective Investment Scheme Control Act of 2015 even as foreign issuers, issues and registration are catered for in paragraphs (b) and (c) the definition. Other rights associated with all paragraphs including derivatives, notes and instruments based on index are all catered for in this definition. The only challenge that exists is however that these rights are unqualified.

While attempting to curtail the scope of some of the traditional instruments, other underlying rights and borderline instruments are left to flourish. This in a sense undermines the qualification in the first place. For instance, an option on an equity instrument is not curtailed in this definition. So also is a foreign issue or registration of those interests either by a resident or non-resident. The nature and character of fractional interests which have been referred lightly in the Collective Investment Control Act of 2015 is insufficient to cover the entire gamut of these interests. One would therefore assume that the word “context” simply comes to mind in addressing these concerns by the courts.

Without including the word ‘context’ in their definition, one would have expected common themes wrapped within specific controlling words in the definitions. Hong Kong and Singapore for instance provides another good example. Every part of the Hong Kong Securities Ordinance has its interpretation section\(^\text{171}\) but provides no definition of securities. Reference therefore is made to Part 1 Schedule 1 of the Ordinance which provides a comprehensive definition of securities.\(^\text{172}\) It is unclear how this definition aligns with that provided in Section 285\(^\text{173}\) especially where the word ‘meaning and ‘context’ have been used in all categories.\(^\text{174}\)

‘In this Ordinance, unless otherwise defined or excluded or the context otherwise requires – securities means –

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\(^{170}\) South Africa’s Financial Market Act 2012 No 19 of 2012, Government Gazette, 1\(^{st}\) February 2013 Section 1

\(^{171}\) Part I to XVII of the Securities and Futures Ordinance 571 2012 (E.R.12 of 2012) and 2015 (E.R.3 of 2015) respectively.

\(^{172}\) Section 2 and 18 of the Ordinance refers to Schedule 1 Part 1 of the Ordinance 2015

\(^{173}\) Securities and Futures Ordinance Cap 571 2012 (E.R.12 of 2012)

\(^{174}\) This use of the word ‘context and meaning’ align with the United States and Singapore model
(a) Shares, stocks, debentures, loan stocks, funds, bonds or note of, or issued by, a body, whether incorporated or unincorporated, or a government or municipal government authority;

(b) Rights, options or interests (whether described as units or otherwise) in, or in respect of, such shares, stocks, debentures, loan stocks, funds, bonds or notes;

(c) Certificate of interest or participation in, temporary or interim certificate for, receipt for, or warrants to subscribe for or purchase, such shares, stocks, debentures, loan stocks, funds, bonds or notes;

(d) Interests in any collective investment scheme;

(e) Interest, rights or property whether in the form of an instrument or otherwise, commonly known as securities;

(f) Interests, right or property which is interests, rights or property, or property, or is of a class or description of interests, rights or property prescribed by notice under Section 392 of this Ordinance as being regarded as securities in accordance with the terms of the notice; (Amended 8 of 2011 s.14)

(g) A structured product that does not come within any of paragraphs (a) to (f) but in respect of which the issue of any advertisement, invitation or document that is or contain an invitation to the public to do any act referred to in section 103(1)(a) of this Ordinance is authorised, or required to be authorised, under section 105(1) of this Ordinance, (Added 8 of 2011 s. 14)

But does not include –

i. Shares or debentures of a company that is a private company within the meaning of section 11 of the Companies Ordinance (Cap 622); (Amended 28 of 2012 ss. 912 & 920)

ii. Any interest in any collective investment scheme that is –
   A. a registered scheme as defined in section 2(1) of the Mandatory Provident Fund Schemes Ordinance (Cap 485), or its constituent fund as defined in Section 2 of the Mandatory Provident Fund Schemes (General) Regulation (Cap 485 sub. Leg. A);
   B. an occupational retirement scheme as defined in section 2(1) of the Occupational Retirement Scheme Ordinance (Cap 426); or
   C. a contract of insurance in relation to an class of insurance business specified in the First Schedule to the Insurance Companies Ordinance (Cap 41);

iii. any interest arising under a general partnership agreement or proposed general partnership agreement unless the agreement or proposed agreement relates to an undertaking, scheme, enterprise or investment contract promoted by or on behalf of a person whose ordinary business is or includes the promotion of similar undertakings, schemes, enterprises or investment contracts (whether or not that person is, or is to become, a party to the agreement or proposed agreement);
iv. any negotiable receipt or other negotiable certificate or document evidencing the deposit of a sum of money, or any rights or interest arising under the receipt, certificate of document;

v. any bill of exchange within the meaning of the Bill of Exchange Ordinance (Cap 19) and any promissory note within the meaning of Section 89 of that Ordinance;

vi. any debenture that specifically provides that it is not negotiable or transferable (excluding a debenture that is a structured product in respect of which the issue of any advertisement, invitation or document that is or contain an invitation to the public to do any act referred to in section 105 (1) of this Ordinance); (Amended 8 of 2011 s. 14)

vii. interests, right or property which is interests, rights or property, or is of a class or description of interests, rights or property, prescribed by notice under section 392 of this Ordinance as not being regarded as securities in accordance with the terms of the notice;

This provision is similar to the section 2(1) of the Securities and Futures Act of Singapore, Capital Market and Services (Amendment) Act.\textsuperscript{175} Singapore understands the importance of her place in Asia and leverages on that strategic location in the heart of the continent.\textsuperscript{176} Its cosmopolitan nature can only be better optimised with a securities law that captures contexts. This is also the thinking behind the Hong Kong Securities Ordinance. The definitions of both countries are similar in the area of qualifying the itemised instruments on the basis of “issuance”.\textsuperscript{177} While the Hong Kong approach goes even further to list all the categories of instruments and with a qualification of the scope of underlying interest therein covered, the Singapore approach only identifies the instruments and hinge underlying interest on the concept of “profit”.\textsuperscript{178} In other words, the element of profit determines whether an underlying interest qualifies as security. This condition seems to mirror the Howey Test in the United States especially around the jurisprudence of the “profit” component. The component of profit in paragraph (d) is followed by specific scenarios that could act as a guide to the courts. These include a reference to profit or loss arising from fluctuation in values or prices of instruments mentioned in paragraphs (a – c).\textsuperscript{179}

Another aspect of the Singapore’s definition which is similar to paragraphs (b) to (g) of Part 1 Schedule 1 of the Hong Kong Ordinance is the provision for borderline instruments, units, unit trust and units in derivative trust.\textsuperscript{180} While Hong Kong took steps to qualify these

\textsuperscript{175} The Securities and Futures Act of Singapore, Capital Market and Services (Amendment) Act 2015 (CIF 15\textsuperscript{th} September – P.U. (B) 369/2015)

\textsuperscript{176} Singapore seats in the heart of Asia and middle of over ten industrialised Asian Countries. This clearly makes the functional approach an attractive prospect.

\textsuperscript{177} Section 2(1) paragraphs (a) – (h) of the Securities and Futures Act Chapter 289, 2006 (Singapore)

\textsuperscript{178} Section 2(1) paragraph (d) Securities and Futures Act Chapter 289, 2006 (Singapore)

\textsuperscript{179} Section 2(1) paragraph (d) Securities and Future Act Chapter 289, 2006 (Singapore)

\textsuperscript{180} Section 2(1) paragraphs (e) to (g) of the Securities and Futures Act 2006 (Singapore)
underlying interests by circumscribing them with Section 392, 103(1)(a) and 105(1) of the Ordinance, the Singapore model simply left this to judicial contexts. This therefore had the effect of demarcating property rights that exist within these interests and other rights. Therefore effective clarity is achieved especially to investors who essentially would be interested in the legal treatments of these rights. Such demarcations are however absent with the Singapore approach which seems heavily reliant on the “Profit” component for the characterisation of underlying interests. Both countries however have excluded similar categories of instruments as securities. These instruments fall under those short term products and those developed for payment purposes. While Singapore relies on short termism and decision or Authority exclusively, Hong Kong relies on the absence of risk factors in addition to short term instruments of payment element\(^{181}\) as the basis for its exclusion. In other words, any instrument that enjoys the protection of other Hong Kong statutes is excluded as securities.\(^{182}\)

Generally, the nature of the statutory design seems to be convergent and vague in terms of coordination amongst the components. The basis for this possibly is to create a window for judicial exploration in line with various contexts. For instance, the Securities and Futures Act of Singapore closed the door on Certificate of Deposit and described it as excluded instrument, and at the same time created a back entrance through paragraphs (c) and (h) of the Section 2(1), that allows any rights as securities and other products that the Authority may prescribe. This more or less broadens the scope and gives a leeway to the authority to capture even more products through the exercise of this discretion. The question therefore is who the authority is in this case? The debate may rage between the market regulators or the courts. Where the regulator is seen to be the Authority and as such exercises their discretion, are the courts prevented to question or overturn such exercise? What would be the basis for such exercise of discretion by the regulators or reversal by the courts? These questions make the functionalist approach the surest system for getting contextual answers and achieving practical depth.

From the point of view of this functionalist Market Focused Approach of which the United States is currently leading, the Securities Act,\(^{183}\) remains the authoritative legislation on this issue. It expressly specifies items that constitute securities\(^{184}\) by providing thus:

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181 Paragraph (g) (iv) of Part 1 Schedule 1 Ordinance Hong Kong
182 Paragraph (g) (i)(ii)(v)(vi) and (vii) Part 1 Schedule 1 of Ordinance Hong Kong
183 Securities Act 1933 – This Act was enacted to address some of the concerns that led to the systemic collapse of the securities market and ultimately the Great Depression in 1929
184 Section 2(a)(1) of the Securities Act 1933; Section 3(a)(10) of Securities and Exchange Act 1934 provides a highly complicated definition – “The term securities means any note, stock, treasury stock, bond, debenture, certificate of interest or participation in any profit sharing agreement or in any oil, gas or other mineral royalty or lease, any collateral trust certificate, pre-organisation certificate or subscription, transferable shares, investment contract, voting trust certificate, certificate of deposit, for a security, 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 instrument commonly known as a security or
“When used in this title, unless the context otherwise requires – (1) 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-organisation 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, or warrant or right to subscribe to or purchase, any of the foregoing.”

The Laundry List Approach of this provision has been criticised as heavy on words and light on details. The purpose of its inclusively rambling nature is to possibly capture all schemes that may have contributed to market abuse and failures under the Blue Sky laws. In addition, it attempts to categorise a catalogue of general and distinct labels as securities by using the phrase ‘Securities means any…’ This approach assumes that securities operate in isolation of the market and there exist no formal or transactional interactions with other asset forms not listed in the Act. The generous use of the word “any” suggests a tendency of generalisation and lack the specificity needed for certainty in the market. This almost tends to render ineffective the purpose of the provision.

It is an acceptable premise that the elusive categorisation of securities in the Act as “notes, stocks, bonds, debentures, certificate of deposits, investment contracts, certificate of interest” makes them even more confusing. The practical difficulties become apparent when the question of what type of capital transfer is asked; given the number of ways capital is transferred and the boundless creativity that enables multiplicity of rights. There is also a question of whether or not Federal law is applicable. To a casual observer, exploring stock as securities might seem straightforward, but when explored against the issuer and those holding them (Government, public, private, institutions), its nature might require further clarifications. The accommodation of notes within this category throws open an array of transactions which according to (...) includes consumer purchases on instalment basis and home purchase under Federal securities law scheme.

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any certificate of interest in participation in temporary or interim certificate for receipt for, or warrant or right to subscribe to or purchase any of the foregoing; but shall not include currency or any note, draft bill of exchange, or banker’s acceptance who has a maturity at the time of issuance of not exceeding nine months exclusive of days of grace, or any renewal thereof the maturity of which is likewise limited.”

185 Section 2(a)(1) Securities Act 1933
186 This is not so straightforward when the conceptual and transactional contexts are placed side by side.
187 Notes and it recharacterisation as securities remain controversial.
It is however unclear what the following phrases mean.” Transferable share,\textsuperscript{188} Privilege on any security,\textsuperscript{189} Privilege entered into,\textsuperscript{190} Certificate of interest in participation in temporary or interim certificate,\textsuperscript{191} Right to subscribe to purchase,\textsuperscript{192} Profit sharing agreement\textsuperscript{193}, Evidence of indebtedness\textsuperscript{194}, Investment contract\textsuperscript{195}.”

The above lack of clarity implicates the accident inherent in open ended cataloguing of items as security. It is the case that this is not a stroke of ingenuity in legislative drafting, but a desperate attempt to spread the fishing net wide enough to capture as many transactions into the regulatory web. These statutory landmines situation, underscores the limitation of legislative language and the need for jurisprudential intervention.\textsuperscript{196}

These legislative challenges highlighted above have hampered harmonisation efforts, made the investment extremely cumbersome, risky and inhibited cross border investment. Consequently, IOSCO introduced a supra-national dimension to the harmonisation efforts through it principles. After a careful study of the nature of definition in respective countries, the commission identified common opportunities and challenges. On the basis of this, it developed three core objectives and thirty-eight principles.

While the objectives clearly align that of most countries, the principles created broad prescriptions which in themselves make sufficient room for manoeuvre. The three core objectives are namely, investor protection, ensuring market fairness, efficiency and transparency, and lastly, reduction of systemic risk. A thorough examination of the thirty-eight principles leaves much doubt about clarity. First, there is no direct definition of the term “securities”. The closest to an express definition was a reference made of which securities are said to include derivatives where the context permits. The decision to omit such an important aspect of the debate, whether or not deliberate has sparked controversies amongst commentators and practitioners. While some\textsuperscript{197} have argued that IOSCO deliberately omitted the definition of security as a way of giving individual countries the leeway to developed appropriate definitions to suit their contexts, others\textsuperscript{198} hold the

\begin{footnotesize}
\begin{enumerate}
\item It is not clear if this is distinct from ordinary or preference share
\item The meaning of “Transferable” in this context is unclear
\item The exact meaning of the word “Privilege” in the context of securities is also unclear
\item It is not clear is this is the same as subscription right
\item The Securities Act 1933 has not defined this phrase – Mazando (supra)
\item Does this cover partnership agreement or interest which otherwise are not reflected in this definition?
\item How is this different from debt? Does this include debentures or simple ‘IOUs’ between individuals and partners
\item This is so imprecise and unclear. However, attempts have been made to clarify this as will be seen below.
\item American courts have risen to the occasion by developing arguably useful Tests for the determination of what constitute securities. This is probably where context used in Section 2(a)(1) of Securities Act 1933 becomes relevant.
\item Guillani, Castellano (supra)
\end{enumerate}
\end{footnotesize}
view that the components inherent in the principles seems mandatory as could be seen by a broad acceptance by many countries. Among the components highlighted within the definition include “tradable” as expressly captured within the principles, and transferability/negotiability and investment. The sum total of its coverage identifies these components as constituting the framework for the conceptualisation of securities. Figure 7 below is a diagrammatic representation of the thematic links between the various elements of securities identified and envisaged by IOSCO. The financial instruments and the concept of investment are seen to be linked with the concept of negotiability and transferability in an endless cycle of interaction. While “tradable” remains the subject and descriptive facilitator, the financial instruments constitute the object and basis for mutual exchange.

Figure 7 - IOSCO Model

The model shows in concentric layers the interaction between components of securities with the ultimate yardstick for their determination in order of importance. This is useful in the conceptualisation of securities amongst member countries. Financial instruments including equity and debt are moderated by the concept of investment and negotiability to produce prescriptive standards for regulating these products. However it falls short of actually providing the guidance needed. This is particularly evident in the drawbacks of the model. Firstly, financial instrument is not defined and it is unclear the framework they intend to rely on in defining what constitute financial instruments. Secondly, tradable is not

https://www.iosco.org/library/academic_work/pdf/Governing-international-securities-markets-David-Kempthorne, pages 1-286 particularly page iii (preamble)
199 This is why, despite its series of amendments to the principles of securities regulation, it falls short of expectations as indicated in the latest 2013 performance report which emerged from the Singapore Summit

89
specifically defined and so it is difficult to understand it within the context of other elements. Thirdly, whilst adopting the concept of investment, it is unclear if it relates to the USA idea of “Investment Contract” as envisaged by the “Investment Contract Test” which is also known as the “Howey Test.” There is no framework within the IOSCO principles to demarcate the term ‘tradable’ from ‘investment’. Fourthly, the concept of negotiability which seems to be very popular in Europe and probably borrowed by the US system through case law, lacks the definitions required to bring them in sync with divergent views orchestrated by the conflict between formalism and functionalism.

Despite the above challenges, a deeper examination of the IOSCO principle seems to exude some green shoots which simply captures a blend of the European Union and United States models. The development of products as a subset of financial instrument with negotiability and transferability as the controlling components which constitute the core of European Union’s MIFID has been embedded by IOSCO. The principles as a starting point also incorporate the predominantly United States “investment” component, which carries the likely effects of an exploration into the Investment contract or Howey Test.

The vintage in the United States model which is absent in other systems, is the availability of substantial jurisprudence developed by the United States’ courts to delineate the contours of securities by espousing these elements. Although some may argue that the said case laws are far from embodying definitive answers, they however prove extremely authoritative in delineating the criteria for the characterisation of securities in line with market expectations. The judicial functionalist approach has been useful in this regard.

2.8 Judicial or Court-Centred Context Sensitive Functionalism

Judicial functionalism or court-centred approach is an approach that incorporates judicial reasoning in the interpretation of the logic of language and contexts. Judicial functionalism and judicial formalism are similar in approach, but in some cases different in outcomes. Having recognised the relative ignorance of rule-maker to facts and the relative indeterminacy of aims, both approaches put the courts at the heart of statutory interpretation. They see legal reasoning as indeterminate in many respects. Whereas judicial formalism adopts a more determinate approach on the basis of ratio decidendi, judicial functionalism applies less machine-like criteria. This is because its reasoning enables greater illumination and insight into subject matter and nature of legal reasoning.

Dworkin while disagreeing with Hart’s ‘open texture’ admitted that judicial functionalism is not a limitless discretionary arena for judges. He maintains that they are guided by

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200 Nnona (2006) page 4
201 Miriam R. Albert, The Howey Test Turn 64: Are the Courts Grading This Test on A Curve?, William and Mary Business Law Review, volume 2, issue 1 (February 2011) at page 38
202 Dworkin, Ronald; Llewellyn, Karl; Justice Scalia
principles within the genius of the law in the process of adjudication. Hart concedes, but argues that variable legal standards are a fair replacement for principles because not all conducts are suitable for principle-based regulation. Whether this falls within variable standards or principles, the bottom-line is in ascertaining the legal effect of applying normative statements by reference to rules in an adjudicatory process. Whilst judicial formalist would stick to the ordinary meaning of statutory text and the principles of stare decisis even if it leads to absurdity or occasion manifest injustice, the judicial functionalist on the other hand, explores the concepts and principles even deeper. The purpose of more exploration is with a view to aligning the concepts with the economic or social philosophies that shape the respective contexts and environment. So that in cases where the underlying philosophy is essentially economic justice, the concept of rights and duties are skewed towards principles that advance profit maximisation. But where the philosophy is social justice, the court will now be at liberty to use the principles to construct the concepts in such a way as to produce social benefits and social good.

Therefore in the case of securities conceptualisation, judicial functionalism seeks to decentralise and democratise securities concepts. This is meant to create opportunities for the court to look at individual contractual intentions to reinforce the principles of party autonomy. The use of empirical data obtained from litigants and business contexts to seamlessly integrate legal and non-legal themes is the hallmark of context-sensitive court centred functionalism. Its drawbacks could however be traced to the inconsistencies in application especially in developing countries with weak judicial systems. With corruption and poor reporting system these countries may struggle to put in place a robust framework for judicial functionalism. Such challenges are however minute when compared to the advantages this approach presents for developing markets to fill statutory gaps, inconsistencies and controversies, while opening the door to effective product and market development.

United States court system for example has been able to address some of the gaps, inconsistencies and rigidity of statutes to guarantee the full application of principles. This informs the choice of the United States system for this study. Through the application of standard tests to concepts, the country’s legal system has been able to develop a coherent jurisprudence for the flexible conceptualisation of securities. For instance, the benefit of this approach is its flexibility and adaptability to varied circumstances that better serve the course of justice. The context-sensitive nature means that market participants are not subjected to the rigidity of formalism. Although formalism is often instituted in developing countries under the guise of reducing corruption by reducing excessive discretion of the judges and regulators, the risk of abuse of judicial discretion is not widespread. In fact the

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204 Nozick; Markie; Rawl; Posner, Holmes;
205 Naveson; Dworkin; Mack; Nozick; Rawl
inherent benefit of the approach is its capacity to use its coherent jurisprudence, tests and standards to check arbitrariness of judges.

For instance, the very basis on which instruments are categorised as securities currently rests on the interaction of components like Trade-ability, Transferability and Negotiability. These words all revolve around the ability to exchange, to store value for returns. Technically, investment forms the hallmark of securities as contracts. The understanding of the underlying concepts and principles make for important contextual exploration. IOSCO alluded to the importance of investment as a key component of securities, but fell short of defining the term expressly. Numerous countries have in one way or other explored and used securities without clarifying the concept that underlies all their activities. The United States itself only made provision for the term without defining what it entails. The courts have however waded in to give effect to statutory intent of investor protection and flexibility. While creating a test to standardise the approach for this determination, there have been challenges with the application of some of the components of the test. This in some sense has been traced to historical, political socio-cultural and linguistic differences.

Several principles have emerged from the definition of securities in the United States unlike other jurisdictions. The difficulties has always been with pinning down each type of instrument to one particular meaning especially where they are susceptible to different interpretations when explored using several analytical lenses. In *Marine Bank v Weaver*, the Court raised a poser as to whether the basis for the categorisation of securities should be determined by (a) the content of the instrument in question which include rights, duties etc; (b) the purpose intended to be served, (c) the factual setting as a whole. Nine out ten judges in *Reves v Ernst & Young* applied the golden rule of interpretation to the phrase “any note” by looking at what congress attempts to achieve by the provision. It is the case that factual context must be differentiated from transactional context. In the case of securities law, the dangers in applying canons of interpretation to judicial analysis without a deeper understanding of the nature of financial instruments, only upholds factual decisions and forecloses transactional ones. This is the view of the Court in *International Brotherhood of Teamster v Daniel* , where the US Supreme Court struck down a non-contributory pension plan as not a security in part because of the existence of the Employee Retirement Income Security Act. The Court in *Marine Bank v Weaver* cited above also made the case where it refused to hold a Certificate of Deposit as securities because the purchaser is guaranteed payment in full by the insurance of Federal Deposit Insurance Corporation.

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206 Other jurisdictions which include civil law, Islamic law, communist law and common law countries currently do not have case law on this subject and as such there is no other jurisprudential comparison with the United States system


208 439 U.S. 551, 569-570 (1979)


210 1974 (88 stat.829,29 U.S.C Sec 1001)
basis of the Court’s decision was on the existence of federal laws and regulations serving the same protective role as the Securities and Exchange Commission.\textsuperscript{212} This factual position by the Court however, foreclosed any inquiry into the transactional contexts of these securities. This exploration would have been necessary in order to determine whether there sphere of operations exceeded the power of those laws that regulated them.

The experience of American courts in interpreting securities statute has been mixed. Majority of instrument adumbrated by the Securities Act are non-contentious. A few of them posed significant challenges to the courts because of their frequency and complexity. Among these is the “investment contract”. This contract like many other instruments within the provision was not defined in the Act. The court was at a crossroad on the appropriate context suitable to achieve the best possible category. In determining the meaning of ‘investment contract’,\textsuperscript{213} the Courts seem to have adopted the transactional context in assessing it for registration. The US Court in \textit{SEC v C.M. Joiner Leasing Corp},\textsuperscript{214} was confronted with a case relating to the offering and sale of assignment of oil leases. The thrust of the transaction was an offer by the promoters to do test drilling to ascertain the availability of oil. Although the 1933 Act included in its definition of securities ‘fraction in divided interest in oil, gas or other mineral rights’, it was silent on leasehold subdivision and assignments. The failure to include divided interest in oil rights to the definition in the Act did not preclude the court from holding the offering as securities, despite the label ‘exploration enterprise’, the parties gave to the transaction.\textsuperscript{215} Further, the US Court expanded the concept of its interpretation within transactional context in the landmark case of \textit{SEC v W.J. Howey Co.}\textsuperscript{216} as a direct response to the criticism of the imprecision of the framework applied in \textit{SEC v C.M. Joiner Leasing Corp.}\textsuperscript{217} In \textit{SEC v W.J. Howey}, the combined use of Land Sale Contract, Warranty Deed and Service Contract to convey units of a Citrus Groove by Howey was in contention. W.J. Howey owned the massive tract of Citrus Acreage in Florida Lake County. Howey in the Hill Service Incorporated is a service company that was engaged vide a contract to maintain and develop these grooves including cultivation, harvesting and sales. Every customer is issued with both sales contract and service contract as a condition for investment in the groove. On meeting the above conditions, the purchaser was free to make arrangements with other service companies, but superiority rights must remain with Howey in Hill Service Incorporated. Based on these conditions, 85%
of acreage assigned was covered by service contracts with Howey. The details of the agreements were as follows:

Land Sale Contract with Howey Company:

a. “Uniform purchase price per acre of fraction thereof, varying in amount only in accordance with the member of years the particular plot has been planted with Citrus trees.

b. Upon complete payment of the purchase price, the land conveyed vide warranty deed to purchaser

c. Purchases are usually effected in narrow stripes of land layout consisting of row of 48 trees each

d. The individual tracts were not separately fenced but only subtly marked on the plat book records to indicate several ownerships.

The Service Contract with Howey in the Hills was as follows:

a. It was a 10 years duration without option of cancellation

b. It gives Howey in the Hills Service Inc. a leasehold interest with full and complete possession of the acreage.

c. The company is allowed to exercise discretion and given full authority to cultivate the groove on the payment of the specified fees

d. The consent of the company must be sought and obtained before the land owner is allowed entry to market the crops and no right to specific fruit guaranteed.

e. The company is accountable only for an allocation of the net profits based upon a check made at the time of picking.

f. All the produce is pooled by W.J Howey and other respondents which do business under their own names.

The Court was confronted with the determination of whether the Land Sale Contract, the Warranty Deed and Service Contracts together constitute an investment contract within the meaning of Section 2(a)(1) of the 1933 Act and as such registrable under Section 5(a) of the Act; or exempted by Section 3(b) of the Act.

In view of the fact that investment contract is not defined in the 1933 Act, the trial Court held that they are not investment contracts but real estate sale and an agreement by the seller to manage the property of the buyer (servicer or administrative agreement). This decision was based on the fact that the court treated the contracts and deeds as separate transactions even though such transactions under State Laws had in the past been construed by State Courts as one which offered the investing public full protection.

The US Supreme Court while placing emphasis on the substance and economic reality rather than form, laid out the condition for the determination of a transaction as being ‘investment contract’. “An investment contract thus came to mean for the purpose of the Act, a contract
or scheme for the placing of capital or laying out money in a way intended to secure income or profit from its employment under a common enterprise which depends solely on the effort of a promoter or third party”. “It’s being immaterial whether the shares in the enterprise are evidenced by formal certificate or by nominal interest in the physical assets employed in the enterprise. Such a definition permits the fulfilment of the statutory purpose of compelling full and fair disclosure relative to the issuance of many types of instruments that in our commercial world fall within the ordinary concept of a security’. 218

The policy basis for this decision according to the US Court is that ‘It embodies a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek to the use of the money of others on the promise of profit’. The transaction in this case clearly involves investment contracts as so defined:-

1. The respondents are offering something greater than fee simple interest in land, something different from a farm or orchard coupled with management services.
2. The respondents are offering an opportunity to contribute money and share in the profit of a large citrus enterprise managed and partly owned by respondents.
   a. They are offering the opportunity to persons who reside in distant localities and who lacks the equipment and experience required for the cultivation, harvesting and marketing of the citrus product. Such persons have no desire to occupy the land or develop it themselves; they are attracted solely by the prospect of a return on their investment. Indeed, individual development of the plot of land that are offered and sold would seldom be economically feasible due to their size. Such tract gain utility as citrus groves only when cultivated and developed as component parts of a larger area.
   b. A common enterprise managed by respondent or 3rd parties with adequate personnel and equipment is therefore essential if the investors are to achieve their paramount aim of a return on their investment.
   c. Their respective shares in this enterprise are evidenced by land sales contract and warranty deeds, which serve as a convenient method of determining the investors’ allocable shares of the profits. The resulting transfer of rights in land is purely incidental.

Thus, the Howey definition presents a much narrower, context sensitive and less flexible punch line compared to the Joiner Test. 219 While the Joiner’s case only provide one general requirement, the Howey’s Classical Test has three uniquely all-encompassing requirements. When applied in courts, the Howey Test which now provides a contextual basis for the

218 H.R. Rep. No. 85, 73d Cong; 1st Sees; Page 11
219 The Howey Test is a flexible device created by the United States’ courts to chieve some levels of standardisation in the conceptualisation of securities. It is context sensitive, normative and seeks to align these characteristics with the nature and economic functions of securities. Malloy M.P: (1983) Definition of Security; Marine Bank v Weaver 445, US. 551 at 560 (1982) page 1063
determination of what constitute securities was generally broken down into three prongs in order to establish the existence of investment contract.\textsuperscript{220} These Test elements have however been reviewed in subsequent cases and broken down by the Supreme Court in four prongs with additional adjustments.\textsuperscript{221} The four prongs for the conceptualisation of securities are (1) There must be investment of money, (2) There must be expectation of profit, (3) The profit must arise from solely the effort of others, (4) The investment of money must be in a common enterprise: Although the elements appear quite straightforward, application in court have been fraught with controversies around interpretation of the tests between functionalism and functionalism.\textsuperscript{222} The disagreements however only exist with some elements of the test rather than the test itself. For instance, with respect to the prong:

1. **Investment of Money**: This generally refers to investment commitment “by an investor,” in a manner that exposes investors or potentially make them susceptible to financial losses or exchanging specific values for new kinds of distinct financial interests. In other words, “a contractual provision that gives Weavers the veto power over future loans and gave them a measure of control over the operations of the slaughterhouse is not characteristic of security.”\textsuperscript{223} It is a requirement that those investing the money must be an investor, not an employer.\textsuperscript{224} The question of investment of money for the purpose of determining securities has raised conceptual issues. These include the meaning of ‘money’ and ‘investment’ in this context. There are conflicting views on this question. The first was raised by the court in International Brotherhood of Teamsters V Daniel where the court rejected the employee’s argument that he invested labour in return for employer’s pension pay out. The court found that the employee’s pension plan constituted an insignificant and indivisible part of the employer’s overall compensation package and as such impossible to distinguish a separable element constituting consideration for the alleged security.\textsuperscript{225}

2. **Expectation of Profit**: - The question of what constitute profit is another source of controversy. The courts were divided on what constitute profit in Forman’s case. While the circuit court disregarded form for substance\textsuperscript{226} in construing the nature of proceeds from shares in a coop, it found the rental reduction resulting from income

\textsuperscript{220} The Howey Test has the following elements:- first, there must be an investment of money; secondly, the investment must be made in a common enterprise; finally, the profit must result solely from the efforts of others. SEC v Howey (supra) page 299 ; Troyer v Karcagi, 476 F.Supp. 1142, 1147 (S.D.N.Y. 1979)
\textsuperscript{221} United Housing Foundation V Foreman (supra); International Brotherhood of Teamsters V Daniel (supra)
\textsuperscript{222} Litigants tend to focus less on the validity or appropriateness of the Test itself. Rather issues in court tend to tie around the meaning of the respective components. Gary M. Brown, Reach of Securities Act Regulation 1756 PLI/Corp. 177, 183 (2009).
\textsuperscript{224} SEC v Rubena; Salazar v Sandia
\textsuperscript{225} International Brotherhood of Teamsters v Daniel 439 U.S. 551 at 560 (1979)
\textsuperscript{226} Tcherepnin v Knight 389 U.S. 332, 336 (1967).
produced by the commercial facilities established for tenant’s use at the co-op city as sources of profit. In the same case, the appellate court found that the tax deduction from the portion of the monthly rental charges allowable to interest payments on the mortgage as another source of profit. The appellate court also determined that savings attributable to the fact that the apartments at the co-op city were significantly less in price compared to the unsubsidised apartments were sources of profit. The Supreme Court strongly disagreed with the lower courts and set the basis of determining what constitute profit in line with Howey Test. It distinguished the three sources of incomes captured by the lower courts from the Howey Test:

Firstly, the supreme court held that the rental reduction from income produced by the commercial facilities created for the tenants’ use at the co-op city did not qualify as profit under Howey Test because the said potential income were far too speculative and insubstantial to bring the entire transaction within the ambit of the Securities Act. The court made it clear that the distinguishing character of this case from the Howey case was the fact the profits from Forman’s case were in the form of a commodity for personal consumption.

Secondly, the Supreme Court also found those deductions for portion of monthly rental charges allocable to interest payments on the mortgage not to constitute profits within the meaning of Howey Test. This is because, these benefits were available to all home owners who were paying interest on their mortgage, and as such, were not unique to this situation.

Thirdly, the Supreme Court found that the savings resulting from the lower cost of apartments at Co-op city were not profits within the Howey Test, because, low rent was derived from financial subsidies made available by the New York State. Hence, “... profit must emanate from capital appreciation derived through initial investment or from participation in earning resulting from the use of investment funds. This profit must not be in the form of a commodity for personal consumption.

3. Profit arises solely from the effort of others: - The courts are also divided on the application of this prong. In United Housing Foundation v Forman, the Supreme Court
Court while defining the term “Profit” adjusted this condition to make it applicable by providing that expectation of profit must emanate from “entrepreneurial or managerial effort of others.” In other words, where investors are seen to retain or maintain control, there is no investment. This has created a lot of questions around the threshold allowable. Indeed the uncertainty has prompted the inclusion of an additional requirement to Howey’s profit prong which require the expected profit to emanate from the entrepreneurial or managerial efforts of others. Therefore, in determining whether a holding pyramid scheme in which the selling efforts of the investor were partially responsible for the profit, the court made “a critical inquiry into whether the efforts made by those other than the investor are undeniably significant one to constitute essential managerial efforts which could affect the failure or success of the enterprise.” In arriving at a decision, the US Circuit Court relied heavily on the decision in SEC v Glen Turner Enter., where a condominium offered together with servicing arrangement was held to be investment contract even when facts showed that the investor was wholly active. This controversy has been left largely unresolved because the US Supreme Court in United Housing Foundation v Forman expressly declined to indicate whether the court was right in Glenn Turner’s case.

As a result of the above uncertainties, courts have adopted functional rather than the literal approach in understanding the intentions of the legislature on the question of profit solely from the entrepreneurial or managerial efforts of others. To establish this particular ingredient, a court looked at the motive of the buyer of the investment product to see if the motivation is borne out of the prospects of profit on investment, rather than intention to use personally or consume product so purchased. This approach has also not yielded much because the court in International Brotherhood of Teamsters v Daniel was faced with an issue of whether an employee’s interest in a compulsory pension plan was a security within the meaning of the Act. The terms of the pension plan stipulated that the employees paid nothing into the pension fund, exercise no choice with regards to participation and could not demand pay-out from employer’s contribution in lieu of

236 The Supreme Court in United Housing v Forman defined profit as “either capital appreciation resulting from the development of the initial investment or a participation in earnings resulting from the use of the investor’s funds” - page 852
237 United Housing Foundation v Forman (supra) Page 855
238 Marine v Weavers supra
239 United Housing Foundation v Forman supra page 855
240 SEC v Koscot Interplanetary Inc., 497 F.2d 473, 483 (5th Cir. 1974)
242 United Housing Foundation Inc v Forman, 421 U.S. 837 (1975)
243 United Housing Foundation Inc v Forman (supra) at 852 n. 16
244 International Brotherhood of Teamsters v Daniel 439 U.S. 551 (1979)
245 International Brotherhood of Teamsters v Daniel (supra) page 553
eligibility (which is twenty-years of continuous service). In a suit by the employee for payment from the pension fund, contended that by allowing the employer pay money into a fund in return for his labour, he had made an investment which satisfies Howey profit requirement. The employee’s contention was rejected by the court on the basis that “the purported investment in the pension plan was a relatively insignificant part of the employer’s total and indivisible compensation package.” Though conceding that proceeds from pension plans depended on the performance of its assets, the court was quick to distinguish this pension fund from this transaction by establishing that a far greater amount of its income was derived from employer’s contributions. The court therefore found that Howey’s profit requirement was not met and supported that finding by clarifying that, the principled inhibitions to an employee’s realising his pension benefit was not the financial health of the fund, but the employee’s ability to meet the fund’s eligibility requirement. So even though the pension benefits were characterised as profits, accessing this profit would depend on the employee’s effort at meeting the vesting requirement, rather than the fund’s investment success. In closing, the court addressed a much wider point of the overreaching effect of Employee Retirement Income Security Act 1974 the “undercut” the argument that employee’s pension was security under the securities Act. These views have been corroborated and extended by Hardy to cover similar plans in Europe.

Another example of the use of the judicial functionalist approach is on the consideration by the courts of whether there exists any significant participation on the part of the buyer in the management of the partnership in which he has invested, to the extent that he has sufficient control of the performance of investment. The expectation of profit is also met where investor or contributor contributes an amount of risk capital i.e by subjecting monies belonging to him/her to the risk of an enterprise over which he/she exercises no managerial control. This view was advanced in Marine Bank V Weaver in an attempt to explore the concept of managerial control. The court introduced the “Risk and Uniqueness Test”

246 International Brotherhood of Teamsters v Daniel (supra) page 553
247 International Brotherhood of Teamsters v Daniel (supra) page 559
248 International Brotherhood of Teamsters v Daniel (supra) page 560
249 International Brotherhood of Teamsters v Daniel (supra) page 562
250 The expected profits must have been derived solely (SEC v Howey supra page 299) from the entrepreneurial or managerial efforts of others. United Housing v Forman (supra) page 855
251 International Brotherhood of Teamsters v Daniel supra pages 560-70; similar position has also been echoed in Marine Bank v Weaver 455 U.S. 551, 557 – 559 (1982);
254 SEC v Koscot Interplanetary, 497 F.2d 473 (1974)
255 Marine v Weaver (supra)
in the characterisation of this prong. A certificate of deposit and an agreement between the defendant and one Piccirillos where held not to have met the investment contract test because of the absence of risk to the investor\textsuperscript{256} and the presence of control by the same investor which makes the transaction quite unique.\textsuperscript{257} The inclusion of the “Risk and Uniqueness Conditions” to the Howey requirement, have thrown up new sets of controversies. These include conflicts\textsuperscript{258} among pre-existing and new test requirements,\textsuperscript{259} the universality of these conditions to wider range of instruments and asset classes, the implication for the modification of securities law as litigants shop for convenient fora within States’ Court Systems and State Laws. The “Risk” and “Uniqueness” Tests have thrown up significant controversies between the Howey Test and Commercial Investment Test, Risk Capital Test and Literal Interpretation Test on the one hand; and conflicts amongst the various tests on the other. These controversies are captured in the discussion of “Notes” below. Even though the “Uniqueness and Risk” Test provide significant guide to the court in qualifying borderline instruments, the court in Marine Bank v Weavers failed to clarify the standards of compliance with the requirements. For example, a comprehensive expose into the concept of “Risk” and how the Federal Banking regulations obviated the need for the application of Securities Act 1933 was absent. Secondly, the “Uniquely” Test was also left in its vagueness. The test of uniqueness was principally ties to the concept of “Control” which was never explained in details. The absence of clear guidance to the test of uniqueness and failure to identify standards for its application is a major disservice by the courts in these cases. It could be recalled that the court in Joiner’s case\textsuperscript{260}

\textsuperscript{256} The absence of risk to the investor was occasioned by the fact that the certificate of deposit was issued by a federally regulated bank which meant that the instrument was already under a comprehensive federal banking regulation and protected the Federal Deposit Insurance Scheme, Federal Reserve’s reporting, inspection regulation as well as banking laws; Marine Bank V Weaver supra page 588. The court went further to distinguish other long term debts from this certificate of deposit by stating that the former exposes lender to borrower’s insolvency, while the latter is guaranteed full payment by the FDIC. Although a similar view was highlighted with the ERISA in International Brotherhood V Daniel, it has been argued that the court’s view was an obiter dictum - page 569 -570. Hence, the Weaver’s case seems to be the first that have elevated the “at risk” standard to a full criterion under the Howey Test.

\textsuperscript{257} On the question of uniqueness, the court considered the agreement between Weavers and Piccirillos and observed that it was not offered to a number of potential investors and no prospectus distributed (page 559-60). Instead, the said agreement was unique and exclusive to Weaver and Piccirillos. Secondly, the court found the provision in the agreement that granted the use of barn and pastures to Weaver only at the discretion of the Piccirillos to be unique and contrary to the principles of Securities Act. Finally the court held that Weaver’s “veto power over future loans gave them a measure of control over the slaughterhouse.” This made the agreement unique and uncharacteristic of a security (page 560). In fact, the Control Clause over loans and use of slaughterhouse at Piccirillos’ discretion could be seen as consideration which is an object of consumption rather than one that could be reinvested.

\textsuperscript{258} The application of Risk Capital Method is now subject to significant controversy as some jurisdiction have stopped its usage after the Supreme Court’s decision in Reve’s case.

\textsuperscript{259} The “Risk” and “Uniqueness” tests have thrown up significant controversies between the Howey test and Commercial Investment test, Risk Capital test and Literal Interpretation test on one hand; and conflicts amongst the various tests on the other. These controversies are captured in our discussion of “Notes” below.

\textsuperscript{260} SEC v Joiner supra at page 351
alluded to the underlying principles of securities—“security was defined to include by name or description, many documents in which there is common trading or investment.”

Also, the Supreme Court in Forman’s case underlined the basis for the application of the Securities Act as follows: “Securities Act is on the Capital Market Enterprise System: the sale of securities to raise capital for profit-making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and protect investors’ interest.”

A judicial linkage of the legislative purpose of Securities Act to the “Risk” and “Uniqueness” Tests could have provided more clarity to the investing public.

The above challenges as was expected, led to a massive move towards State courts to file actions. This move led to conflicting judgments even on similar facts at the State level as litigant tried to apply blue sky laws. The question of flexibility as espoused by the Securities Act soon gave way to its policy and legislative purpose of the Act around the impact of uncertainty on investors’ protection. This dilemma surfaced when the US DC Circuit Court of Appeal in SEC v Life Partners and the Eleventh Circuit in SEC v Mutual Benefit Corp applied the same law to almost identical facts but got different results. Both companies at different times were defendants in suits brought against them by SEC for the offering or sale of unregistered securities in violation of Section 5(a)(c), 17(a)(1) of 1933 Act and Section 10(b) of 1934 Act. In both cases, the district court supported the imposition of injunction against the viatical settlement firm prohibiting sales of these securities. However, the US DC Court of Appeal reversed the district court’s finding in LPI on the ground that viatical settlement is not a security because it is subject to the supervision of insurance authority.

The Eleventh Circuit on the other hand affirmed the US District Court’s finding and held that viatical settlement is a security.

261 SEC v Joiner supra at page 351
262 United Housing v Forman supra page 849
263 United Housing v Forman supra page 849
264 In SEC V Capital Gains Research Bureau, 375 US 180,186 (1963) the court reiterated that the primary purpose of the Act is to “substitute a philosophy of full disclosure with that of caveat emptor.” However later cases insisted on the full disclosure requirement – Tcherepnin V Knight, 389 US 332, 335-46 (1967); Santa Fe Indus V Green 430 US 462, 477-78 (1977); consequently, United Housing V Forman laid out the contemporary thinking on page 849 “The primary purpose of the Act of 1933 & 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Act is on the capital market of the enterprise system: the sale of securities to raise capital for profit making purposes, the exchanges on which securities are traded, and the need for regulation to prevent fraud and to protect the interest of investors. Because securities transactions are economic in character, congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto.”
265 SEC V Life Partners: 87F. 3d 536 (DC Cir.1996)
266 SEC V Mutual Benefit Corp 408 F.3D 737 (11th Cir. 2005)
267 The Eleventh Circuit in SEC V Mutual Benefit Corp in page 743 acknowledged that the facts of that case were similar to that of SEC V Life Partners Inc.
268 SEC v Mutual Benefit supra page 549; this is pursuant to Section 77(c)(a)(8) – SEC v Life Partners (supra)
A side by side analysis of the outcome revealed the inconsistent application of the Howey Test, especially on the interpretation of what amounts to “expectation of profit.” This unevenness is partly due to the conflict between judicial formalism and judicial functionalism. Secondly, it is also a function of contextual application of the principles and concepts in a flexible manner. While the courts catalogued the promoters’ efforts to be ascertained principally on the basis of “undeniably significant”, “essential”, and “managerial effort”, two themes emerged. The first were the “pre-sale promoters efforts and secondly, the post-sale promoters’ efforts. As for the pre-sale efforts, the both court identified and assessed all the activities of the viatical companies in relation to the viators and the nature of external help sort. It was found that both companies developed policies, engaged the viators in the purchase price negotiations, prepared the legal documents, hired doctors to evaluate the viators’ life expectancy, and signed undertakings to pay the post-closing premium that would ensure the policy is in full compliance from the point of view of operating funds or investors’ funds, where any purchase agreement so provide. Secondly, after identifying the promoters’ efforts, both courts by adopting a relaxed approach to the “solely from the efforts of others” requirement, measured them against the Howey requirements. Two themes further emerged from this exercise. The first theme looked at those efforts that are “undeniably significant” from the point of view of the courts, while the second theme, assessed those “essential managerial efforts which affect the failure or success of the enterprise.”

The outcomes of both courts’ interpretation of these standards were different. Both courts were faced with the issue of achieving a distinction between promoters’ activities prior to resale of fractionalised interests to the investors and post-sale activities for the purpose of this test. The defendant’s in SEC v Life Partners Inc argued that the promoter’s pre-sale activities were outside the scope of the Howey test and that the test required the investor’s expectation of profit to be derived solely from efforts of the promoter’s post sale activities. The court agreed with the defendant’s contention and on this basis held that the viatical settlements are not investment contracts and therefore not protected by the federal securities laws. It has been argued that the policy of flexibility as espoused by securities law formation may have informed the DC Circuit’s decision in creating this “bright-line

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269 SEC v Life Partners supra page 737  
270 SEC v Mutual Benefits supra page 539  
271 SEC v Life Partners supra page 740; SEC v Mutual Benefit supra page 540  
272 SEC v Life Partners supra page 737 quoting SEC V Unique Fin. Concept, Inc. F.3d 1195,1201 (11th Cir. 1999); SEC v Mutual Benefit page 545  
273 SEC v Mutual Benefit supra  
274 SEC v Mutual Benefit supra page 545  
275 SEC v Mutual supra page 548  
276 Miriam R. Albert 2011 (supra)
test” to attach time of sale so that some pre-sale activities that are considered “undeniably significant and essential managerial efforts” are excluded. They further argued that the “bright-line test” is unsupported and in some sense inconsistent with the totality of foundational principles on which the Howey test and securities laws are built. In fact the 11th Circuit\textsuperscript{277} asserted that the “bright-line test” should be discouraged in the context of defining securities under the Act, because it creates loop hole for dishonest schemes that could put investors at risk.\textsuperscript{278}

The court however was unconvinced that the profits from viatical settlements are derived from purely from forces external to the actual date of viator’s death.\textsuperscript{279} While the viator’s date of death was important from the profitability standpoint, the underlying pricing of the viatical settlement which is based on the company’s effort is more significant.\textsuperscript{280} The court further noted that viator company’s efforts that include “prepurchasing, locating and negotiating terms of purchase and calculating a probable life expectancy of the viator” are what determine profitability.\textsuperscript{281} It concluded the the investor’s initial reliance on the viatical settlement expertise in the pre-sale determination of the above activities does not cease even after the sale. Hence there was no need for the dichotomy created by the “bright-line” test.\textsuperscript{282} This position is seen to have given impetus to earlier refusal to apply the “bright-line test” by some State courts in the country.\textsuperscript{283} Other State courts on the basis of “bright-line test” have held that viatical settlements do not constitute security.\textsuperscript{284} Despite the minority view of the Texas court in favour of the bright-line test, the Arizona Court of Appeal\textsuperscript{285} expressly rejected the application of “bright-line test” by reference to the

\begin{footnotesize}
\begin{enumerate}
\item[277] SEC v Life Partners supra page 737; the key issue for determination before the court was whether profit are derived from the promoter’s activities or from the operation of external market forces beyond promoter’s control.” On the basis of this standard, the court rejected the defendant’s argument that profit in the viatical settlement are determined by external force
\item[278] SEC v Life Partners supra page 737
\item[279] SEC v Life Partners supra page 1342
\item[280] SEC v Life Partners supra page 1342
\item[281] SEC v Life Partners supra page 1342
\item[282] SEC v Life Partners supra page 739
\item[285] Siporin v Carrington, 200 Ariz. 97 (Ct. App. 2001)
\end{enumerate}
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Arizona Securities Act and the Federal Securities Act 1933. It remarked that “the bright-line test is a convenient but inflexible and formalistic approach to the application of the 1933 and 1934 Federal Securities Act that does not serve the prophylactic and remedial purposes of the Arizona Securities Act.”

In a bid to avoid the controversies surrounding the “bright-line test”, States Parliaments are now legislating around the Howey Test, so as to achieve some level of certainty. It is doubtful if legislation could remove the interpretative requirements of words or clauses that ordinarily need clarification for securities to be characterised accurately.

4. Investment of Money in a “Common Enterprise”: This provided an additional layer of challenge for investors and courts alike. The conceptualisation of what amounts to a common enterprise assumed different interpretations. Common Enterprise was seen to mean: “Investment in which the fortunes of the investor are interwoven with and dependent upon the efforts and success of those seeking the investment of third parties…”

This interpretation has thrown a series of issues and debates with regards to the question of ‘interwoven’; ‘dependent upon efforts and success’; ‘seeking the investment of 3rd parties’. There are difficulties in drawing the nexus that should counterbalance its functional effects on transactions generally.

The courts therefore responded by drawing up three judicial tests for determining what constitutes “common enterprise.” These tests essentially look at the directions where interests, rights, duties, liability, disabilities etc., meet and converge, in relation to investing parties and circularity. They include Horizontal Commonality, Broad Vertical Commonality, and Narrow (Strict) Vertical Commonality.

The Wal v Foxhill case presents a strong reminder of the controversy and inability of the courts to agree on this application of the commonality prong. The Federal Courts of Appeal are divided on this conceptualisation question and the Supreme Court seems to have maintained an uneasy silence. This has left the Securities and Exchange Commission in limbo and commentators piqued.

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286 Siporin v Carrington, 200 Ariz. 97 (Ct. App. 2001)
287 H.L.A Hart supra page 124 -135
288 SEC v Koscot Interplanetary supra
291 Gordon termed this, “a Failure of American Corporate Law”
The split among the courts goes to the question of whether to apply the vertical (judicial formalism) or horizontal commonality (judicial functionalism) to all transactions. The Third, Sixth and Seventh Circuit Courts support the horizontal commonality, while the Fifth, Eight, Tenth and Eleventh Circuits, use the vertical commonality test. The Ninth Circuit however, now accepts either vertical or horizontal commonality, while the First and Fourth Circuits are undecided. The Second Circuit has however not expressed this as a requirement although it seems to lean towards the horizontal commonality. These splits raise the question of what constitute or distinguishes vertical from horizontal commonality.

The Vertical Commonality: - this commonality only requires that the “fortunes of the investor are interwoven with and dependent upon the effort and success of those seeking the investment or third parties.” In other words, the balance sheet of promoters in terms of a particular transaction must correlate with that of the investor. The extent of such correlation or linkage is the subject of further controversy. The Fifth, Ninth, Tenth and Eleventh Circuits believe that vertical commonality is the only way to establish common enterprise. Under this method, it is only necessary to show a coterminous rise and fall in investors’ fortunes without the necessity of providing evidence of pro-rata sharing of profit and losses. This view has however been controversial and has been criticised as limited in scope. The inputs of promoter in its aggregated and disaggregated forms are not considered in the determination of what constitutes common enterprise. This therefore makes it impossible to rationalise the essence of commonality or common enterprise.

The above challenge therefore, has led to the development of two distinct kinds of vertical commonality, based on the scope of the fortunes of the promoter, investor and vice versa. The Narrow Vertical Commonality creates a standard to the effect that the success or failure of the manager must correlate with the investor’s profit or loss. In other words, the “manager’s fortunes must rise and fall with those of the

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292 Deck-ebach v La Vida Charters Inc., 867 F.2d 278, 282 (6th Cir. 1989); Stenger v R.H. Love Galleries, Inc., 741 F.2d 144 (7th Cir. 1984); Salcer v Merrill Lynch, Pierce, Fenner & Smith, Inc. 682 F.2d 459, 460 (3rd Cir. 1982)
293 McGill V American Land & Exploration Co., 776 F.2d 923, 925-926 (10th Cir. 1985); Villeneuve v Advanced Business Concept Corp., 698 F.2d 1121, 1124 (11th Cir. 1983); SEC v Continental Commodities Corp., 497 F.2d 516, 521-522 (5th Cir. 1974); SEC v Koscot Interplanetary Inc., 497 F.2d 473, 478-479 (5th Cir. 1974); Miller v Central Chinchilla Group, Inc., 494 F.2d 414, 418 (8th Cir. 1974)
294 Hocking v Dubois, 839 F.2d 560, 566 (9th Cir. 1988)
295 Revak v SEC Realty 18 F.3d, 81 87-88 (1994)
296 SEC v Glenn W. Turner Enter., Inc. 474 F.2d 476, 482 n 7 (9th Cir. 1973); Hocking v Dubois – the court held that the fortunes of investors must be linked to those of the promoters to establish a clear vertical commonality
298 Brodt v Bache & Co; 595 F.2d 459 461 (9th Cir.1978)
The Broad Vertical Commonality simply requires links between fortunes of the investors and the promoters’ efforts. In looking at this, the inquiry should be whether the fortuity of the investment is collectively hinged on the promoter’s expertise. The practicalities of adopting either types of vertical commonality to a transaction are in itself not free from controversies. Even though both views rely on certain linkages with participants in the transaction to gain validity in application, the threshold and standards for such connection in relation to specific products are unclear. While the narrow view sees the linkages from the point of view of profit and loss with respect to investors/promoters’ fortunes, the broad approach, views the linkages of fortunes essentially from the input or expertise of promoters.

This broad approach has been criticised as vague. The courts have also posited that it eliminates the second and third prong of the Howey Test by merging the prong that inquiries into whether the success or failure of investment is dependent on promoter’s effort. As a follow up to this critique, the Fifth Circuit has responded in recognition and by so doing relaxed the vertical commonality requirement. It also acknowledged that in certain circumstances, the second and third prong of the Howey Test may overlap. The US Circuit Court held:

“We are not convinced that it would be desirable to adopt a rigid requirement that profits and losses be shared on a pro-rata basis among investors, or that the promoter’s fortunes correlate directly to the profits and losses of investors. Howey sought to establish a standard which would embody a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek the use of the money of others on the promise of profits. It may be that in declining to adopt the rigid formulae of other circuits, our standard comports more fully with Howey’s desire to fulfil the remedial purposes of the Federal Securities laws.”

This watered down approach has also not gain wide acceptance especially among those courts that lean to the extremes of vertical commonalities.
group of courts however, see the horizontal commonality as the most functional approach to address the commonality question.

Horizontal Commonality Approach: This represents the pooling of assets from more than one investor in such a way that risks and rewards of a project are shared. It focuses on the horizontal legal relationship (where claim rights and duties interact) among investors in an enterprise or economic venture where their fortunes are tied to one another through a pooling of assets with pro-rata distribution of profits. Several Circuit courts hold the view that the horizontal commonality is the only valid approach for the determination of common enterprise. These include the district court, the First Circuit, Second Circuit, Third Circuit, Fourth Circuit, Sixth Circuit, Seventh Circuit and most recently the Eleventh Circuit, have considered the common enterprise and found that the movant must show the pooling of investors’ funds as a result of which individual investors share risks and benefits.

This position has been validated even by the Court of Appeal in Wals v Foxhill. In this case, the plaintiff bought Week 5 Condo and entered a swap agreement with developer to swap their week in February with a week in the summer. He also agreed not to occupy the apartment during the week in the summer but instead allow developer rent it. As part of the agreement, the plaintiff was entitled to $1400 (less of development fees of 30%) as rental income from his participation in the 4 Share Programmes of defendant with the said amount paid in an escrow account.

Dispute erupted when the plaintiff maintained that the defendant’s guarantee agreement puts them in a position to receive similar amount in subsequent years and as such the defendant cannot refuse to pay in subsequent months. Having admitted in court that he was inexperienced in financial matters, the plaintiff further maintained that they would have invested in the time share units if not for the guaranteed rental income and prospects of similar receipt in subsequent years. In the determination of whether this was an investment contract, the court was left in dilemma since diversity of parties was non-existent and the jurisdiction of the court

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306 Revak v Sec Realty Corp, 18 F.3d 81 (2d Cir. 1994); Hocking V Dubois 885 F.2d 1449 at 566 (9th Cir. 1989)
307 SEC v Banner Fund Intern, 211 F.3d 602, 341 (DC Cir 2000)
308 SEC v SG Ltd., 265 F.3d 42 (1st Cir. 2001)
309 Revak v Realty Corp., 18 F.3d 81, 87 (2nd Cir. 1994)
311 Teague v Bakker, 35 F.3d 978 (4th Cir. 1994)
312 Hart v Pulte Homes of Michigan Corp., 735 F.2d 1001, 1004 (6th Cir., 1984)
313 Hirk v Agric-Research Council, Inc. 561 F.2d 96 (7th Cir. 1977)
314 SEC v ETS Payphone 300 F.3d 1281, 1284 (11th Cir. 2002)
315 Walls v Foxhill supra
to entertain the matter was raised on the basis of lack of diversity. The plaintiff asserted that the offering and sale of time share, combined with flexible time agreement and rental pool agreement was an offering and sale of investment contract.

The US District Court held that the purchase and associated agreements do not constitute investment contract because horizontal commonality never existed. On appeal to the Court of Appeal, Wals further contended that the Condo time share purchase and associated rental agreement converted the Condo sale to an investment contract sale. Hence he submitted that since developers failed in the requirement to register the security, such sale should be rescinded. The Court of Appeal also disagreed with plaintiff while affirming the district court’s decision by holding that condo timeshare and rental agreement were not investment contract. It further noted that the rental agreement connoted a pooling of weeks rather than pooling of profit, since Wals chose their summer week swap from a pool of available weeks. The court also noted that the Supreme Court had ducked the issue of the definition of common enterprise which should have been resolved by holding that horizontal commonality best comported with the purpose of Securities Act 1934.316

One of the fundamental achievements of judicial interpretation of legal concept within securities is the exposition of its underlying purpose and philosophy. Essentially, the central theme that seems to resonate across the spectrum of case analysis is the role of economics and economic benefits in the conceptualisation of securities. An exposition of this nature informs the logical allocation of legal concepts among parties to meet the end of economic growth and value creation. On the test of economic benefit, the court was confronted with an argument from Securities and Exchange Commission with respect to the SEC Release, to the effect that federal securities law is better applied to the condo market to find for investment contract if (1) emphasis is placed on the economic benefits to be derived from the managerial efforts of the promoter, (2) where a rental pool arrangement is included for the purpose of meeting economic ordering and philosophy for the purpose of economic benefit only, (3) where the agreement materially restrict the ability of the purchase to rent or occupy the unit.317 These elements according to SEC are necessary to help in the characterisation of transactions in the Condominium market. The court implicitly considered these ingredients in the SEC Release one after the other.

316 Wals v Foxhill supra page 1018

108
2.9 Purposive implications by tracing out the philosophies that shape the economic or social arrangement and ordering/philosophy

The US courts seem to have applied the economic benefit test rather than the social benefit test in the conceptualisation of securities. This was also clearly evident in the Wal’s case leading to conflicts in philosophies on the basis of context. On the first element that emphasises Economic Emphasis Test, the court reasoned that the owner of the Condo does not own the undivided share of the building. Rather, he owns only his condo and receives rental income on his unit when rented and not an undivided share of the total rental of all. On the question of rental pool which constitutes the second element, the court in defining what amount to pooling, addressed what constitute a rental pool. It stated that that the rental arrangement did not aggregate all rents received and expenses attributable to all units. Also, proceeds were not remitted to investors on a pro-rata basis. For this reason, it did not constitute a rental pool that is contemplated by the SEC Release. On the basis of this, the Flexible Time and the 4 Share agreements did not prevent Wals from using the units. Therefore the economic substance of the transaction shows that horizontal commonality was non-existent.

If the test was directly applied in the interpretation of the SEC Release and Wals’ transactions, the court would have considered the following to arise at its decision. These include (1) the terms of the offer, (2) the distribution plan and (3) the economic inducement to the investors. In that case, a condo with a rental arrangement that guarantees economic benefits to purchaser which is essentially derived from the managerial effort of the promoter from rental units could easily be struck down as an investment contract. The plaintiff’s attempt however at drawing the court’s attention to the defendant’s implicit representation of expected rental income was rejected by the Court of Appeal. The basis for such rejection has been extremely controversial.

This decision of the Court of Appeal have been criticised by the Miriam Albert who questioned the rationale for the non-consideration of the ordinary language of the SEC Release. He ascribed the non-consideration of the ordinary language of the

318 “Pooling has been interpreted to refer to an arrangement whereby the account constitutes a single unit of a larger investment enterprise in which units are sold to different investors and the profitability of each unit depends on the profitability of the investment enterprise as a whole.” – Savino v E.F. Hutton & Co., 507 F. Supp 1225, 1236 (S.D.N.Y 1981)
320 SEC Release No. 33 – 5347 stated “Typically, the rental pool is a device whereby the promoter or a 3rd party undertakes to rent the unit on behalf of the actual owner during the period of time when the unit is not in use by the owner. The rent received and the expenses attributable to rental of all the units in the project are
Release as leading to the court’s findings that were not based on the Economic Emphasis Test and in all any event, the affirmation of the District Court’s decision.  

The Miriam Albert further argues that the plaintiff’s position that he received a representation from the defendant with regards to the rental income and the promise of economic benefit in the purchase and rental agreement should have been listened to. As a result of this case and the broad language of the Release, the court has restricted the application of the Economic Benefit Test and by extension the third prong of Howey.  

Hence, the Emphasis Test as used by SEC and Federal Courts is one of the many factors to consider when ascertaining whether an offer satisfies the last prong of the Howey.

The renewed emphasis on this Economic Test seems to present a direct contest to the Howey test to the extent that suggestion points to the possible displacement of the latter by the former. This is against the backdrop of the linkage between the Economic Test and the Vertical Commonality which emphasises pro-rata sharing of profit that emanates from promoters’ expertise. This direct attack to the entire theory on investment contract, may have contributed to the Court of Appeal’s silence and the implicit but hazy application of the Economic Benefit Test in reaching a decision in Wal’s case.

Gordon bluntly disagrees with both the Economic Test argument and the horizontal commonality supremacy by referring to the policy justification of the 1933 Act. According to him, the 1933 Act was enacted to protect the public by preventing dishonest promoters from circumventing securities law provisions through countless and variable schemes. This is to ensure that the public are not exploited by the sale of “unsound, fraudulent and worthless securities through misrepresentation, and

combined and the individual owner receives a ratable share of the rental proceeds regardless of whether his individual unit was actually rented.”

The Release further stated that “If the condominium are not offered and sold with emphasis on the economic benefits to the purchaser to be derived from the managerial efforts of others, and assuming that no plan to avoid the registration requirements of the Securities Act is involved, an owner of a condominium unit may after purchasing his unit, enter into a non-pooled rental arrangement with an agent not designated or required to be used as a condition to the purchaser, whether or not such agent is affiliated with the offeror, without causing a sale of a security to be involved in the sale of the unit.”

Even as Miriam Albert criticised the US Court of Appeal for not using the ordinary wordings of the Release, she failed to avert her mind to the very essence of the SEC Act which is predicated on flexibility


This view seems to point to power of the Vertical Commonality which is so all encompassing to the extent that it has been argued that it has merged the second and third prong of the Howey Test thereby making the entire test superfluous – SEC v ETS Payphone page 1284 Per Justice Lay

promote honest enterprise, clean up the entire value chain from presentation, competition through to promotion. He insists that while unwanted schemes are expected to be sifted out, the Act never envisaged these discrepancies between theories.

The US Supreme Court in Howey\textsuperscript{325} while narrowing down the principles in Joiner’s case\textsuperscript{326} also re-echoed this sentiments by noting that “instruments of variable character ... and necessarily designed by more descriptive terms as ... Investment contract, are also known as security.”

Gordon, while emphasising the all-inclusive nature of the term investment contract even within the blue sky laws, see no reason for the dichotomy between the vertical and horizontal commonalities. In his view, both tests exist side by side in the determination of the fourth prong of the Howey Test. He went on to justify this position by identifying two sets of cases within six of the seven States he studied and came to the conclusion that they are equally matched.\textsuperscript{327} For the States where horizontal commonality is absent, he identified the following cases in support, \textsuperscript{328} and for those that presented horizontal commonality included the following.\textsuperscript{329}

Jonathan Shook\textsuperscript{330} completely disagrees with the view that horizontal commonality should be considered as comporting with the 1933 Act. He stated that the historical backing for the horizontal commonality by the Seventh Circuit is unsupported by the 1933 Act or Howey. Hence the Court of Appeal should have applied the vertical commonality to satisfy common enterprise in Wal’s case. Had it done so, the court would have found the purchase and rental agreement as investment contract under the 1933 Act. While accepting that the 1933 Act is a disclosure state, he maintained that such disclosure will be more apparent where investors obtain the same thing – which is an undivided share in the pool of assets and profits.

The Miriam Albert\textsuperscript{331} also took this view by arguing the Wals’ case rigidly applied the horizontal test by focusing on factors that bore no relationship with the test requirement. He stated that the Court of Appeal in Wals’ case should have followed the Howey prescription of broad protection to investors. Although the court in Wals’

\textsuperscript{325} SEC v Howey supra page 297
\textsuperscript{326} SEC v Joiner supra page 351
\textsuperscript{327} Gordon supra
\textsuperscript{328} Prohaska v Hemmer-miller Dev. C., 256 Ill App. 331 (1930); State v Evans 191 N.W. 425 (Minn. 1922); Steven v Liberty Parking Corp., 161A, 193 (N.J. 1932)
\textsuperscript{329} Moore v Stella, 127 P.2d 300 (cal. Dist. Ct. App. 1942); People v White, 12 P.2d 1078 (Cal. Dist. Ct. App. 1932); State v Gopher Tire & Rubber Co., 177 N.W. 937 (Minn. 1920)
\textsuperscript{330} Jonathan Shook supra
\textsuperscript{331} Miriam Albert (supra)
read the Howey Test which requires pooling of investment and receipt of pro-rata, an alternative application was presented.\textsuperscript{332}

You will recall that the court in Howey’s case examined the contract where the seller offered investors a tract of citrus groove with an optional ten-year service contract in which the seller would jointly cultivate the grove and harvest the fruits.\textsuperscript{333} However, horizontal commonality was not implicated in Howey because each investor individually owned specific tract of land. This is why the Court of Appeal in Howey noted that it was an outright sale of individual’s definite and indefinite tract of land.\textsuperscript{334} But when the Supreme Court considered this, it was of the view that the produce was pooled and that the produce might have been put together for marketing purposes.\textsuperscript{335} Gordon argues that this is not the purpose of pooling in the horizontal test. Moreover, there was no pro-rata sharing in Howey. In fact the Fifth Circuit Court of Appeal held though persuasively, that there was a sale of a right to share with others in the profit of land held in common with the defendant company or others.

In each plantation groove, the cost of care and proceeds of the fruits may be distinctively accounted for with respect to the specific property owned by individuals.\textsuperscript{336} Thus, while profits of the entire Howey enterprise were to be divided based on the selling of the pooled produce, each individual investor return was based on the production from his specific tract of land. This independent return, informed the Fifth Circuit’s Court of Appeal decision that it was not a security.\textsuperscript{337} However the Supreme Court found the Howey situation to be an investment contract. This makes it extremely surprising for the court to find an investment contract in a situation where investor’s return depends on the income from its own asset as against the requirement for a pro-rata sharing of profit to achieve common enterprise. It is unclear how commonality was established in the case of \textit{Wals v Foxhill}.\textsuperscript{338}

This means that each yield of tract of land was identifiable from the bulk. The pooling was only administrative and did not commingle the individuality of the structure as created by the apportionment of the tract of land.

\textsuperscript{332} Wals v Foxhill supra page 625
\textsuperscript{333} Gordon sees this as Vertical Commonality – page 645
\textsuperscript{334} SEC v Howey supra page 716
\textsuperscript{335} Gordon supra page 645
\textsuperscript{336} “indeed 51 sales involving 195.26 acres, eight of those sales were of non-bearing trees totalling 103.21 acres, and 43 were sales of bearing trees totalling 92.05 acres “ – Howey page 716
\textsuperscript{337} Gordon supra pages 645-646
\textsuperscript{338} Walls v Foxhill supra page 1016
The Figure 8 above is a diagrammatic representation of the process of pooling of investor funds for the acquisition of land and the creation of distinct structures to the effect that the investors’ only benefits from their specific produce from their distinct tract of land and not from the common pool of profit from all the land put together. This is a unique structure that shows the nature of pooling in all instances. It goes to express that the function of specificity and identification in the characterisation and conceptualisation of securities is sacrosanct. Therefore the risk of commingling could alter the economics and intended outcomes of pooling as shown in the comparison between the scenario in Wals v Foxhill and Sec v Howey as seen in Table 1 below.
Figure 9 – Comparison of the Wals v Foxhill and Sec v Howey on the application of Investment Contract Test

<table>
<thead>
<tr>
<th></th>
<th>Wals</th>
<th>Howey</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Investment was on a specific time and a slice of a specific apartment whose physical and temporal characteristics including price was different from those of other unit – page 1019</td>
<td>Investment in specific tract in a grove</td>
</tr>
<tr>
<td>2</td>
<td>Pooling of weeks</td>
<td>Pooling in produce</td>
</tr>
<tr>
<td>3</td>
<td>No pro-rata sharing or pooling of profit</td>
<td>No pro-rata sharing or pooling of profit</td>
</tr>
<tr>
<td>4</td>
<td>The investor in defendant’s timeshare did not receive an undivided share of some pool of rental profit. They receive the rental on a single apartment.</td>
<td>Investor only received the proceeds from his specific tract in the groove and not an undivided share in some pool.</td>
</tr>
<tr>
<td>5</td>
<td>Plaintiff lives in distant locality. The plaintiff is unsophisticated and inexperienced in the ownership and operations of income producing properties and purchased this timeshare as investment for a guaranteed return on income for 1990 and the prospect of similar receipt in the future and not to occupy the time.</td>
<td>The grove was offered to persons in distant locality who lack the necessary equipment and experience to cultivate, harvest and market the produce. Hence, such persons have no desire to occupy or develop it themselves as they are only attracted by the prospects of return.</td>
</tr>
<tr>
<td>6</td>
<td>Marketed as part of an enterprise</td>
<td>Marketed as part of an enterprise</td>
</tr>
</tbody>
</table>

Held: Court of Appeal: Required horizontal commonality, but found it to be absent. Hence held no investment contract (security).

Held: Supreme Court: there was investment contract (security). The court adopts flexible formula to capture the remedial purport of the Act which is the protection of the investing public.

Comparison between two notable cases to demonstrate the lack of uniformity in the application of prongs could be based on ideological positioning rather than functional pragmatism. This is one of the risks of the court centred functionalist approach if not properly regulated.

Flowing from the above analysis in Figure 9, it therefore means that Wals’ case could easily have been characterised as investment contract without the necessity of
identifying any incidence of “pooling”. 339 On the basis of this, the Miriam Albert argued that vertical commonality could have been applied as was noted by the Court of Appeal. 340

The court stated:

“..The resulting division of rental income makes the developer and the condominium owner, coventurers in a profit-making activity impacting on the condominium interest itself, the character of an investment for .. those circuits that believe only vertical commonality is required to create an investment contract would deem the combination of sale and rental agreement in this case an investment contract.”

The implication of a coventurer in this case between the investor and promoter, removes the 3rd prong which emphasises a reliance on the professional expertise of others in the determination of what constitutes investment contract. The Wals’ controversy persisted even up till 2002 when the Supreme Court narrowly escaped addressing the commonality question in the case of SEC v Edwards. 341 This matter was first commenced against ETS at first instance where SEC alleged that the sale and leaseback agreement was a security and defendant violated the Anti-fraud provision of SEC Act 1933. Edward was the CEO/Chairman of ETS and owner of PSA. He also owned Twinleaf Inc (a consulting company).

Investor purchase a payphone from PSA and then lease the telephone back to ETS to provide its management services, in return for its $6,750 purchase. In return, the investor would receive a monthly fixed fee of 14.1% on investment or $82 a month during the 5 years lease period under this agreement. It also provides that investors retained little or no control. 342 ETS offered these purchase and leaseback agreement to the general public through a sale force and distributors who solicited by mail on the internet. ETS portrayed the company in its sale literature as experienced and successful in the telephone industry and invited investors to watch the profits add up. The company went into insolvency.

The US District Court highlighted the relevance of the horizontal commonality but stated that it was bound to apply the vertical commonality. 343 On application of the vertical commonality, the court relied on evidence that the fortunes of all investors are tied to the efficacy of the promoter. 344 This element was satisfied. On appeal, the

339 “Pooling has been interpreted to refer to an arrangement whereby the account constitutes a single unit of a larger investment enterprise in which units are sold to different investors and the profitability of each unit depends on the profitability of the investment enterprise as a whole.” – Savino v E.F. Hutton & Co., 507 F. Supp 1225, 1236 (S.D.N.Y 1981)
340 Page 1017
343 Stare decisis – SEC v ETS Payphone supra page 1353
344 Edward v ETS Payphone (supra) page 107
court considered a narrower issue as to whether the transactions constituted a security under the definition of investment contract? That although time share were not specifically mentioned in the 1933 Act, the term investment contract has limited purpose for identifying unconventional instruments that have the essential property of debt and equity. Within this context, the court noted that share of stock represent an undivided interest in an enterprise entitling the owner to pro-rata share of profit.345 The court further reasoned as in this case that the owner of a condo does not own the undivided share of the building. Rather, he owns only his condo and receives rental income on his unit when rented and not an undivided share of the total rental of all. It follows that the arrangement whereby investors interests are made manifest, involves investment contracts regardless of the legal terminology in which such contracts are clothed.

From the above analysis therefore, the United States’ it is clear that judicial functionalism in the United States court system has contextually flexible interpretation of the concepts of rights and duties through the use of judge-made tests and standards. The essence of such interpretation is the furtherance of risk distribution for economic benefits. Therefore the capacity to seamlessly generate, cut into slices and transfer pieces of unhedged risks as value within the market, is the hallmark of the US conception of securities. This is represented in Figure 4 below:

345 Edward v ETS (supra) page 107
The Figure 10 above is a diagrammatic representation of the approach adopted by the US to characterise securities by weaving together the component of securities using statutes and case law. While the US securities statute have listed the instruments that could constitute securities if context permit, the US court have applied the ingredients in the inner circle is convergent, exploitative and inward looking. The actual weaving of the components in the inner circle is usually done by the court on the basis of empirical data and evidence for the determination of the context to guarantee flexibility in achieving the policy basis of the US Securities Act. Also from the diagram, it can be seen that the policy basis of securities concept and statutory intent have been achieved. The purpose of functional (context sensitive) approach of the US Courts and statutes is to “... embody a flexible rather than a static principle, one that is capable of adaptation to meet the countless and variable schemes devised by those who seek to use the money of others on the promise of profit.”\textsuperscript{346}

Therefore the internal circle constitutes the engine room where the courts have tried to the listed instruments in statutes represented by the outer rectangles into the components contained in the inner circle.

\textsuperscript{346} SEC v Howey, 328 US at 299
Chapter Summary

The research has demonstrated through literature that a court centred functionalist approach to securities conceptualisation has the capacity to close the gaps and significantly reduce the incoherence in the formalist definition of securities. Securities conceptualisation is the process and interaction between the various legal concepts and theories that constitute securities. It includes how these shape the construction and application of the products in the financial market. This research identifies the different legal systems and approaches adopted in the conceptualisation process. The formalist and functionalist approaches represent the civil and common law system respectively.

Formalism strictly applies standard deontic logic while functionalism utilises both conditional deontic and dyadic deontic logic. The differences between both philosophies are not binary. It is a spectrum that oscillates within different approaches within both philosophies. While statutory formalism and statutory functionalism are clearly distinct, the judicial formalism and judicial functionalism could coexist in a system with its attendant tensions as seen in the US. These differences have significantly exposed the gaps, incoherence and contradiction in the understanding of securities. The gaps identified include: (a) the intangible nature of the instrument and their legal effect, i.e., whether governed by property, contract law or a statutory creation of a special kind specifically for the financial market, (b) tension between national laws in terms of cross-border activities leading to potent gaps in the understanding of securities. These gaps include:

i. Lack of understanding and clarity in the meaning of ownership, relationship, rights of ownership, negotiability and transferability

ii. Difficulties in understanding the classification systems that best suit the proper characterisation of securities from a host of available criteria that comprise currency denomination, ownership rights, maturities, liquidity, status, tax treatment and income payment methods.

iii. The conflict as to whether securities is a property subject to lex situs rules, a contractual right subject to the rules of substantive contract law or whether it enjoys a special status. Legal authorities across the globe are still divided on this question.347

These have further contributed to failed efforts at international harmonisation of rules for cross border transactions.348 Differences in interpretation techniques, language and tendencies to preserve historic legal traditions further widens the gaps and stand in the way of product development

347 Benjamin, Joanna supra
348 MiFID, Hague Convention, IOSCO Principles.
While acknowledging the court centred functional approach is not full proof in terms of the non-uniformity in the application of certain test within the prongs, this research demonstrates that those defects do not affect the core utility of the model and its capacity to facilitate a flexibly liquid market. This lack of uniformity in the application of the prongs created the following interpretative glitches:

a. The absence of a definition of what constitutes “investment” is controversial. As a result, the distinction between an investor and employer was hotly disputed in International Brotherhood v Daniel.\(^{349}\)

b. The element of “Profit” that is necessary to establish the second element of the Investment Contract test was also debated.\(^{350}\) In Tcherepnin v Knight, the court was caught between distinguishing income streams and savings from profit. Also, the question of how profit is ascertained was problematic especially where the courts had to decide whether the criteria should be based on pre-sale or post-sale and which part of both is considered significant for this purpose.\(^{351}\)

c. The element of “Effort of Others” needed to establish profit also presented problems. The courts applied different interpretative nodes to understand what constitute “Effort”. This shows the varieties of contexts that exist with every transaction.\(^{352}\)

d. Of all the prongs, the Commonality question seems to be more controversial than other elements of the Investment Contract test. The conflict was as a result to differences in interpretative prongs and the ununiformed outcomes achieved from the manipulation of words/language within those prongs in the interpretation.

These differences in interpretation reflect the courts’ understanding of variations in contexts and their impact on the appreciation of legal texts. This is one unique feature that makes its application adequate in developing market and court system where there are likely to be institutional gaps. The tendency for courts in these markets to abuse an unbridled discretion in securities conceptualisation is circumscribed by these judge-made principles and tests while providing a base for the elucidation of the concepts. For instance, while the definition of common enterprise created the opportunity to explore the nature of securities deeply so as to appreciate to role of context; it also delineates the contours of judicial discretion. This has helped galvanise deeper insights into the inner workings of securities and the different commercial contexts under which they operate.\(^{353}\) Secondly, while the controversies between the vertical and horizontal commonalities with regards the characterisation of investors’ fortunes may create a window for judges to arm twist in developing markets, the US has shown otherwise. The US courts have been able use the

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\(^{349}\) International Brotherhood v Daniel supra  
\(^{350}\) Tcherepnin v Knight (supra)  
\(^{351}\) SEC v Life Partners (supra)  
\(^{352}\) United Housing v Forman (supra); Teamster v Daniel (supra); SEC v Life Partners (supra); SEC v Mutual Benefit Corp (supra)  
\(^{353}\) Wals v Foxhill (supra)
tests as a tool to interrogate the concepts of securities in line with underlying philosophy of the society.\textsuperscript{354} Thirdly, the power of judicial context-sensitivity as shown in the acquiescence of the US Supreme Court is viewed from two distinct lenses. First, the court’s silence may be interpreted as a deliberate and implicit admission of the failure of precedence (doctrine of stare decisis) to further the idea of contextual flexibility.\textsuperscript{355} Second and most importantly, it could mean recognition of the importance of flexibility at achieving context based decision making at the lower courts. Therefore, through the provision of a coherent jurisprudence for the conceptualisation of securities as shown in Figure 4, this review demonstrates that the inbuilt flexibilities of the US Model could be useful in achieving definitional coherence of securities.

Conclusion

Inconsistencies in application of approaches to the conceptualisation of securities are its major drawback. The judicial formalist and judicial functionalist approaches are two parallel approaches operating through the courts. This raises questions about the impact of statute at delineating the contour of judicial discretion at the same time maintaining some level of flexibility in language to enhance innovation. The dilemma therein created from the gaps in legal frameworks facilitates the preponderance of ideological positioning that obstructs contemporary transactional flexibility. As the analyses show, the key developments that are currently shaping the understanding of securities are changing. For instance, formalism is a product of language constructed and interpreted through standard deontic connections. This is implemented through a system of stare decisis. In addition, the functionalist approach which emphasises context adopts a mix of dyadic deontic and conditional deontic and implemented through a system of stare decisis and judicial activism. The tensions resulting from conflict between both approaches further places constraints on the proper conceptualisation of these instruments. The meaning of concepts like proprietariness, negotiability and transferability can no longer enjoy its illusive and fragmented characterisation simply on the basis of their statutory inclusion. Its true meaning as it relates to the context of every transaction must be clarified. Consequently, a context sensitive judicial functionalist legal conceptualisation has the capacity to develop a coherent jurisprudence for the conceptualisation of securities by harnessing and weaving together all contexts including the physical and human stories. It can as a result, define a framework for the characterisation of the components that make up securities by developing standards to regulate their deployment and implementation within any given contexts. This will help

\textsuperscript{354} Wals v Foxhill (supra)

\textsuperscript{355} This means that the Supreme Court is deliberately acquiesced by leaving the floor open for the lower courts to take positions that best suit their requirements within the various contexts available to them. The idea of unguided flexibility create that temptation to introduce extraneous factors indiscriminately into the characterisation of securities, thereby watering down the context sensitivity of the case law centred functional approach. This is one dilemma, the Supreme Court acknowledged in SEC v Howey (supra).
create uniformity in the application of these components and clarify the scope and meaning of specific instruments that are warehoused within these components.
Chapter 3  

Research Methodology

A research of this kind interrogates various legal approaches to identify the ontological and epistemological positions that shape the interrelationships of securities concepts. These approaches are important, not because they possess any normative value, but they help to clarify assumptions, perspectives and notions that shape the realities of this research objective.

In terms of assumptions, perspectives and notions, the researcher’s bias must be clarified so as to reduce incidence of unreliability. Becher identifies the importance of extricating bias to uphold objectivity and reliability. Chynoweth strengthens this view when he maintains that the measure of objectivity is not in the choice of research design, but in ability to integrate the research design to the objective and research questions. Schwandt identify the connections between normative legal principles and the philosophical approaches. They posit that clarity in the application and enforcement of norms is a function of the level of philosophical understanding of their scope and operations. This according to them extends beyond the mere legal provision to the very effect in legal relationships. As such Hart and Savigny relate the above position to the need for research to construct legal philosophical approach so as to expose the nominal essence of legal provisions.

This study examines the paradigms briefly to elicit the best approach to the research into the legal conceptualisation of securities.

3.1 Ontology

Capon and Visser explain the importance of ontology in legal research. They describe is as a science of ‘self’ as it relates to the basic constituent of self and its relationship with other phenomena. This is important because of the position of the researcher in relation to the research. Ability to discover reality (truth) in normative principles by distinguishing subjective (experiential and self) from objective (independent self) in the choices of participants and data is critical to reliability. The question of how legal language and structure shape legal relations within legal

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360 Friedrich Carl Von Savigny, On the Vocation of our Age of Legislation and Jurisprudence (Abraham A. Hayward trans., 1831)
361 Trevor J.M Bench Capon and Pepijn R.S Visser ‘Ontologies in Legal Information Systems; The Need for Explicit Specifications of Domain Conceptualisation
concepts in securities, goes to the core of construction, perception and effect. Therefore, there is the need to clarify assumptions and remove inhibitions to the objective assessment of these concepts in relation to securities rules/law. While the ontological perspective looks at concepts themselves and inconsistencies in their operation, it lacks the tools to ascertain the level of inconsistencies and how these stand in the way of a coherent and contextual conceptualisation of securities. This is a problem the epistemology attempts to resolve.

3.2 Epistemology

This philosophy looks at the processes and method of ascertaining the right context that confirms the appropriate reality suitable for the operation of phenomena. In other words, it is interested in knowing how things are known, the origin of a particular state of affairs and the criteria for arriving at them. It also seeks to understand the underlying basis for those criteria. Epistemology seeks to know the state of current reality when confronted with varied set of unrelated state of affairs. This is apparently where its usefulness lies in establishing linkages between ontology and epistemology. The relationship between ontology and epistemology implicates the subjectivity of the researcher in his ontological viewpoint. This invariably exposes the objectivity or otherwise in his epistemological choices. Also, both ontological and epistemological viewpoint are a function of objectivities and subjectivities. Whitehead posit that objective epistemology sees a state of affairs as externally determined and not a product of theories. Subjective epistemology however, sees a state of affairs as a subjective construct which means that actual state of affairs represent the researcher perception. This is why reliability of data is hinged on the test as to whether such data are insulated from researcher’s bias. It is argued therefore that participant-led approach in eliciting and presenting normative legal principles extricates researcher’s perspectives as much as possible. However Saunders et al argue that the choice of data presented and analysis cannot be free from the subjectivity of the researcher. Such influence is perhaps the reason why true objectivity can only be at best imagined. But in terms of normative legal principles, their certainty lies in the language and effective application of legal approaches. This approach to a large extent removes the focus from the researcher and places it squarely within the purview of legal interpretative approach which is influenced by theory and adopted by the system.

365 Whitehead, The Concept of Nature (1920); Northrop (1964) supra page 734
366 Participant-led approach aims to elicit responses from individuals directly involved and experiencing the problematic situation that constitute the research interest – Greenwood, Davydd, William Foote Whyte and Ira Harkavy ‘Participatory Action Research as a process and as a Goal’, Human Relations 46.2 (1993): 175-92; Hall, Budd I, ‘From Margin to Centre? The Development and Purpose of Participatory Research, American Sociologist, Winter 1992, page 15-28
Krannich et al\textsuperscript{368} define legal approaches as the framework that clarifies the beliefs and interpretative philosophies that inform the understanding and application of legal concepts. They help explain the relationships between the concepts within legal provisions, theories and methodologies. In terms of language, they are linguistic materials which inform the mutual choices in particular syntax. According to Habermas,\textsuperscript{369} there are two main types of legal approaches which inform several sub-paradigms. These are Formalism (conventionalism, textualism, and positivism) and Functionalism (pragmatism, contextualism and legal realism).

3.3 Legal Research Approaches

3.3.1 Formalism

This is an approach that applies inductive and deductive legal reasoning in legal interpretation. General rules, standards and principles which Hart\textsuperscript{370} describes as a means of social control are given rigid interpretation to eliminate room for judicial discretion. The quest for truth is objective, external, logical and scientific. This is why it is a useful tool within the positivist school. Posner\textsuperscript{371} suggests that law must be certain where it refers to classes of persons, acts, things, circumstances and their qualification. Therefore its principal devices which are legislation and precedent must ensure they are adequately structured to ensure this. As for legislation, certainty in language as it relates to classes of acts, things and circumstances must provide a basis to reduce broad classifications into a single item which the law seeks to achieve. With regards to precedent, the presence of standards and principles of behaviour that discourages the introduction of new ones, guarantees transfer of rigid behaviours from superior courts to lower courts. This is the argument of formalism as it seeks to disguise and minimise the need for choices once the general rule has been laid down Hart.\textsuperscript{372} It does this by freeing the meaning of rules so that the general terms have the same meaning in every case where its application is in question.\textsuperscript{373}

Formalism further fastens certain features in legal provisions and rules to bring anything which has those features within the scope of those rules and social aims.\textsuperscript{374} This is to ensure certainty, determinacy and predictability.\textsuperscript{375} It is also to obviate the need to blindly anticipate the future swings in state of affairs. “No effort in the form of judicial enquiry is required to interpret terms in the light of different issues at stake in its various reoccurrence”.\textsuperscript{376}

While this approach may ensure some level of certainty in the short term, it is fraught with assumptions and inaccuracies which have the capacity to constrain interpretation and construction


\textsuperscript{370} H.L.A Hart supra page 124


\textsuperscript{372} H.L.A Hart supra page 129

\textsuperscript{373} H.L.A Hart supra page 129

\textsuperscript{374} H.L.A Hart supra page 126

\textsuperscript{375} H.L.A Hart supra page 126

\textsuperscript{376} H.L.A Hart supra page 130
to arrive at the truth. Given the fluidity, dynamics, extensiveness and complexity of securities, formalism is unlikely to be appropriate in capturing its nominal essence. Therefore, functionalist approach within the realist school is recommended to apply deductive reasoning to elicit the concept of securities by exploring the application of existing theories in a contextual manner towards developing new theories and frameworks.

3.3.2 Functionalism

This approach emerged from serious critique of the flows in the formalist approach. It combines legal contextualism (Ronald Dworkin) and legal realism (Oliver Wendell Holmes 1841-1935 Harris) in the construction of legal concepts for the purpose of eradicating the flaws in formalism. For example, while legal formalism (positivism) takes the view that interpretation of rights and obligations are rigidly limited to institutional practice, contextualism appropriate both institutional practices and other moral considerations in deriving the truth in legal concept. According to Dworkin, this helps to elicit the normative significance of right and obligation. Contextualism also explores the legal impact of its principles and moral fact on the institutional practices that lead to certain characters in rights and obligations.

The idea of fairness and justice within the interaction of rights and obligation is a product of interpretation. This underscores the division between its approach and that of formalism in giving the law a contextual application. While formalism operate legal language as it is without reference to whether it is fair or just, contextualism considers moral influences in legal principles. Given the vagueness and lack of clarity in the concept of fairness and justice, legal certainty will be compromised with so much discretion in the courts. This weakness in contextualism led to the emergence of realism. The realist school believes that the truth is outside the logic of science or the subjective views of contextualism, but on the underlying phenomena that shapes the observable events within the objective science and subjective insights of interpretation. This underlying phenomenon is what Holmes refers to as state of affairs (contexts).

Therefore, functionalism as a realist tool seeks to understand this state of affairs that regulate the objectivity of positivism and subjectivity of interpretivism. It draws from the interaction between the concepts, theories and philosophies as it seeks to make meaning from them within prevailing state of affairs. By so doing, varied contexts are catered for in legal interpretations. In terms of the conceptualisation problems with securities, functionalism is likely useful in helping to clarify the underlying phenomena by amalgamating the standards and principles of formalism and subjective interpretation of rights and obligations.

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377 Freeman F.D.A supra page 99
378 Freeman F.D.A supra page 99
3.4 Chosen research Approach

This study adopts the functionalist legal approach and deploys contextualism as a tool for this analysis. Figure 11 below captures the main thrust of this study. Apart from the literature review which examines the legal approaches to the legal conceptualisation of securities, this research aims to identify the best approach for the conceptualisation of securities in Nigeria (under Nigerian law). Even though literature has been influential in this research, the intention is not to explore the issues through quantitative analysis. The research seeks to utilise interview data obtained through structured, unstructured interviews and personal observation of market operators, participants and regulators to understand the application of securities as a concept and its rules in the market. It is an internal participant-led qualitative research into legal rules, their interpretation, application and effect in the market. Given the normative nature of legal rules, there is simply no room for generalisation. This is the case especially where the research discusses the legal effect of rules through the use of case study. Therefore, the inability of market participants to interact due to the rigid nature of legal rules is the main shortcoming of formalist nature of Nigeria’s securities. This has led to lack of flexibility in the market and inability to innovate in terms of investment products development. This research considers these legal barriers created by language, language construction and interpretative approach adopted within the Nigerian legal system as pertaining to securities law with a view to proffering solutions.
Aim:
How can context sensitive judicial functionalism improve legal conceptualisation of securities to stimulate product development in the market to meet diverse investment needs.

Theoretical Perspective:
Challenges to developing a legal conceptualisation of securities in the Nigerian Capital Market to enable product development and market deepening

Research Design:
(1) Observation (structured & disguised)
(2) Focused group and target individuals using structured and unstructured survey questions

Research Questions
3.5 Research Strategy

There are broad research strategies in operation. Arthur identifies four types to include legal theory research, expository research, law reform research and fundamental research. The choice of a strategy is determined by the research aims, objectives, theoretical/conceptual framework and approach. With the chosen philosophy for this study, the researcher adopts single case study strategy given the contextual nature of the research and its specific focus on legal conceptualisation of securities within the law in Nigeria as they relate to the Nigeria securities market.

The real life context which is expressed in the effect created by the interaction between legal concepts within securities also informs the choice. More specifically, two distinct views justify this research strategy. Those in favour of action research support the active engagement of market participants to capture contexts by exploring subjective impressions. The innate reactions to legal language and effect on behaviour, informs attitudes of participants in the market. Although this view is resisted by authors who think legal rules are normative and ethnographical studies seek to dilute its effect and reduce it to social sciences. Even where their view holds some validity, it is insufficient to erode the advantages of research study into how legal language, structure and application affect the way participants and market function.

On the choice of case study, the research is able to make methodological inquiries into specific context of the law in relation to the Nigerian Capital Market. This doctrinal methodological inquiry has the advantage of achieving expository research in law and its relationship with legal theories, concepts and philosophy. It also helps researchers elicit inductive and deductive answers to the how, what and why questions they relate to the language and structure of legal provision and their application within the market. This is able to achieve through the combined effect observation, interviews and secondary data. The above strategy is different from others in the following ways.

Figure 12 – Navigating the methodology

<table>
<thead>
<tr>
<th>Legal reform research</th>
<th>This is social-legal research into for the purpose of achieving socio-legal context. It is an applied research about law as it explores the law from interdisciplinary standpoint. The Experimental Strategy is suited under the legal reform research because it places contextual variable within control. Time constraints make the experimental strategy unsuitable for this research.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fundamental research</td>
<td>This is the study of the sociology of law. It is a pure and fundamental research about law from an interdisciplinary position. The questionnaire strategy is appropriate here to restrict the variability of data for the purpose of limiting any contextual voyage into the legal concepts, theories and philosophies underpinning securities.</td>
</tr>
</tbody>
</table>
3.6 Research Methodology

The object of the functionalist approach in utilising the choice research strategy is to achieve triangulation. This means therefore that the strength of ethnography (research in action) which encourages participant-led contextual inquiries into the state of the law and responses from market participants will triangulate the weaknesses of rigidity of case study. The depth of clarity that the participant-led case study method can achieve on the specific context of legal provisions in the ISA 2007, CSCS Rules, SEC Rule, CAMA with respect to their practical application in the market is able to triangulate the broad descriptive data obtained from the ethnographic (research in action) strategy. Also since both strategies are participant led, subjectivity of every participant is a regular feature. In order to achieve triangulation, promote some level of objectivity, the highly subjective and descriptive ethnographic research is triangulated with a real case study and doctrinal application of the rules to elicit their application in practice. This helps define the limits of descriptive data and streamline the basis for their existence. It also helps enrich the quality of the research as a whole by providing a human perspective to practical legal application of rules by situating their nominal effect.

3.7 Research Methods

3.7.1 To further triangulate data, the researcher adopts the structured, unstructured interviews and personal observation methods. This is to ensure that the rigidity of structured method is triangulated by the flexibility of unstructured method is a question of depth, clarity and validity of data. The structured survey presents open-ended direct and indirect questions requiring personalised answers to direct to direct questions and personal views to indirect questions. The unstructured survey present probing questions based on the answers provided to previous questions. While the structured data keeps the unstructured data in check and within research objectives, the unstructured method is able to achieve depth by clarifying assumptions and inaccuracies of the structured method.

3.7.2 The non-participant disguised observation is simply to validate the structured and unstructured survey by looking at surrounding environmental contexts to identify the role of people, their action and circumstances under which they operate. As a useful tool in behavioural science, this method helps to elicit data that interviewees are unwilling to furnish or omitted during the interviews. It is useful in this research to tease out the non-legal factors that underlie and shape legal rules, their application, enforcement and the place of participants in the pyramid. Therefore, within the context of this study, the researcher puts the structured and unstructured survey questions to participants to elicit their interpretation of relevant provisions of the law, their views on the interpretation and their effect on participants and market functioning. This is with the view to identifying both the structural problems with the rules, their application and effect on participants and market as a whole.

These methods cannot be effective at achieving reliability and validity if the views captured are not representative of the perspectives shared by majority of market participants. This therefore necessitated the choice of the sample size.
3.7.3 Sample Size

To test representationality of views canvassed in research, the research sample size was chosen carefully. The table below shows the sample size from the approximate number of participants in the Nigerian securities market. Sample Size - Figure 13

<table>
<thead>
<tr>
<th>Market Participant</th>
<th>Population</th>
<th>Sample</th>
<th>Sampling Technique</th>
<th>Survey</th>
<th>Observation</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSCS</td>
<td>9</td>
<td>4</td>
<td>Stratified random probability (SRP)</td>
<td>Unstructured and Structured Interview (USI)</td>
<td>Observed</td>
</tr>
<tr>
<td>Custodian</td>
<td>11</td>
<td>5</td>
<td>SRP</td>
<td>USI</td>
<td>Observed</td>
</tr>
<tr>
<td>SEC</td>
<td>6</td>
<td>4</td>
<td>SRP</td>
<td>USI</td>
<td>Observed</td>
</tr>
<tr>
<td>NSE</td>
<td>7</td>
<td>4</td>
<td>SRP</td>
<td>USI</td>
<td>Observed</td>
</tr>
<tr>
<td>Investors</td>
<td>23</td>
<td>15</td>
<td>SRP</td>
<td>USI</td>
<td>Observed</td>
</tr>
<tr>
<td>Sub-custodian/Nominee</td>
<td>5</td>
<td>4</td>
<td>SRP</td>
<td>USI</td>
<td>Observed</td>
</tr>
<tr>
<td>Stockbrokers/Banks</td>
<td>27</td>
<td>18</td>
<td>SRP</td>
<td>USI</td>
<td>Observed</td>
</tr>
</tbody>
</table>

3.7.4 Justification of Sample, Sampling Technique and Triangulation

It is important to justify the choice of sample size, sampling technique and triangulation strategy to ensure internal validity and reliability.

a. Sample Size and Sampling Technique:

The need to achieve representationality informed the choice of sample size and stratified random probability technique. The difficulties encountered in listing the actual population of lawyers and investors within the institutions that constitute market participants informed the adoption of stratification on the basis of legal experience in securities law practice. The major inhibitions were privacy policies of various companies operating in the market and overlap of roles and responsibilities in the various specialisms within the market and the varying degrees of experiences. Therefore, this research lists the population on the basis of stratification and thereafter extracts the sample size and on the basis percentage points scored against stratification criteria. These criteria include the level of legal experience in securities law practice as judged by years of practice and levels of duties assigned. Based on the above criteria, each participant was rated on a scale of 1 to 10 to indicate their level of compliance with (10) as highest rating and (1) as lowest. To derive the proportionate stratification, the research divided the number with the highest score by the sample population and converted result to percentages. The outcomes are as follows CSCS (44.3%); Custodian (45.4%); SEC (66.6%); NSE (57.1%); Investor (65.2%); Sub-Custodian/Nominee (80%); Stockbrokers/Banks (66.6%). The research thereafter selects the sample using simple sampling to minimise likely bias after the highly representative sample obtained through stratified
random sampling. The sample figures obtained through this technique as seen in Table above also ensure that no strata were over represented. The possibility of comparing strata and quality of data from participants within different rating also provided a basis to assess the quality of the rating system.

b. Triangulation

The need to ensure accuracy, consistency, reliability and internal validity informed these triangulation methods of personal observation, repetitive questioning and re-contacting interviewees. To validate data from the different strata of participants, the researcher adopted repetitive questioning of the participants by re-contacting them within each stratum chosen randomly until it was clear that no new information were emerging. The researcher also observed some randomly selected participants to re-validate data.
Securities in Nigeria is one of the most important aspects of law but least studied. Every aspect of business transaction is characterised by one form of interest or the other. Within these interests lie definitive rights that carry monetary values. As a result, security is perceived by operators and investors as a form of collateral and a trading capital of companies from which investors make profit. Given the economic nature of these instruments and their perception as a demonstration of society’s capacity to store value, its creation and maintenance are regulated by agreement between economic actors. The management of the structure and proceeds of such value is the basis of shared interpretative divergence.

Drawing on the Nigerian context, this chapter addresses this interpretative disagreement. First, it argues that the whole contradictions in the ‘form versus function’ debate provide a basis for conflict within the laws themselves and their application. This chapter also shows how market participants are unable to leverage the potentials of the laws to create investment products in the Nigerian Capital Market. While highlighting the importance of laws in this regard, it goes further to reveal the impact of poor understanding of these products and lack of studies in this area have on their development. Therefore, drawing on interview data from market participants and regulators in the Nigerian market, this chapter shows a relationship between the interpretative incoherence in the definition and poor development of products in the market. Rather than explore this from a unilateral causality point of view or a single source, this research highlights the network of causalities that draw inspiration from structural incoherence, language or etymological incoherence and transactional incoherence. By contrasting the interview data from market participants from different levels of competence, this research demonstrates how conflict in the structure of a definition can radically inhibit its interpretation and by extension its utilisation for the purpose of product development and market liquidity. Second, this chapter uses a combination of research tools to show how the adoption of a formalist approach to the conceptualisation of securities and under-development of the Nigerian Capital Market. By bringing this often ignored area to light, an opportunity is created for a proper engagement with its impact and contributions to the poor understanding of securities.

To achieve these, this research is divided into three sections. The first presents the conceptual framework from whence the definition of securities under Nigerian law is examined. It traces the history of securities development in the Nigerian Capital Market and evaluates the philosophical themes that underscore the chosen approaches and interpretation. It examines the formal approach to the definition of securities under the ISA 2007 and loopholes created. The second section explores the structure and content of the definition and how it contributes to the incoherence in the conceptualisation of securities under Nigerian law. It shows that understanding securities as an economic instrument goes beyond their labels. The third section explores the lack of proper qualification of instruments identified, lack of coherent definitional structure and lack of context as three elements that principally drive the incoherence in conceptualisation. It argues that these elements are not so much a feature that cannot be addressed by exploring the language and statutory connection, but the presence of formalistic template prevents such contextual interference. It relies on interview data to justify these positions and by so doing elucidate clearly the impact of the formal approach to poor product development and liquidity in the Nigerian Capital Market.
The history of securities in the Nigerian Capital Market is an intricate mix of political interference in legislation with its attendant effect on the evolution of several contradictory set of social formations that impacts legal rules and their application. At the heart of this unholy alliance is the increasing tensions between the objectives of a market and incentives the laws are capable of providing. These constraints place significant burden on markets and investors to fashion ways of navigating the potent disempowerment that results from weak structural situation of legislation to guide market activities. A critical part of this dilemma is the understanding of conflict between form and function in relation to the essential ingredients that constitute securities (negotiability). The limited subtlety in understanding has left a muse on the question of their relationship. This section addresses the conceptual framework of securities by explaining the conflict between the functional and formalistic interpretation of legislation through the entire history of securities in Nigeria.

4.1.1 Statutory Formalism in Nigeria

The regulatory model and concept applicable in Nigeria is Statutory Formalism. This is explored within the context of the language of the definition and structure of the definition in the Investment and Securities Act 2007. The legal structure of Nigeria’s definition of securities remains one of the inhibiting factors to its effectiveness. The absence of clarity with respect to the operating word ‘Means’ and components of the definition are key disincentives to the provisions and a vital source of incoherence. This has therefore made the definition extremely cumbersome especially when construed against the word ‘means’ which envisages certainty and exactitude. The section argues and goes further to show that the absence of definition for these operating words makes definition meaningless and difficult to interpret. Therefore, the structure of the Section 315 ISA provision and its practical application within the market in relation to practices in other advanced markets, show a significant disconnect in conceptual approach. This is evident by the following:

(1) The confusion with respect to the practical use of the definition’s operating words “issue”, “transfer”, “holding” and their justification within the market. On the basis of this justification, the comparison of their practicality with other advanced markets.

(2) Through the analyses above, the identification of commonalities and differences. As a result the concepts as used in the definition are considered to be insufficient and confusing at qualifying the nature and scope of securities. Therefore, has resulted in significant incoherence in the conceptualisation of securities.

(3) Consequently, drawing on the above aspects, there is the need to create clarity in concepts to support the development of a new model for Nigeria and West Africa.

(4) Section 315 does not incorporate Section 304 Part 2 of ISA 2007

It must be noted that the approach and definitional structure adopted in Nigeria has no replica anywhere else other than its slight semblance with the United Kingdom model. This presents

379 The United Kingdom has done a lot more to introduce some level flexibility to its model by cross-referencing other statutes and introducing flexible rules. The UK has also been able to create several interfaces between the FSMA 2000 and other Laws and Directives
significant problems for useful comparisons and precedent. Therefore this section identifies the operating components of the Section 315 ISA 2007 definition and addresses them distinctly on the basis of how other jurisdictions have utilised their effects to drive functional models.\textsuperscript{380}

The definition of ‘issue’ above means the concept of issue is effective on the basis of transfer of value. This clearly fits the intendment of the economic function of securities. However, reference to ‘Proposed Issue’ in the Act seems to present difficulties in interpretation. Although the Act has nowhere defined what amounts to ‘proposed’, it could be inferred that it may relate to intention to issue which could be ascertained from the circumstance of particular cases. Where this is the case, the modicum of context is activated. Such activity renders nugatory the effect of any formalistic approach which the structure of the definition seems to elevate. These contradictory nuances in the definition contribute to the incoherence in the definition.

“Proposed” in this sense may refer to a point between the Cum Right and the Ex-Right for the issue of securities this has not been made clear in the Act. What is certain however is a proposal to issue securities to transfer economic value in the form of tradable rights within a security. Those rights are however silent in this case of “proposed”. Where this is the case, the Act through that definition may be accused of having altered the legal nature of the concept of transfer which is generally seen a movement of value or notional value.

The question of ‘transfer’ which has nowhere been defined by the ISA 2007 is usually measured by assessing the interactions between positions and flows.\textsuperscript{381} This has been useful in gauging liquidity in the market. Liquidity measurement (which is a way of assessing the effectiveness of a security in the performance of its economic function is usually ascertained through positions and flows. Position refers to the level of asset and liability at any point in time. In accounting terms, this shows the transformation of instruments on the basis of “issuer” and “investor” actions. This is also the case of parties in a trading arrangement of listed securities. The position of the parties may be categorised as assets and liabilities on the basis of their investment decisions and legal interpretation of those decisions in relation to the structure of the financial instruments.\textsuperscript{382} Flow on the other hand, is the economic action and effect of events within the accounting period.\textsuperscript{383} In general economic flows are described as transactions or interactions between the institutional units that occur by mutual agreement and involve exchange of value. In other words, flow is a series of positions over a given time or changes of a series of positions over time. We must be careful not to confuse transactions emanating from issues flow with re-evaluation of existing issue.\textsuperscript{384} This therefore means an issue must be a new transfer and not subsequent transfer. The difficulties with this definition would arise where an issue is achieved for the purpose of redemption of instrument or done in fulfilment of

\begin{itemize}
\item \textsuperscript{380} Even the operating words in the definition of securities (Issue, Holding) when explored deeply neither clarifies nor advances the universally known concept of securities (negotiability, transferability). Rather it merely leads one to certain conclusion that the definition of security is with reference to certain instruments for the purpose of one-off payment
\item \textsuperscript{381} Bank of International Settlement Handbook on Securities
\item \textsuperscript{382} Scott T. FitzGibbon, ‘What is a Security’: A Redefinition Based on Eligibility to Participate in the Financial Markets, Minnesota Law Review 64, no.5 (1980): 893 -948
\item \textsuperscript{383} Bank of International Settlement Handbook on Securities
\item \textsuperscript{384} This is one area that is lacking in the ISA 2007
\end{itemize}
conditions for redemption of pre-existing issue.\textsuperscript{385} This makes the demarcation between issue and holding extremely important.

\textbf{The concept of ‘holding’} has also not been defined in the Act. The closest mention is where it is referred to in relation to a recognised exchange. The basic questions therefore are (1) what is the legal entitlement of the holder? Is the holder a trustee of the securities held or a buyer of the said instruments from the issuer on behalf of the investors? If the transaction is a sale, can it qualify as a true sale?

These questions strengthen the need to seek further clarifications from the Act on the relationship between the issuer and the holder. Since issue can be effective only on the basis of transfer as in this case, it raises questions about the nature of the said transfers. The wider point could then be the nature of legal relationship between the issuer and holder of which the Nigerian law has not provided answers. Therefore the solutions to the above questions could go a long way in validating the effectiveness of an issue in relation to the definition or conceptualisation of securities. It could also have implications on the changes in the composition of the financial assets held (increase or decrease in value as a result of changes in interest rate or exchange rate). For example, the upward or downward movements of interest rate could increase or decrease the value and in some cases the profitability of debt instrument that have either fixed or variable rates.\textsuperscript{386} Therefore the holding company is in a position to revalue its holding for gains or losses in relation to prices of securities.\textsuperscript{387} In the case of foreign currency denominated assets, the holding company is better placed to do this re-evaluation against the foreign exchange situation of a particular country.\textsuperscript{388} This raises the need for clarity within the definition of securities in the area of residency of issuer, place of issue or holding in relation to the nature of asset held.

Changes in physical characteristics of securities resulting from political events, destruction of ownership evidence, uncompensated seizures (where government or other institutional units take possession of the assets of other institutional units including non-resident units) without full compensation, for reasons other than the payment of taxes, fines or similar levels” may alter the holding structure. In the case of debt securities, changes in financial claims resulting from write-offs or unilateral debt repudiation may rupture the character of instruments held by the holder. These have not been catered for by the Section 315 ISA definition. Also, changes in sectorial structure and classification of securities as a result of changes in the legal status of institutional units,\textsuperscript{389} reclassification involving the movement of institutional units from one sector to another, or changes in the structure of institutional units themselves, giving rise to the reallocation of assets.

\textsuperscript{385} A classification and qualification of these terminologies need to be made
\textsuperscript{386} Lonergan Eric, ‘Interest rates are a spent economic force’, Financial Times, August 12, 2016 7:13pm, \url{https://www.ft.com/content/b9c48db8-6075-11e6-aef3-77baadeb1c93}; Michael Heise, ‘Monetary policy lacks the muscle to boost growth’, Financial Times, August 21, 2016 5:32pm, \url{https://www.ft.com/content/9b8fda66-11e6-8310-ecf0bddad227}
\textsuperscript{387} Miles Johnson, ‘Valuation investors have got it all wrong on US stocks’, Financial Times, September 1, 2016 5:00pm, \url{https://www.ft.com/content/d4db43a2-6f8a-11e6-ac9-1365ce54b926}; Nicole Bullock, ‘US stocks: a market that needs everything to go right’, Financial Times, September 1, 2016 12:20pm, \url{http://www.ft.com/content/d94116a-6fd4-11e6-a0c9-1365ce54b926}; Richard Turnbull, ‘US stocks need more than fumes to keep profit engines turning’, Financial Times, August 16, 2016 7:53am, \url{https://www.ft.com/content/0d945f3a-6379-11e6-8310-ecf0bddad227}
\textsuperscript{388} This is the case in practice
\textsuperscript{389} For example, from partnership to corporates and vice versa; government to corporate and vice versa
(which may cause the appearance and disappearance of certain financial assets); have not been catered for by the definition. When a Corporation ceases to be independent legal entities because one or more other corporation absorb it, all of that corporation’s position in terms of securities vis-à-vis the corporation(s) that absorbed it disappears. Its position in relation to third parties remain contentious especially where corporation’s price changes becomes another issue for recharacterisation. The question therefore remains as to the nature of relationship between the holder, issuer and investor.

One other clarity not provided in the definition which has implications for accounting is the failure to state the type of holding. There are several types of holding\textsuperscript{390} where assets are held to maturity and those where they are not. Both scenarios have legal and accounting implications. There are also valuation implications, especially where valuation at the point of issue is different from valuation at the point of holding. This also differs significantly when viewed against the type of product.

The above issues make it imperative for the definition in Section 315 ISA 2007 to clarify whether the ‘Issue’ referred to there are for newly issued shares or subsequently issued shares. This is especially important when viewed against product issue. For instance, the existence of scrip issue makes such character of Section 315 even more opaque. It raises the question of whether this issue is with regards to issue of new issue of new shares or reissue of existing shares by way of earning capitalisation (scrip issue).

The confusion inherent is the lack of clear definition on the concept ‘issue’ also plays out within the dynamics of products that are created through a series of ‘issuances’, technical redemption and holdings. These include structures like covered bonds, reverse transactions and stripped instruments. (a) The reverse transactions for instance, are arrangements that involve the sale or change of legal ownership of instruments, with a commitment to repurchase same or similar securities either on a specified date or with open maturity at pre-agreed price. Reverse transactions have two common characteristics:

1. A commitment to reverse the transaction on a specified future date or on demand
2. Although legal ownership is transferred to the purchaser, all risks and benefits of ownership remain with the original owner.

The problem here now results from the question of whether there is actual transfer of ownership and the place of redemption in this arrangement. This is important when characterising the relationship between “issue”, “transfer” and “holding” of instruments.

Reverse transactions include securities repurchase agreement (Repos), securities lending and sell/buyback transactions.

It is however noted that commitment to reverse the change in legal ownership in the future at a fixed price means that the original owner retains the risks and benefits of changes in the price of the asset. The lender or investor still receives the income yielded by the security coupon payments and dividends are passed on in the form of manufactured dividend. Accordingly, the economic ownership of securities provided under reverse transactions does not change because legal title and

\textsuperscript{390} There are several types of holding within the market. These include short positions, options, local or foreign holding or holding through PLC, Trust etc.
economic ownership are distinguished. This approach is only possible in the United States because of its functional legal structure that is flexible and context sensitive.

4.1.2 The Origin/History and Reason for Statutory Formalism in Nigeria

The development of the Capital Market in Nigeria has gone through several chequered stages commencing with the highly formalistic colonial government and culminating in this present stage of the process which adopts a mix system, although still heavily weighted towards form rather than substance. Each stage has been punctuated by various institutional challenges brought about by various internal and external influences. It has been argued that its creation in the 1940s was to assuage the perceived liquidity challenges experienced at that time in the colonial administration of their new conquest. This was against the backdrop of the paucity of revenue derived from the sale of agricultural products and the need to stimulate revenue mobility from public sector to fill funding gaps noticed from the lull in the performance of the private sector (which was largely unorganised). Both views however well-articulated, captures the implicit economic benefits derived from the colonialist and the people. At least, Nigeria presided over the first legal instrument of loan issuance to fund infrastructure within the country which created the framework for the development of other stages.

Stage 1 (1946 – 1956)

To achieve a burgeoning market that the government craved for, there was the need at first instance to secure funding for the development of key infrastructure necessary to run it. This required funding and technical know-how that was not readily available in Nigeria. The colonial government developed a 10 year plan pursuant to a highly formalistic Local Loan Ordinance (1946) to issue five year tenure Government Stock of N300,000 at 3% to be managed by the Accountant General (1956 to 1961). The ordinance empowered the Governor of the colony to issue 8 million pound loan in England and 1 million pound loan in Nigeria with repayment secured on Nigeria’s assets and revenue. This also included provisions empowering him to set up Loan Development Board (LDB)

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393 Esosa Bob Osaze (2007) supra
395 Such argument does not sit well with Peter Kilby’s characterisation of the object of the colonial activity at the time. He stated that the development of the infrastructure within Nigeria was to empower the local communities to raise finance for internal development.
396 Ihonvbere, Julius supra; Esosa Bob Osaze supra
397 This Development Loan Ordinance No 3 and the Nigeria (Ten Year Plan) Local Ordinance No 10 of 1946 where the legislative framework for the institutionalisation of the Nigerian Capital Market, created unidirectional opportunities; the Ordinance was highly formalistic and admitted no room for deviation. Understandably so, because the colonial authorities had command and control structures which permeated every instrument of governance to achieve its objectives.
398 This was the very first bond issuance in Nigeria – Esosa Bob Osaze (2007) supra
399 Development Loan Ordinance No 3 of 1946
400 To act as finance institution to cooperative societies and bodies that meet the requirements set by the Governing Council.
subject to approval of funds by the Nigerian Legislative Council. These loans were used to finance infrastructures\textsuperscript{401} within industries in the regions.

The planning as envisaged by the Ordinance fell below expectations due to multiplicity of agencies occasioned by the highly formalist command and control structure with limited flexibility built in. This created institutional overlaps, uncoordinated efforts and increased cost of project execution\textsuperscript{402}. Excessive top-down bureaucratic bottlenecks, impacted timely access to quality data to facilitate project success. This meant every action needed the setting up of agencies to administer them, since cross sectorial harmonisation was technically absent in a highly formalist structure.

**Stage 2 (1957 – 1959)**

Despite the failure of the first stage, the Ordinance supported a successful flotation of issued government stocks which gave impetus to expansion of the market. Management of the said stocks however had its challenges, especially as it bothered on conflict of interest emanating from duplicity in the role of the Accountant General, transparency flowing from non-disclosures of management failings with respect to the values of stocks and accountability issues\textsuperscript{403}. This led to the enactment of the 1957 Government and Other Securities (Local Trustees Powers) Act which created the position of Trustees for the purpose of managing securities. The Act specifically delineated the roles and responsibilities of the Trustee including funds which they are allowed to invest in. As a further measure, the government inaugurated a Market Development Committee chaired by Professor Barback. This committee was vested with specific objectives which included the expansion of the products within the market to especially infrastructure that can facilitate dealing in shares, a regulatory framework for share transfer and issuance of securities.

As part of the Professor Barback recommendation, a legislative enactment to regulate the activities of the Central Bank was necessary to complement the establishment of a robust securities/capital market and strengthen corporate governance. This led to the enactment of the CBN Act 1958, Loan Stock Act 1957 and the Statutory Corporation (Guarantee of Loans) Act 1959. All the enactment provided the necessary infrastructural framework for the capital market\textsuperscript{404}. These framework led to confidence in the market and increased issuance of securities therein (issuance of N2M Development Loan Stock and the first Central Bank of Nigeria Treasury Bills in May and April of 1959 respectively. These were used to plug short term liquidity problems by the government.

\textsuperscript{401} Public utilities, processing plants and cottage industries \textsuperscript{402} Falola (2004) Economic Reform and Modernisation in Nigeria 1945 – 1965. Kent State University Press page 106 \textsuperscript{403} Multiplicity of planning institutions gave rise to duplicity of roles, regulatory lapses and conflict of interest issues. The incidence that played out showed the impact of the formalist ordinance had even product that were developed in the market. Ihonvbere, Julius O; Shaw, Timothy (1998) Illusion of Power, Nigeria in Transition, Africa World Press page 28-30 \textsuperscript{404} This led to the issuance of the N2 million worth of Federation of Nigeria Development Loan Stock and the first Central Bank of Nigeria Treasury Bills in May and April of 1959 respectively. These were used to plug short term liquidity problems by the government.
Stage 3 (1960 – 1962)

In furtherance of the increased confidence in the capacity of the Capital Market to unlock investments potentials, the government encouraged the registration of the Lagos Stock Exchange under the Lagos Stock Exchange Act 1960. By this Act, members of the Exchange and the Central Bank of Nigeria were empowered to deal in financial asset. This led to the 1961 development of 19 different securities, 3 equities, 6 Federal government bonds and 10 industrial loans.

Issues around corporate governance and the need to create investment funds to support the market led to the development of the National Provident Fund which represented a type of pension scheme to act as guarantees towards retirement, cessation or loss of employment due to ill health/incapacity. This legislation also empowers the fund managers to only invest surplus funds on securities as provided by the Trustee Investment Act 1957. This led to significant problems with the demarcations of these securities when housed within mixed funds. There were challenges around delineation of funds for the purpose of compliance with the Act. The significant cost of compliance, potential loss of private sectors’ investment coupled with risk of commingling assets that fit or do not fit into the criteria as spelt out by the Trust Act, led to the 1962 restriction of securities within the ambit of the Trust Act to those issued on behalf of the government. This restriction reduced the market capitalisation and number of products that could be generated in the market. With the reduced participation came decrease in regulatory scope; hence the need to unify the regulators and the regulatory process.

Stage 4 (1962 – 1975)

In 1962, the Exchange Control Act and Trustee Investment Act which addressed the above also provided for the creation of a single regulatory body for the capital market. The advent of the single regulator led to a consolidation of the entire industry through the enactment of various Acts of parliament (The Borrowing by Public Bodies Act, The Companies Decree of 1968 and the Banking Decree of 1969). This was followed by the Nigerian Enterprise Promotion Decree 1972. The reason for these enactments was basically to create a formidable pricing system and timing in the issuance of securities (offer for sale or subscription) and creation of a single regular form of capital market. A move from Colonial legislation to Military Decrees may seem significant departure in governance approach, but the retention of the highly formalistic legislative language remained a key feature. The Military’s ‘Command and Control’ strategy introduced a stronger element and inflexibility.

Stage 5 (1976 – 1978)

A sudden change of government in 1976, led to significant shift in policy towards indigenisation as part of the recommendations of the Adeosun Industrial Enterprise Panel of 1975. The Lagos Stock Exchange was one of the first casualty as it was renamed the Nigerian Stock Exchange. From the development of the Nigerian Stock Exchange, 6 additional trading floors emerged. These include (Nigerian Stock Exchange, Kaduna 1978, Port Harcourt 1980, Kano 1989, Onitsha 1990, Yola 2002).

Further to this development, 1978 saw the emergence of the Securities and Exchange Degree which took over the role of capital issues commission on the recommendation of the Okadigbo Financial System Review Committee of 1976. This panel also recommended more than one exchange and

405 The rigidity of the Act made it difficult to envisage this challenge.
share allotment by SEC. This led to the issuance of the Bendel State revenue bond (7%, N20 million in 1978).

**Stage 6 (1985 – 1988)**

As a follow up to this expansion, the second tier securities market was set up on the 15th of April 1985 to cater for the SME sector. This helps improve the market especially with the flexibility in listing requirement and improved enterprise. The responses received led to the promulgation of the Nigerian Enterprise Promotion Decree 34 (known as Issue of Non-Voting Equity Shares).

The above development now empowered public companies in the NSE to issue non-voting paid up shares for subscription to portfolio investors whether in or outside Nigeria. The success of the above led to the extension of the remit of SEC by Decree No. 29 of 1988 to review and approve the mergers and acquisition activities by companies in the market. This reform however, necessitated the strategy of structural adjustment and increase in private participation in the capital market. To this end, government embarked on mass privatisation of enterprise the Federal government had equity interest in. Increased private sector investment created the need to develop systems to safeguard investment, improve monitoring of the financial system and insulate investors against default of banks. This led to the establishment of the Nigerian Deposit Insurance Scheme.

**Stage 7 (1990 -1991)**

This provision of safeguards also meant increased regulation of companies operating in the capital market. The Companies and Allied Matters Decree (now Act) was promulgated in 1990 to regulate the activities of companies from incorporation, management to winding up. Sections 541 – 623 were specifically inserted to cater for the administration of securities by the Corporate Affairs Commission. These provisions principally dealt with IPOS, securities registration, prospectuses, allotment, unit trust, mergers,, acquisitions, takeovers and restructuring. The highly formalistic nature and application of these legislations stifled markets, discouraged innovation and engendered sharp practices. Regulators were not empowered to sufficiently apply contexts in legal language and as such incapable of capturing these evolving sharp practices of operators.

Barely six months after the promulgation of the Companies and Allied Matters Decree, had it become evident that the current legal framework in the market was insufficient to sustain the liquidity. The increasing number of distress cases witnessed during this period was testament to that fact. In swift response the government promulgated the Banks and Other Financial Institution Decree (BOFID) No 25 of 1991 to cater for the banks and the entire financial sector generally. This was meant to insulate the banks from any possible distress contagion.

As a follow up to the above, the capital market was further urged by a committee of ministers to halt the establishment of more Stock Exchanges and official pegging of securities prices. This was coupled with the fact that it became obvious that the Central Bank was ill equipped to carry out regulation of the financial market alongside monetary policy and fiscal stability duties. Consequently, the CBN 1958 Act was replaced by the CBN Decree of 1991. This created greater confidence in the market.

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406 Section 2 defined securities to mean property interest

407 Especially with banks engaging in risky behaviour in the capital market or the banks using companies or vice versa to engage in risky business within the market.
and led to the issuance of municipal bond (N100 million at 24%) by the Lagos Island Council. While confidence returned to the market, investors were not happy with the quality of practitioners and transparency of their respective roles. Capacity of operators was clearly an issue that needed to be addressed for the sake of investor confidence.

**Stage 8 (1992 – 1993)**

In 1992, there was the need to regulate the practitioners in the capital market to ensure their transparency and confidence. This led to the promulgation of the Chartered Institute of Stock Brokers Decree that made it mandatory for brokers to be screened, tested and certified fit to practice in the capital market. The entrenchment of capacity building within the market needed increased investment in infrastructure to support its activities. This led to the creation of a computer enhanced Central Securities Clearing System (implemented through Stock Exchange Management System) that supported immobilisation of share certificate.

The government in accordance with the recommendation of the panel finally unbundled the capital market and ended its pegged pricing of securities. As a result, issuing houses were vested with the timing and allotment of securities issuance (1993). Also in the year and as a function of increased confidence in the market, States began creating Trust Funds to improve the capacity of the market and shore up investments in their respective State.408 Expectedly, these legal developments happened under extremely regimented and formalistic structure.

**Stage 9 (1995 – 1999)**

To further boost the market and prevent systemic shocks due to sudden capital flights and allay fears of portfolio investors with regards to safety of their investments, there was a need to guarantee ease of fund transfer into and out of the country through authorised channels. This led to the promulgation of the Nigerian Investment Promotion Decree No 16 of 1995 which empowered foreign investors to transfer dividends and net profits in respect of investments, payments of loans obtained in foreign financial institutions, remittance of net proceeds of investments in the event of liquidation of the company.409 The lack of flexibility discouraged investment transfers within the market.

The weak momentum witnessed in the market despite huge investment in legal reforms led the Federal Government to constitute the Odife Panel (19th March 1996) to understudy the market and recommend to government the best way to improve its performance.410 Members of the panel included Chief Dennis Odife as Chairman, Otunba Ogunde, Dr Ahmed Abdullahi, Alhaji Baba Danbappa, Prince Lekan Fadina, Mr O. Abiose and Mrs A Lashmann (secretary). This committee was tasked with terms of reference which included

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408 Kaduna State for instance – Kaduna State Revenue Trust Fund under the NSITF due to the repeal of the decree creating the National Provident Fund.

409 The effect of this 1995 decree repealed the Exchange Control Act of 1962 and the Nigerian Enterprise Promotion Decree of 1989 which added further incentive to the government’s encouragement of foreign capital and support for domestic savings and investment.

410 There was significant hesitation on the part of foreign and local investors to commit to the Capital Market.
1. A review of the capital market in its current state at that time and advice government on its contributions to economic growth.

2. Assess the objectives of the capital market with a view to identifying its continued relevance to the future needs of the country; suggest ways the capital market can contribute to the anticipated growth trajectory of the country.

3. Study the current performance of the capital market and recommend the best possible structure that can guarantee it organically comfortable growth.

4. Assess the adequacy of current structures in place side by side the current economic growth trajectory and recommend ways forward.

5. Review the relevance of all current laws and regulations in place, suggest ways of strengthening and incorporate them into a single document applicable to every transaction in the market.

6. Recommend ways of improving the institutions and frameworks that run the capital market to make them relevant to the needs of the governance units within the country.

7. Review the current structure of the Nigerian Stock Exchange and their relevance to the privatisation programme of the government.

8. Assess the current regulatory framework, systems and process to understand their fitness of purpose, to recommend ways the capital market can be structured to boost performance and meet the demands of all investors.

9. Advice on the best method to develop an adjudicatory system within the market to determine disputes arising therefrom (inter-se or among operators).

10. Recommend the best method and sequencing of support by government to the capital market to guarantee optimum performance.

11. To make other recommendations they consider expedient to ensure effective alignment with the development thrust of government.

Stage 10 (1999 – 2009)

The final report of the panel was submitted to government on the 24th of September 1996. This led to the enactment of the Investment and Securities Act 1999. This Act became the single document for the regulation of the entire Nigerian Capital Market and its products. It created a governance structure with the Securities and Exchange Commission (SEC) as the apex regulatory body of the market. The Act also empowered SEC to register securities, prevent the issuance of unregistered securities and make rules to further its objectives. The language of the Act however simple, gave an indication of flexibility and opportunity for the exercise of wide discretion. There were challenges inherent in these broad responsibilities of SEC. This included limited human and

411 This legislation was actually promulgated as Investment and Securities Decree No 45 in 1995 but was made to have effect in 1999 as an Act of the National Assembly. In line with the recommendation of the Odife Panel Report, the ISA 1999 repealed the Securities and Exchange Decree 1998, Lagos Stock Exchange Act 1960, Nigerian Enterprise Promotion (Non-voting Equity Shares) Decree 1990, Part XVII of CAMA and Sections 21(2) of the Nigerian Investment Promotion Degree of 1995.

412 This reform process gave steam to other activities within the market including the launch of African Capital Market Forum to brainstorm on the likely modalities for the setting up of a Continent–Wide Capital Market, promotion of cooperation and exchange of best practices amongst capital markets on the continent. The Act empowered SEC to deploy the instrumentality of ‘registration’ as a control tool in the market regulation.

413 A community reading of Sections 32, 33, 44, 46, 52, 57, 58, 171, 172, and 173 of ISA 1999.
financial resources to provide sufficient protection within their areas of responsibility, the cost implications arising from complying with the enormous registration requirements and the perceived dangers inherent in the uncertainties or lack of clarity of these registration requirements.

These uncertainties emanated from the inconclusiveness of the parameters for delineating what or what does not constitute securities within the meaning of the Act. There were no clear guidelines in the determination of liabilities and responsibilities on the part of investors especially as it pertains to Sections 62 and 63 of the Act. Apart from securities expressly excluded from the provisions of the Act, it also emerged that there were securities within its reach but excluded by omission because of their relationship with expressly exempt transactions. The inability of the Act to envisage the myriads of products which fell outside its regulatory web culminated in the systemic crisis that disrupted the market especially within the Nigerian Stock Exchange (NSE) in this era. Even more problematic was the fact that SEC Rules lacked the capacity to insert or make non-registrable securities within the Act automatically registrable. Hence the structure of the Capital Market which included the NSE and other Exchanges engaged in all sorts of complex transactions (mostly by banks) outside the regulatory watch of SEC. The reform of the banking sector in 2000s led to fewer banks and increase in their size financially. Their strong balance sheets led to more capitalisations of the equity and federal government’s debt market by banks amounting to over 60%. This was further exacerbated by the perception that the NSE head was an appointee of the SEC Director General, increase in insider dealings and share price manipulation.

The reform of the market to promote collective investment schemes and corporate governance code were jettisoned, leading to systemic collapse of the market during the 2008 global crisis. A total of 260 persons and companies were prosecuted for insider trading and share price manipulation. This led to the resignation of the SEC Director General (Alhaji Al-Faki) in 2009 and replacement by Miss Arumah Oteh.

Within this period, the 2007 Investment and Securities Act repealed and replaced the 1999 Act in an attempt to correct some of the errors highlighted above. While majority of the provision existed with slight adjustments, the technical definition of securities was completely overhauled.

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415 Section 264 ISA 1999. Transactions engaged in by non-corporate, despite their relationship with corporate was inadvertently omitted from the Act. This left a window for market abuse, lack of transparency and accountability.  
416 The liabilities of investors hung on their ability to decipher what was registrable from a retinue of transactions.  
418 Rules 106A(iii) and 40A of the SEC Rules  
419 Abuja Commodity Exchange  
420 This made the capital market vulnerable to the risks of banks.  
421 Professor (Mrs) Ndi Okereke-Onyuike  
422 Alhaji Musa Al-Faki  
423 Section 314(1),(2),(3) Investment and Securities Act 2007  
424 Section 312 ISA 2007 modified the existing provisions of previous Acts passed during the course of history nd stated that such modifications must be in conformity with the provisions of the ISA in relation to Capital Market matters. These Acts include Trustee Investment Act, The Borrowing and Public Act, The Companies and Allied Matters Act, The Insurance Act, The Central Bank Act, Nigeria Social Insurance Trust Fund Act, Bank and
changes were brought about by shifting dynamics in the Nigerian economy and the need for realignment with the capital market.\textsuperscript{425}

The 1999 Act had presided over a catalogue of structural problems which included difficulties in intermediation and capital mobilisation owing to poor product availability in the market. The lack of diversified funding, mismatch of risks, made risk management and price discovery extremely difficult. Poor product availability was traced to disjointed macroeconomic variables and weak regulatory structure which in some sense impacted clarity in product categorisation. This led to disproportionate representation of sectors in the market despite the presence of a list of plain traditional instruments in the market.\textsuperscript{426} Whilst the non-availability of sophisticated products inhibited risk management, price discovery and transactional efficiency,\textsuperscript{427} little attention was paid to the contribution of definitional structure of securities in this regard. Understanding the letters and structure of the law is one thing, others include the nature and scale of the market, the level of government intervention, market structure and practices, the level of awareness by operators and the sophistication of market infrastructure. Therefore, an exploration of the language of the law must be contextual in nature to accommodate these internal and external influences.

This may have informed the use of ‘context’ in the definition of securities under the Investment and Securities Act 1999. Although Nnona\textsuperscript{428} strongly argued against its use on the basis that it promotes uncertainty in the legal characterisation of securities, its usefulness cannot be underestimated. The basis for such loose definition was actuated by a deliberate policy to leave the field of characterisation of these instruments unencumbered so that all sorts of instruments could emerge. The ability to review the nature of any instrument by considering the intention of parties and other surrounding circumstances promote the development of a robust jurisprudence in the area of product development, encourage the creation of a knowledge base in capital market activities, and guarantee investors’ confidence because are seen to be what they truly are.

The Section 264 Investment and Securities Act 1999\textsuperscript{429} only make an instrument registrable if it qualifies as a security. It defines securities as follows:

\textit{In this Act unless the context otherwise requires ... Securities mean:}

\begin{itemize}
  \item[a.] Debenture, stocks or bonds issued or proposed to be issued by a government;
  \item[b.] Debentures, stocks, shares, bonds or notes issued or proposed to be issued by a body corporate or incorporated;
\end{itemize}

\textsuperscript{425} Section 313(1)(2)(4)(6)(7) – Securities and Exchange Commission is empowered to make rules to complement the Act. This is to ensure the Act is continuously in tune with the realities of the market. What is however unclear is whether those rules also assume the supremacy status of the Act pursuant to Section 312 ISA 2007.

\textsuperscript{426} Other Financial Institutions Act, Nigeria Investment Promotion Act, Foreign Exchange (Monitoring and Miscellaneous) Act, Chartered Institute of Stock Brokers Act; Section 312(2)(3) ISA 2007 specifically makes the Investment and Securities Act 2007 supreme to all of the above named legislation on capital market matters, but subordinate to the Constitution of the Federal Republic of Nigeria 1979.

\textsuperscript{427} Capital Market Master Plan page 27 -29

\textsuperscript{428} Capital Market Master Plan page 30

\textsuperscript{429} Section 264 of ISA 1999 is somewhat different from the definition of securities under the Securities and Exchange Act of 1988.
c. Any right or option in respect or any such debenture, stocks, shares, bonds or notes; or

d. Any interest as defined in Section 106 of CAMA 1990;

e. Futures contracts;

f. Bills of exchange;

g. Promissory notes or certificate of deposit issued by a bank which has tenure of not less than 9 months.

The functional approach adopted in the Investment and Securities Act 1999 was cleverly interwoven with the Companies and Allied Matters Act 1990 which also defined Securities in Section 567(1) as follows:

“In this PART, that is PART A of this Act, unless the context otherwise requires, securities include shares, debentures, debenture stock, bonds, notes (other than promissory notes) and units under a unit trust scheme.”

These definitions had the advantage of placing the enumerated documents within a system that required further validation for the instruments to be certified as truly what they are and not merely addressed the basis of labels by contracting parties. It had a second advantage of enumerating those items that qualify to be considered as securities, subject to context. The presence of context opens the doors to the courts to explore the true nature of the instruments and set their yardstick for categorisation. The obvious absence of a clarifying yardstick on the face of this provision and dearth of case law on the issue opened the door for a myriad of criticisms. The definition was criticised as omitting note issued by government and could have not been read mutatis mutandis with notes generally. Although he tried to justify this omission by stating that notes may have been omitted because, they are considered as short term instruments. This did not prevent a wholesale reform of the definition in the 2007 version of Investment and Securities Act.

Section 315 of the Investment and Securities Act 2007 made drastic changes to the definition of securities by removing the phrase ‘unless the context otherwise admit’, changing the structure of the definition and including more instruments. Security is therefore defined as follows:

“Securities means:

a. Debentures, stocks or bonds issued or proposed to be issued by a government;

b. Debenture, stocks, shares, bonds or notes issued or proposed to be issued by a body corporate;

c. Any right or option in respect of any such debentures stocks; shares, bonds or notes; or

d. Commodities futures, contracts, options and other derivatives, and the term securities in this Act includes those securities in the category of the securities listed in (a) – (b) above

Although CAMA was enacted during the military era and emanated from a Military Decree, the effect of context may have been red herring. It was against the grain of other legislative language and government policies. The military command structure left little room for contexts.

The reason for such removal may have been because of what was perceived as failure of the ‘context’ or ‘functional’ experiment. It could have been easy to blame the functional system for the failure without an indepth study as to why it failed to achieve the needed purpose.

The use of the word ‘means’ is the first source of etymological confusion in the definition of securities under Nigerian law; it is unclear if it attempts to create certainty or make room for contextual voyage.
which may be transferred by means of any electronic mode approved by the commission and which may be deposited, kept or stored with any licensed depository or custodian company as provided under the Act.

This definition could be easily broken down into three subsets. First set looks at the instruments themselves that have been identified. These are debentures, stocks, bond issued or proposed by government and body corporate. Note that the difference between paragraphs (a) and (b) is with reference to government and body corporate. The only distinction between both seems to be the mention of ‘share’ in respect to body corporate. The second set of instrument refers to ‘any right or option with respect to instruments mentioned in paragraph (a) and (b).’ The third and final category refers to commodities futures, contract option and other derivatives with respect to items in paragraphs (a) and (b) above which may be transferred by electronic mode approved by Securities and Exchange Commission and which may be deposited, kept or stored with any licensed depository or Custodian Company as provided by the Act. The use of ‘or’ between paragraph (c) and (d) is instructive.

For the first category which highlights the instrument, the Act has not defined debentures, notes, bonds. It is unclear if this was deliberate. Reference to the Companies and Allied Matters Act further accentuates the incoherence in the definition for these products. Although the Companies and Allied Matters Act tries to define debentures as generally known as instrument that acknowledges indebtedness (debt instruments), their very nature as different from bonds and other instruments is very unclear within statute. The reasons for the omission to define bonds, notes, debentures in the Act could be deliberate because debt instruments are very dynamic and frequently overlap with equity products especially convertible instruments. Debt securities have some close affinity with money market instrument and there is a tendency to confuse one for the other. These are potential areas of conflict that require legislative and judicial clarity. Therefore defining these instruments expressly without set criteria create significant strains in market activities and innovation by market participants. It could also be argued that not categorising these instruments may have been done to create vagueness and flexibility required to provide sufficient dragnet to capture exoteric schemes and at the same time create the needed allowance for product innovation. However these contradictions as currently experience may inadvertently contributes somewhat to the definitional incoherence of securities. Even where ‘Shares’ have been defined in Section 315 of ISA 2007 to ‘mean a proprietary interest in the share capital of a body corporate and except where a distinction between stocks and shares is expressed or implied, includes stock’, such attempt may invoke greater controversy on the conceptual meaning of shares, nature of share capital and the capacity to own proprietary interest in company. Therefore, the definition of securities under Nigerian law is fraught with structural and conceptual problems militating against the opportunities inherent in these instruments to stimulate economic growth.
4.2 Identify and Discuss how the contradictions in ISA 2007 creates confusion and limits products development and invariably the expansion of Securities Market in Nigeria

This section explores the structure and content of the definition of securities and how they contribute to the incoherence in its conceptualisation. It shows that the understanding of securities should move beyond its labels. This requires a thorough appreciation of their contexts and qualifications to ensure optimal usage. There is a tendency to assume that combination of words in a definition has no direct impact on the overall meaning and message conveyed. Evidence however proves to the contrary; it now settled that a coherent definitional structure is a sine qua non for comprehension and practical application. Therefore, this section examines interview data from issuers, staff and solicitors of issuing houses, registrar, reporting accountants, bank employees, stockbrokers, trustees and trustees’ solicitors against data and information obtained from personal observation. This is to show that the formal approach adopted in the definition of securities contribute to its incoherence, irrespective of differences in the background of interviewees.

The Investment and Securities Act 2007 as a legislation covers various aspects of securities and the market. This law is administered by the Securities and Exchange Commission through its rules and regulations. It gives meaning to the Act and advances the objective of ISA.

The fundamental function of SEC essentially is registration of securities offered by issuers to the public. In essence, the combined effect of Sections 54, 55, 315, 75 and 303 ISA create a control system that manages public issue of securities in respect of which a proper prospectuses or allied document has not been filed with the Securities and Exchange Commission and registered by it.

Prohibitions captured in the above sections are broad and appears to create a blanket ban on public issue of unregistered securities. There should be a justification for the creation of necessary guidelines for delineating securities and achieving restrictions on these broad prohibitions. This is true given the limited capacity and resources of SEC and the need to galvanise same towards more productive specialised uses. There is also the need to ensure that requisite flexibility exist with respect to certain securities in terms of requirement for registration. There must exist therefore a business case for such exemption as is required in the usual dealing in securities within these spaces.

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434 Act No 29 of 25th June 2007 which repealed ISA 1999 and established SEC as apex regulatory authority for the Nigerian Capital Market. It also seeks to regulate market to ensure investor protection, reduce systemic risks; and create efficient and transparent market.

435 Section 1(1) (2) (3) and Section 13 of ISA 2007

436 The effect of Rule 279 of the SEC Rule also captures the import of this control element through registration at the point of issue.

437 Section 54(5) provides express prohibition. This provision is further extended by Rule 279 of SEC Rule to include more methods of offering and product categories but refers to public companies, investment trust companies, collective investment schemes, governments, government agencies and supranational bodies. Other categories of private companies or unincorporated entities are impliedly excluded by the provision. Paragraph (c) of the rule which prescribes the manner of offering of securities registered under paragraphs (a) and (b) also implied exclude private offering outside those categories thereof. However, exclusion from registration does not preclude the body or person from obtaining a certificate of exemption under Section 76 ISA. It is unclear whether the courts are bound by a certificate of exemption issued by SEC.
With respect to limiting the scope of registrable securities, this can only be achieved where there are clear guidelines for the delineating registrable securities from those not registrable. The question now rests on what those criteria are for distinguishing registrable securities from other forms of instruments within Section 315 ISA definition. A further question could be whether the fact of qualifying as security so-called, obviates any need to inquire about its registrability or registration status? There has always been the added challenge of what constitute registrable securities within the meaning of Section 315 ISA 2007 and especially when drafting prospectuses and other documents for the registration of securities. There is also the fear of liability for wrongful, misleading or erroneous content of prospectus and the risk of re-characterisation of non-Registrable ones are Registrable (Sections 85, 86, 87 of ISA 2007 and other Anti-fraud legislation). One wonders if the specific label of parties is sufficient to characterise these instruments without the necessity of context. Given the huge negative implications of getting it wrong, it has become imperative that clear guidelines be present in the Act to delineate the boundaries for securities and provide better guidance about products within and outside these purviews for the purpose of registration. This is also true with respect to exempt securities erroneously registered as non-exempt and vice versa. To reduce the complexities and narrow the scope of such critical part of this research, this section explores the above inadequacies within the purview of ISA 2007 by:

- Highlighting the challenges with the definition in terms of content and structure
- Clarifying possible boundaries anticipated by the Act and the difficulties in disclosing these delineation succinctly
- By looking at these instruments that are possibly included and excluded to identify areas that could potentially expose them to re-characterisation risks. This is with a view to highlighting transactions that could be considered securities when in fact they are not or products which have the character of securities but whose transaction disqualifies them as securities or where they are, it excludes them from registration.
- The conclusion

The approach to this debate first of all addresses the question of delineating the boundaries through a strategy of identifying what is generally excluded and narrowing down systematically to the least robust of the exclusions (i.e. looking at fully registrable securities but with exemption only with certain types of transactions). This paper attempts to explore all the angles captured within the ISA 2007.

Mr A. Inyang, a Capital Market Lawyer based in Nigeria and born into a family of stock brokers, traders, capital lawyers and investors leads the researcher on an ethnographic voyage into the intricate world of securities market, and its pockets of discordant socio-economic and political influences. With his twenty-three years’ experience in the Nigerian market, both as a lawyer and an active policy-maker, he has a firm grasp of the legal, political, social, cultural, historical and structural

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439 Rule 8 of SEC Rules tend to exempt certain instruments from registration. This only serves to distinguish registrable securities from non-Registrable ones. These registrable securities eventually turn up in both primary and secondary markets through issuance and listing. While this looks like a good way of ensuring accountability and transparency of instruments circulating in the market, the legal regime that should support such clarity operate within the sphere of form and not substance. This has made imperative for market practitioners to stick to labels thereby reducing that capacity to innovate.
issues with the market. He addressed the question of the inchoate nature of the definition by stating as follow:

“The definition of securities under the Nigerian ISA 2007 is influenced by factors that are essentially non-legal. The focus on the definition itself from the point of view of international best practice, takes away the cultural and religious differences in Nigeria. Certain instruments are undefined because of religious sensibilities. The politics of resource allocation and concentration of energies on the oil economy are at the expense of legal innovation and development. Politicisation of laws and rules making means the agents of enforcement remain subject to political influences. Jurisprudence suffers as a result.”

The rules and laws as it seems, are not the only victims in the politicisation and contradictory cultural emasculation of the legal process. Specific language of the Act with regards to the conceptualisation of securities is also very vague. This stems from the commencement of the definition with the word ‘means’, which clearly has etymological and cultural connotations. Even though that was intended to suggest some level of certainty, such expectation is illusive when weighed against the entire definition. The first incoherence stems from the reading of the word ‘means’ against a catalogue of instruments within the definition that were not expressly defined in the Act. Apart from shares that were defined in both the ISA 2007 and CAMA, the ISA has not expressly defined the debt instruments which were mentioned to include debentures, notes and bonds. Also omitted are derivative products like options, commodities futures and other derivatives. The definition captures what it terms ‘contracts’ without providing further details.

These instruments from a conceptual standpoint are not only meaningless, but also confusing. Significant overlaps currently exist among instruments that make them difficult to categorise especially on the basis of a single set criteria or what parties intended as distilled from labels. Therefore failure to create a framework from which these instruments can be properly delineated is both a transactional and conceptual risk.

The first point to note from the omission occasioned by the above is that the failure by the Act to properly define debt instruments within the ambit of the Act. This is a major source of incoherence and it goes further to question the legitimacy of agreements that are not catered for within the Act in view of absence of judicial interpretation. The important role debt instruments play in financing investments for instance; have wide implications for equity market and even money market. Investors are particularly interested in knowing the nature of rights created and the possibility of issuing subsequent rights on those instruments. The lack of identification and proper qualification of the rights warehoused in these products are inimical to the perceptions and desire to deal in them. It is important to clarify the sorts of rights that are acceptable with specific classes of instruments. Although domestic rules may vary this according to need, there is the need to have an overarching framework for identifying what is deemed acceptable in every circumstance.

440 It is not clear if this relates to the investment contract as in the case of the United States
441 Even if read in conjunction with Section 304 ISA 2007
442 The mere itemisation of several descriptive labels as securities, does not explain their function or purpose for the sake of proper identification. On factual and transactional basis, it is meaningless because it does not consider the economic effect of their application.
Debt instruments, for instance (notes, debentures, bonds) which have not been defined within the Investment and Securities Act 2007 should be explored to understand their true nature to assess and contribution to the incoherence in the definition of securities. The lack of classification of these instruments carries both real and potential risks. The real risks include limited clarity in their issuance and holding activities for data analysis purposes that is critical for fiscal and monetary policy formulation and implementation. Also the idea of qualitative categorisation invokes those rights of debt securities issuers which are in the form of indentures and covenants (i.e the default risk attached to debt securities) which represent credit worthiness assessed against ratings by Credit Agencies.

For the purpose of examining the rights conveyed through debt instrument, it has been argued that interest receivables constitute a property income for debt instruments. This raises the question as to which rights of this receivable interest is proprietary in nature. There is also a question as to whether such rights operate within the realms of property law? This absence of clarifications within the Acts or definition of securities raises potential risks for investors. It must be noted that even if receivable is seen as proprietary, can the interest rate on receivables also constitute a property or seen as having proprietary rights? Now looking at the instruments specifically, does the fact that interest rate are fixed or varied alter the proprietary character of debt receivables? These questions formed the basis of interaction with two groups of capital market lawyers. They were divided on the conceptual nature of interest housed within securities. Mr Adeboye and his group, who have an average of eighteen years practice experience in capital market activities, stated that:

“There were proprietary interests in these instruments. For debts, both the right principal and proceeds from interest rate are distinct proprietary rights in a debt investment. The character of interest rate does not affect its nature. “. “For shares, the right to dividend, residual rights and ancillary rights are distinct and separate from the proprietary rights warehoused within the instrument. However the nature of these rights is better assessed at the level of application. The various types of shares carry varied rights and exercise of these rights is contractual and dependent on the companies’ articles of association.”

While these views may represent the practical position with a lot of lawyers in the market, Mr Onochie and his group who are specialists and work as a solicitor to the Issuing Houses for thirteen years argue that even where the ISA and CAMA defines shares as proprietary, the incidence of that classification in practice is debatable. They say:

“In as much as the rules governing the rights of investors as well as obligation are provided for by contract and to an extent dependent on the type of instrument in issue, the laws do have a role to play. Even though ISA 2007 for instance defines shares as proprietary interest, such definition is not consistent in practice. The doctrine of specificity alters the very proprietary nature of these assets in several ways (1) the incidence of proprietary right is ownership. Ownership cannot be effective unless the actual item can be clearly identified and delineated. The absence of specificity leaves the rights or interests exposed to the vagaries of multiple claims in the event of solvency. (2) The unrestricted exercise of possession, withdrawal, tracing or creation of successive rights is incidences of proprietary right which can only be effective when asset is clearly identified. (3) The right to take legal action in respect of asset and be entitled to damages are incidences of this. The practical
fallouts have not been catered for by statutes defining these rights to property. Differences in the nature of securities do not change the character of property rights."

The views held by both sets of interviewees seem to paint diametrically opposite categorisation of the concept of proprietary right. It is even more worrisome that the Act or even the courts have been unable to clarify the exact meaning of this term.443

Mr A. Inyang gave a good example of when an equity product was developed and the regulatory agency approached for registration. “The question of proprietary nature of the instrument was not part of the issues I was engaged about during my visits. The concern was more about the name we gave to the instrument, rather than their interpretation of it.”

The Act only defines shares and ascribes same as carrying proprietary interest. Abugu444 identified securities as proprietary intangibles. For bonds, a line ought to be drawn between these instruments and other types of debts outside the labels that parties place on them. Sometimes the distinction between a loan and a bond becomes so blurred that context becomes extremely useful to demarcate them for regulatory purposes.

4.2.1 Bonds:445

Although not expressly defined in the Investment and Securities Act 2007, bonds generally represent long term debt securities that confer on holders the unconditional rights to fixed sum payments or contractually determined variable payments on agreed dates at interest specified interest rate. The absence of a statutory definition of a bond carries significant risks. Firstly, it prevents or discourages a conceptual enquiry into its nature thereby limiting the understanding. As a result, investors are weary of its use. Secondly, because of the existence of different types of bonds and the absence of statutory demarcation, little opportunity is presented to interrogate its differences, nature and use. The question on the nature and use of bonds put to a set of interviewees revealed some of the problems of formalistic approach to the definition of securities. Mr Abel Usman a staff of the apex regulator views bonds as “negotiable loans”. Mrs Nneka Obi holds an opposing view. She describes bonds “as negotiable debt instruments traded in an authorised exchange.” The difference in the views held by both parties is one of function rather than form. This explains the basis on which the researcher argues that a more towards functionalism is the right step toward understanding the components of securities.

4.2.2 Debentures:

Despite the statutory definition of debentures by the Companies and Allied Matter Act,446 the researcher’s interaction and observation of a team of investment lawyers, stockbrokers, registrar

443 Johansson, Erica supra page 170-173 describes proprietary right as pertaining to ownership of asset –page 172
444 Abugu E O. Joseph (2014) supra
445 The debt instrument is mentioned in the ISA 2007 but no effort is made to define it. In addition, the courts have not been given the opportunity to explore its true meaning and import.
446 Section 567 of CAMA 2004 which defines debentures as written acknowledgement of indebtedness by a company setting out the terms and conditions of indebtedness and include debentures, stocks, bonds and any other securities of a company whether constituting a change on the assets of the company or not. Sections 166-177 address issues relating to the debenture while Section 171-174 spells out the types of debenture.
and regulators were quite revealing. Their views of debentures were quite basic and formalistic. Everything seemed to point to the statutory definition and nothing more. The level of engagement with the interviewees continuously revealed that lawyers are strictly bound to the statutory categories and what it provided. Views on debenture are so strait-jacketed excessively procedural and points to the instruments as acknowledgment of indebtedness. In an interview with Mrs Osem ede Aigbokhian explored the substance of a debenture “as a debt instrument is one foot away from money market instrument. The nature of specific instruments and the effect it creates is critical to this understanding.” On the question of how this plays out in practice, she stated that most of it does not really find expression in practical terms because of the regimented legal guidelines on what debentures must contain. The critical question therefore is whether the interests or rights created by debenture are similar or different from those of bonds, notes and other debt instruments? If not, why? If yes, what is/are the basis?

Section 304 of the ISA 2007 and Part 1(2) of the Second Schedule to the ISA 2007 defines debentures as including debenture stock, loan stock, bond, other instruments rating or acknowledging indebtedness, not being instruments falling within paragraph 3 of the Schedule being loan stock, bonds and other instruments creating or acknowledging indebtedness issued by or on behalf of government, local authority or public authority. Section 304 Part 1(3) of Second Schedule ISA 2007

The provision above is very vague. It has not defined debenture specifically or disclose any criteria for its delineation. It also refers to ‘other instruments creating and acknowledging indebtedness without clarifying whether they are ejusdem generis or separate from the specifically mentioned instruments. The use of the word ‘OR’ makes this definition extremely unclear. This leaves investors wondering whether ‘OR’ in the definition should be applied conjunctively or disjunctively. Nothing in the entire provision of Section 304 ISA gives any indication of the strategic objectives of the provision. It is even more confusing where the said Section 304 ISA makes no specific reference to Section 315 ISA which is the definition section of the Act. A critical look at the preamble of the Act of the various definition sections within the Act make no provision(s) indicating that these Sections be read together. Also the continuous use of the word ‘MEANS’ equally makes it extremely difficult to input the application of other sections to Section 315 ISA 2007. The absence of court decisions in this area, even make matters worse. For instance, Part 2 of Section 304 ISA 2007 itemise activities constituting investment business. These include (1) dealing in securities, (2) arranging deals in investment, (3) managing investment, (4) establishing a Collective Investment Scheme, (5) engaging in other activities constituting investment business. Nothing in this section makes reference to ‘Issue’ of securities. Although ‘Offering’, ‘Buying’ ‘Selling’ were used, it may not have issuance. Also, there is no reference within the Act linking these provisions to Section 315 ISA 2007. Even where

These include Section 171 – perpetual debenture; Section 172 – convertible debenture; Section 173 – secured and naked debenture; Section 174 – redeemable debenture. The participant where strictly tied to either simple debenture which is akin to a loan from a bank or debenture by Trust Deeds pursuant to Section 183 CAMA 2004.

447 Section 304 Part 1(3) of the Second Schedule ISA 2007
448 Section 304 Part 1(3) of Second Schedule ISA 2007
Section 315 ISA 2007 defines ‘dealing in securities’, this provision is not coterminous with that of Section 304 ISA 2007.\textsuperscript{449}

4.2.3 Other Debt:

This is nowhere defined or clarified in the Act. For a definition that intends to maintain certainty especially with the use of the word “Means”, this presents significant conceptual difficulties. The use of the word “Other Debt”, cannot be interpreted to mean anything that has the character of debt because Section 18(3) of the Interpretations Act\textsuperscript{450} provides that “the word ‘OTHER’ shall in any enactment be construed disjunctively and not implying similarity.” This even raises more confusion with respect to instruments that are linked to existing debt instrument or recharacterised as debt.

As hinted earlier, innovations within the debt market has significantly altered the traditional nature of bonds, debentures and notes, to the extent that any formalist interpretation of these instruments may lead to regulatory and structural challenges. For instance, some debt instruments now have ‘Linked’ characteristics. They could be linked to equities or money market instruments. In such cases, clarity in their characterisation is extremely necessary. There are also cases where portfolios of loans passed through securitised structures assume the cloak of both debt and derivatives. It becomes difficult to untangle for legal, regulatory, accounting and tax purposes. These demarcations have not been provided in the Act as a market practitioner Mr John Nwaonu, an employee of an issuing house in Lagos, hinted in an interview.

“The traditional criteria for delineating debt instruments from others are changing but our laws are yet to take account of these. Before now, a bond is labelled and registered as such if the following characteristics are met (1) agreed and ascertainable sum to be issued, (2) board approval for bond issuance, (3) the coupon rate, and market to float all agreed. These make it a bond”. Mr Amarachi Oyewole of the Securities and Exchange Commission presented a view that seemed to capture the mood of his colleagues in the office by stating that ‘we are guided by law as to what constitute a debenture whether secured or not. CAMA has always been a reference point …’ “But for bonds, notes we will simply rely on what the parties have agreed in the prospectus but are guided by the general nature of debt which is that they must have interest rate tied to a desire to obtain investors’ funds for specific project”.

The views presented by the interview seem to capture the simplistic aspects of debt instruments, but neglect the exoteric part of them. Debt instrument have the capacity to comingle. Therefore

\textsuperscript{449} Section 315 ISA 2007 defines dealing with securities – ‘means (whether as principal or agent) making or offering to make with any person, or inducing or attempting to induce any person to enter into or to offer to enter into: (a) any agreement for or with a view to acquiring, disposing or subscribing for, or underwriting of security or (b) any agreement the purpose or pretended purpose of securing a profit to ny of the parties from the yield of securities or by reference to fluctuation in the process of securities”. Part 2 of ISA 2007 defines dealing in securities – ‘Buying, selling, subscribing for or underwriting investment or offering or agreeing to do so, either as principal or as an agent.” Part XIII Section 152 ISA 2007 defines dealing in securities ‘means doing any of the following things (whether as a principal or as an agent) that is making or offering to make with any person or including or attempting to induce any person to enter into or offer to offer to enter into any agreement for or with a view to acquiring, holding, disposing of securities or any other property or any agreement for the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities.”

\textsuperscript{450} Interpretation Act, Chapter 192 Laws of the Federal of Nigeria 1990

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delineating all securities instruments without identifying specifically the categories they belong to, create the risk of incoherence and ambiguity.

A staff of one of the foremost investment firms in Lagos states that

“We structure bonds, notes or debenture to carry the following features:

1. There must be coupon basis with a stipulated periodic interest or coupon payment regime during the life of instruments and principal, whether amortised or not, either at par value or deeply discounted or even index basis.
2. Intend that the product is to be issued in the market.

Once the product is developed in the offer document and presented for issuance and accepted by the registration. It is a security to us”.

Mr A. Inyang contributes to this point when he stated as follows “It should be noted however that legislative form may only serve to delineate mono-line instruments. Characterisation of hybrid instruments requires functional approach that is flexible and contextual.”

The data obtained from the interviewees reveal the dilemma confronting market practitioners in delineating the contours of these instruments. Apart from the issues of proper identification and delineation of these instruments, the personal interaction and observation of market participants reveal. (1) Limited clarity on the nature of rights conveyed by these instruments. (2) Limited clarity as to whether these rights can be created successively and whether the rights exist independent of one another. (3) Whether the rights created are all of similar character and transferability. (4) Where to draw the line between an equity interests and a debt especially where clarity is needed on the difference between a preference share and a debt.

4.2.4 Share:

Section 304 Second Schedule Part 1 (1) ISA 2007, defines shares as shares and stock in the share capital of a company. Section 315 ISA 2007 takes the definition even further and states the “Share means a proprietary interest in the share capital of a body corporate and except where a distinction between stock and shares is expressed or implied, includes stock.”

On the equity side, the Act only recognises shares. The nature and character of shares has not enjoyed the level of qualification that is desired other than an attempt to define what it means in the same section. Share under the Act means ‘a proprietary interest in the share capital of a body corporate and except where a distinction between stocks and shares is expressed or implied to include stock’. Firstly, the use of the word ‘mean’ also runs afoul of the definition that attempts to capture some level of certainty at the expense of clarity. To state that shares means ‘proprietary interest’ is an admission of certitude to the exclusion of other interpretative possibilities. Secondly, by ascribing shares to mean proprietary interest in the share capital of a company raises the following issues which to a large extent further compound the incoherence in the conceptualisation of securities under the Act.

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451 A staff of an Investment Firm
452 Section 315 of the Investment and Securities Act 2007 (Nigeria)
1. What type of proprietary interest? Is it with respect to tangible or intangible assets? What is its nature and legal effect? At what point do these rights or interests attach to the assets and how do they pass from one party to another?
2. By ascribing the features of property to shares, does that invoke the incidence of property law?
3. If property law therefore does not apply, where is the place of contract and company law in determining the legal nature and effect of distinctly different slices of legal rights?
4. Where is the place of CAMA (statute) in all of this?
5. Can a shareholder or an investor in shares within the capital market acquire proprietary interest in the share capital of a company by virtue of purchase of shares in an authorised exchange?
6. Are shares fungible? Can individual investors acquire an identifiable piece of the share capital of a company by virtue of share purchase in an authorised exchange?
7. Does shares in this category extend to other equity types or merely restricted to company share?

These sources of confusion further heighten the possibility incoherence in the legal characterisation under the ISA 2007 and reinforce the need to tackle the conflict between form and function. Mr Enoch Oziegbe aptly captures the controversies when he stated his position as is unique to the Nigerian legal environment as follows: “The concept of property law has over the years been tied to land and physical assets; however CAMA and the ISA seem to have introduced the idea of property in intangibles. How this would play out in court is still unclear…”

The point raised by Mr Oziegbe above led to a series of disagreements in a group interaction with lawyers. Two prominent diametrically opposite views where held by distinct groups on the question of where true ownership (proprietary right) lies in an intangible dematerialised shares? The consensus was although CAMA and ISA say it exists, but the mechanics for identifying it is unclear. The same is true for other instruments, rights and options as captured in the Section 315 ISA definition.

4.2.5 Rights or Options in respect of Shares, Bonds, Debentures, Stocks and Notes:

Section 304 defines Options as ‘options to acquire or dispose of (a) investment falling within other paragraphs in the schedule; (b) currency of the Federal Republic of Nigeria or any other currency traded on the exchange and capital points; (c) gold or silver or (d) an option to acquire or dispose of an investment falling within this paragraph and by virtue of sub-paragraph (a) (b) or (c) of this schedule. Pursuant to Paragraph 7(a), the paragraphs of this second schedule are (1) shares: shares ad stocks in the share capital of a company, (2) debentures: including debenture stock, loan stock, bond and other instruments rating or acknowledging indebtedness, not being instruments falling within Paragraph 3 of this Schedule – (Paragraph 3 of this schedule being loan stock, bonds and other instruments creating or acknowledging indebtedness issued by or on behalf of a government, loan authority or public authority), (3) government and public securities: loan stock, bond and other

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453 Is it ownership or possession?
454 Enoch Oziegbe interview 2016
455 Second Schedule Part 1 – titled ‘Type of Investment’
instruments creating or acknowledging indebtedness issued by or on behalf of a government, local authority or public authority, (4) instrument entitling to share or securities: warrants or other instruments entitling the holder to subscribe for investment falling within paragraph 1, 2, 3 of the Schedule, (5) certificate representing securities: certificate or other instruments which confers proprietary right in respect of any investment falling within paragraph 1, 2, 3 or 4 of this schedule acquire, (b) any right to dispose of, underwrite or convert investment, being a right to which the holder would be entitled if he held any such investment to which the certificate or investment relates; or (c) a contractual right (other than an option) to acquire any such investment otherwise than by subscription, (6) units or shares in collective investment scheme: units in a collective investment scheme, including shares in or securities of an open-ended investment company or real estate investment company or trust, (8) rights under contract for the sale of a commodity or property of any other description under which delivery is to be made at a future date at a price agreed upon when the contract is made, (9) or any other forms of investment or capital investment within the meaning of investment generally.”

Even though the provision above seems to cover instruments identified in the Section 315 ISA definition of securities, they are however described as ‘Investments and Investment Businesses’ and not securities. Secondly, there is no visible linkage or cross referencing between Section 304 and Section 315 sufficient to draw useful connections. These are major gaps and a source of incoherence in the definition of securities in the Securities and Investment Act 2007.

Paragraph (c) of Section 315 ISA 2007 specifically provides or includes any right or option in respect of shares, bonds, debentures, stocks and notes as securities. A literal reading of this paragraph presents an attempt by the legislature to capture all associated trading rights, beneficial rights, underlying rights, contractual rights tied to the above named instruments under the definition. While this presents a piece of drafting ingenuity, it still carries similar defects of over formalisation of statutory definition of securities at the expense of clarity. First, it may be difficult to determine with sufficient certainty the rights that are tied to the above named instruments when the nature of these instruments is unclear and incoherent. For instance, the ISA 2007 is effectively unclear on the position of linked notes especially where such instruments rest on borderline between a debt and what the Act seems to refer to as shares (which is still very much inconclusive). Where trading rights or beneficial rights attached to these instruments are intended to be issued or traded, does that in any way affect the characterisation of the principal instruments as security under the ISA? A derivative overlay on any of these instruments in the form of an option seems to have been captured here; it is unclear why it was further repeated in paragraph (d) of the definition.

The risk of asset commingling under this circumstance is not only apparent, but real. This has the potentials to limit the level of confidence, reduce trust and lead to a run on the market. As Mrs Audu Ibrahim (a stockbroker) puts it, “A share as it is defined in CAMA and ISA is what markets follow. There is no need to seek public opinion when we have been told what it is.”

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456 Open-ended investment company is defined by Section 315 ISA – ‘means a company with an authorised share capital and article of association which authorised the acquisition of its own shares structured in such a manner that it provides for the reissuing of different classes of shares to investors, each class of shares representing a separate portfolio with a distinct investment policy’. This is part of Collective Investment Scheme as described in Sections 153 and 154 of ISA 2007.
Secondly, and on the question of structure in relation to statutory language, the controlling element that connects instruments to the issuers is the word ‘Issue’. This happens to be the basis for which the legislator attempts to characterise securities under Nigerian law. In other words, these instruments are securities until they are issued or there is a proposal to issue them. Two key terms have been left undefined. The first is what constitutes a ‘Proposed Issue’ and secondly, when is a security deemed to be issued? These questions constitute a vital source of incoherence. The impact therefore of this legislative inadvertence or oversight is felt throughout the entire definition of securities under the ISA 2007.

In terms of structure this study attempts to examine the operating words on which the entire definition rests. This is with a view to understanding the basis and criteria for categorising these instruments as securities.

Firstly, the use of the term ‘Issue’ is a major source of controversy. This terms is not defined anywhere in the Act and court decisions. There is also a lack of basic distinction between the term ‘issue’ and ‘reissue’ which is essential in categorising instruments used in Open-ended Investment Schemes. The Act seems to have mentioned two issues, the first being ‘government’ in paragraph (a) and the second ‘body corporate’ in paragraph (b). These issuers have not been defined with sufficient clarity. On the first issuer, the type of government referred to in this case is largely unclear. We have local, state, national, regional and global governments on the one part and companies, partnership, trustee on the other part. It also fails to state whether the companies mentioned here include regional and global companies’ issue. There is the tendency to assume that Section 315 ISA reference to ‘companies’ is with respect to those incorporated in Nigeria under CAMA, however what is unclear is the status of subsidiaries of Nigerian companies and partnerships arrangements in other jurisdictions.

Secondly, the use of the word ‘OR’ is another subject of controversy. The statutory and literal use of this word has been conjunctive and on the basis of choice between two connected variables. However its categorisation and use under Nigeria statute is disjunctive. This is because the Section 18(3) of the Interpretation Act provides that “The word ‘OR’ in any enactment, be construed disjunctively and not as implying similarity.” The implications of such disjunctive interpretation are discussed below.

Thirdly, the question of rights as mentioned in the definition does not clarify if such rights also include obligation. The general attitude towards assignability of rights as distinct from obligation raises questions whether the distinction is worthy to warrant any differentiation. It is likely that any question of right could mean those legal rights that exist within and between these instruments. Even if one where to assume that to be useful in examining the provision to see the nature of rights

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457 Interviewees were divided on what in their view constitute “issue” and the difference between “issue” and “reissue”. There were significant divisions both in terms of grammatical function and conceptual feasibility.

458 Sections 315 ISA 2007, Section 153 & 154 ISA 2007

459 Although Section 152 of Part XIII of ISA 2007 defines issuers to mean - ‘The person performing the duties of a Manager pursuant to the provisions of the Trust Deed or other agreement under which the units or securities are issued’. It must be noted however, that this provision relates to collective investment scheme.

460 Section 315 only defines government securities

461 Interpretation Act Chapter 192, Laws of Federation of Nigeria, 1990

462 Within this chapter in pages 159 and 160
envisaged, the nature of these rights themselves are controversial. This was a subject of debate during an interactive session with interviewees. Two prominent but opposite views emanated from the discussions. The first was on the question of rights with regards to all instruments identified and whether it is possible to conclude that this right is by nature one and the same thread running across all instruments. This issue could not be resolved by interviewees as they could not provide any statutory or legal basis for their answers. The second question was with respect to the creation of successive rights and the capacity to maintain coterminous right on the same instruments cited in Section 315 ISA 2007. Both issues where left unresolved.

Fourthly, the reference made to ‘other derivatives’ is simply unclear. Derivatives in their character are a mix of rights and obligations. The mention of option seems to cater for derivatives generally and a school of thought holds the view that the entire gamut of derivative transaction is simply a series of options contract.

It is surprising that property that characterise securities are not found in the instruments themselves, but seems to be tied to what the instrument is to be used for or the use to which the instrument is being put. Micheler distinguished ordinary securities from registrable securities. The basis for achieving registration is not extricated from the very fundamental characteristics that make it security. Registration may be for the purpose of accountability. The instruments, as it may seem, should satisfy the characteristics of securities because the need for registration is triggered. In other words, registration is not one of the ingredients that make a product qualify as securities. As Guillani maintained, the ingredients of securities are negotiability, transferability for the purpose of investment, what is however unclear is with regards to where such negotiability ought to be applied on these products in order to qualify as security. In other words, does it suffice to situate this ingredient within the primary market or both primary and secondary markets? Is it about the location of transfer or more about the inherent capacity of the instrument to be transferable?

In Nigeria therefore, an instrument seems to be securities only when it is issued. The question as to what constitutes an issue is not prescribed in the definition. Although Micheler seems to hold that it demonstrates an intention to trade or make the instrument available to circulate in the market. Such intention however is not conclusive, as can be seen from various issued instruments that exist within captive frameworks. The non-availability of a precise definition as to what constitute issue or proposed issue is a source of confusion in defining securities because an issue could be done for various purposes (i.e to raise funds to finance business undertaking). Secondly, the lack of clarity on the question of ‘issue’ does seem to demarcate between new or initial issue and seasoned or successive issues. An examination of the statutory meaning of the term issue throws up requirements in the prospectus. The absence of a special technique to clarify the nature and extent of information that it should entail therefore, is a source of worry. An isolated reading of the term would lead to manifest absurdity because of the various forms of issue identified above. These include ‘issue’, ‘proposed issue’ and initial and subsequent issue. There are structural difficulties in

463 Eva Micheler supra
464 Guillani, Castellano supra
465 Micheler, Eva supra
466 Section 78 ISA 2007 provides for subsequent issue within six (6) months on the basis of the initial prospectus. This has not been captured in Section 315 of the ISA 2007. Therefore, there is limited clarity as to what should happen after the expiration of the six (6) month within the meaning of Section 315 ISA 2007.
the inability to untie issues for the purpose trading and one which exist to pay for business undertakings. Nothing in the section seems to distinguish ‘issue’ from ‘listing’. It refers to ‘issue’ as the only doorway to securities.\textsuperscript{467} This is different in the United Kingdom as instruments in the Official List are registrable as securities irrespective of whether they were issued.\textsuperscript{468}

The process of issue is different from listing and both have their rules.\textsuperscript{469} The group interview could not come to the basic difference. These practical understanding was to the effect that the purpose of bringing products to the market, a securities cannot be listed without first going through the issuance process. Mr A. Inyang threw some light into the debate by stating that listing is for the purpose of trading, while issuance is for capital raising purpose. All the parties could not confirm whether securities could exist and be listed without first going through that issuance process. Generally, ‘issue’ is for the purpose of raising capital. The basis for such decision to raise capital and the use, for which such capital will be put, becomes relevant. Clearly the Section 315 definition does not clarify the purpose of issuance for which approval must be granted to characterise an instrument as securities for the purpose of investment. A chat with a member of staff of the Securities and Exchange Commission was quite revealing.

“We generally do not have guidelines on this particular question. Essentially, we look at the nature of instrument(s) created and what the capital is to be used for and the borrower”. “We also rely on the decision of the Corporate Affairs Commission if shares are to be issued. This is done by looking at the Articles and Memoranda of Association, and Board Resolutions”.

It was found that exploring the nature of the instruments themselves does not go far enough. The distinction between issue for the purpose of trading within a market and that for payment as part of business operation, raises a fundamental perspective on the delineation of the two types of securities.

“The basic difference as it seems between listing and issue is predicated on the market in which the instrument functions. Listing is for the purpose of trading in the secondary market. These are governed by listing rules. Issue is for primary market to enable public companies approach the public to seek funding. The law has not unified both methods, but practice seems to merge them for convenience. A practice which is unsupported by law is a source of worry to investors”\textsuperscript{470}

Fifthly, the use of the word ‘transfer’ seems to appear as a verb rather than a noun or adjective. It is not whether both terms are mutually exclusive. This has serious implications for the interpretation of the term ‘issue’. One wonders if it is all about an action, or the capacity to carry it out. Secondly, there is an ‘Or’ in between paragraph (b) and (c) of the definition.\textsuperscript{471} This raises two issues and produces many possible interpretations outside the contemplation of the provision which seeks to achieve certainty by the use of ‘means’. The first context is whether instruments issued automatically become securities by virtue of such issue. Views on this very question are divergent. Mr A. Inyang thinks that “once instruments are issued, they become securities automatically”. Mr

\textsuperscript{467} Section 315 ISA 2007
\textsuperscript{468} A process that has set the United Kingdom apart from other formalist systems in Europe
\textsuperscript{470} This view was also captured by Abugu E.O Joseph supra page 179
\textsuperscript{471} As highlighted above on page 157
Esele (a staff of Securities and Exchange Commission) takes a different view: “They are securities before the actual issuance. This is because the ISA 2007 says so.” Mr Oluniyi, Mrs Odofin and Mr Theodore Onu who are staff of Issuing Houses seem to support Mr Esele’s position on this issue. They stated “The disagreement over the question of when an instrument is a security, to some, may be academic given that the Act already say so. However, a careful examination of the provisions of Section 315 ISA 2007 raises several possibilities. But the view from position is that the ISA referred to the instruments as securities and we cannot change that position.” If this is the case, a possible question would be, where lies the distinction between instruments of payment and that meant for investment?  

The second context is whether the ‘Or’ in the end of Paragraph (c) should be read conjunctively or disjunctively from Paragraph (d) of the definition? Section 18(3) of the Interpretation Act provides that “OR” in any statute shall be read “disjunctively and will not be under any circumstance construed as similar. This throws up even more contradiction and implications as stated above. They include:

(1) Instruments specifically mentioned in paragraphs (a),(b) and (c) of the definition are securities irrespective of elements in paragraph (d). If this is the case, it therefore means the said Paragraph (a),(b) and (c) of Section 315 definition of securities present a confusing picture when read against Section 304 of ISA 2007 which referred to the same products as “Financial Instruments.”

(2) Since paragraphs (a) – (d) instruments are specifically mentioned in paragraph (d) but only where such instruments are transferred by means of any electronic mode, deposited and stored with a licensed depositary or custodian, it therefore means that instruments that do not satisfy the electronic mode requirement are not securities.

(3) It also means that instrument not transferred in electronic mode does not qualify within the definition of securities under paragraph (d).

(4) It means the “issue” as applied in paragraph (a), (b) does not apply to paragraph (d) this therefore means that instruments can be transferred, deposited and stored with the custodian without going through the process of issuance.

The effect of these implications is that no coherent definition of securities as distinguished from financial instruments and no coherent conceptual framework for the delineation of securities across the entire definition.

Even where it is meant to be read conjunctively, how much help does the verb ‘Transfer’ provide to the definition in clarifying the very nature of the instruments and providing a coherent framework for their characterisation? To what extent an action word ‘Transfer’ that seems to indicate a one-off

472 Issuance is meant to raise capital. The law has not at this stage stated what the capital is to be used for
473 Interpretation Act 1990 supra
474 The definition of electronic mode is not provided for in the Act, although Section 28 ISA 2007 made mentioned transfer of electronic form without a definition of what ‘any electronic mode’ means.
475 That is the term “Issue” is not linked to the other concepts “Transfer”, “Stored” and “Deposited”.
476 The choice of conjunctive interpretation could occur where the courts may attempt to apply the golden rule of statutory interpretation in circumstances where the literal meaning may lead to absurdity. This is unlikely in this case because of the inhibitions placed by the overly formalistic language of the provision itself.
operation support a descriptive colouration that words used in a definition ought to carry? The verbal connotation of Paragraph (d) seems to suggest that instruments become securities during the process of transfer. The policy basis for the choice is unsupported in the provision itself. Recourse to other paragraphs within the Act and Rules do not seem to provide clarity. The basis for this question and its practical importance is seen when a distinction is drawn between ‘transfer’, ‘transferability’ and ‘negotiability’. This confusion is further heightened when an attempt is made at distinguishing between ‘trading’ and ‘transfer’.

Transfer of instrument can be achieved within the primary and secondary markets through the use of different techniques and vehicles. It could be achieved by assignment, trust, novation, or through a more complex more of securities entitlement depending on the nature of contract. The one-off nature and verbal description of the word ‘transfer’ seems to suggest one of payment, rather than the circularity of these instruments which tend to promote and in very many respect distinguish instruments of payment from instruments of investment. In addition, the lack of clear definition of the term within the Act and Rules has created difficulties in appreciating their practical and theoretical usages. This is especially the case when weighed against the tendency to treat physical movement as constituting transfer.

The understanding of the nature of securities laws means that words used loosely, radically alters the purpose of the entire provision by creating conflicting signals. Within the context of the provision, the transfer of instrument is intended to be achieved through the instrumentality of the capital market rules and the ISA 2007. Where this is the case, several issues could emanate. The first is ‘Transfer’ is distinct from ‘Transferability’ and nothing in the Act seems to suggest that both are similar. If the argument on transferability remains hazy, it will be difficult to draw its close association with negotiability. Secondly, the purpose of the said transfer is also not disclosed. Clearly, there are distinctions between transfer for the purpose of payment and one for investment. Thirdly, the thresholds for such transfer, the nature of transfer, the vehicle used for the said transfer have not been disclosed. This shows the inchoate nature of this provision. Lack of clarity on the question of purpose, seems to have pervaded the entire provision and paled it into insignificance. This question of transfer led general discussion with about sixty-seven interviewees on different occasions to sample their views on the legal entitlement of the custodian in relation to the investor with respect to the securities. Thirty-four interviewees were of the view that custodian is a trustee to the investors with respect to those asset, while investors are beneficiary. The other thirty-three see the custodian as mere agent for the owner with respect to dematerialised securities. From observation, the nature and structuring of this relationship under Nigerian law remains extremely unclear. Mr Haruna posits that “One of the problems we have with understanding the legal entitlement of the custodian is with respect to lack of clarity as to the model currently adopted by

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478 One-off payment indicates a single payment for items purchased or services rendered. This has the regulatory effect categorising such transaction as payment and therefore outside the regulatory ambit of the Investment and Securities Act. In other words, the ISA 2007 was enacted to regulate securities as investment. Therefore any such transaction does not qualify as securities are automatically excluded for purposes of registration. The incidence of securities is that it must be structured in such a way that it is made to circulate continuously in the market for liquidity enhancement, capital formation and price discovery.
479 Such omission in the definition of the term “Transfer” has the capacity to blur the distinction between transfer for the purpose of payment and one which is intended for investment.
Nigeria. It is unclear if Nigeria has moved away from the English Trust Model”.\(^{480}\) Such difficulties now lead to challenges in the third contextual interpretation that may arise on the question of whether such transfer must be held by a custodian known to the exchange for it to qualify as securities. In other words, whether holding by a custodian known to the exchange is a material condition in all cases for an instrument to qualify as security? The lack of certainty and clarity in this interpretation throws up several practical and regulatory issues. These include:

a. Does it take a custodian to hold these instruments for them to be characterised as securities?

b. Does it matter that the custodian is a 3rd Party to the transaction?

c. What is the legal relationship between the issuer and the custodian?

d. Does it matter what the custodian does with these assets being held?

e. Does the activities of the custodian with respect to the asset contribute or factored into the characterisation of instruments held?

f. Does the provision attempt to reduce the position of a custodian to one of intermediary or promoters akin to the United States’ Investment Contract Test?\(^{481}\)

The fact that no clear answers have been provided to these questions, every attempt to conceptually and practically delineate instruments of payment from those intended as investment have been difficult. This lack of demarcation has created significant risk aversion to the market as the head of an issuing house in Nigeria aptly put it.

“The lack of clarity in this area has constrained operators to seek only those products that are simple and similar to those already known and approved”.

“We try not to be too ambitious in designing these products because the risk of getting it wrong far outweighs the benefits one may get from being innovative”.

“Investors are extremely sensitive in this clime. We try not to overstretch their appetite to engage us in the market”. “Investor education might help to increase participation. Trust is also a factor here especially given several market failures due to infractions.”

“There are greater incentives to operate outside the market than being in it. The decision to invest through the market must not be taken lightly”.

Apart from the views of operators in the market, personal observation revealed that even though there are incentives outside the market sufficient to discourage investment through products in the market. A sizeable proportion of investors in the market are those who are either well known international brands, or those companies in the oil and gas sectors, or those close to the government of the day and uses the market as a vehicle to access government patronage. This handicap has far wider implication for the capital market and the economy as a whole. The capital market should be a market place for investors to meet their investment objectives. It should support the economy with its intermediation role by allocating long term capital efficiently and effectively as Mr. A. Inyang puts it in the interview –

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\(^{480}\) Haruna interview 2016

\(^{481}\) Is this likely to be akin to the United States system where a promoter or intermediary whose expertise is factored in the characterisation of an instrument as securities.
“The Nigerian Capital Market has not been very prominent in playing its role in our economy because it is stuck to traditional practices, weak and politically weighty regulation, government patronage and mono-products like plain vanilla equities and government treasuries. These do not cater for the broad requirements of investors. We have been in situations where we have been constrained to realign investors need to what is available in the market rather than push the envelope for new products.”

4.3 The practicalities of the language structural incoherence

This section specifically discusses and in some compares the statutory structure of the 2007 Act and the 1999 Act to understand the implications of the word “Meaning” as used in the latter. Also an attempt is made to explore the nature of “Meaning” in the 2007 Act and how its impact shapes relationship between Section 315 of the Securities and Investment Act and Section 304 ISA 2007. The experiences of Mr A. Inyang are the prism through which the author navigates the legal terrain of law and language in the securities market. It forms a pivot to both explore the thought, process of lawyers and other market practitioners and at the same time validate or contradict the personal views held about the operations of language and characterisation in legal interpretation and application.

4.3.1 Language:

This study looks at the practicalities of language of the law and its effect, the combination and interpretation of language and their effect, the way language influences the structure of institutions and levels of legal compliance, and how the language of the law filters through into contracts that securities represent. An understanding of this effect would open a window to proper contextualisation of the formalist and functionalist approach to legal interpretation.

There seems to be no clear demarcation between ‘Securities’ and ‘Registrable Securities’ for practical purposes. Nnona examined the registration of securities from the point of view of section 264 of the 1999 ISA. While he attempted to demarcate the contours of instruments for the purpose of registration, the very ingredients that make them, securities were ignored.

In as much as registration still remains the control measure exercised by ISA to regulate securities there must exist requirements expressly or by implication to delineate what constitute securities from what is not. ISA Sections 75 expressly prohibits the transfer, issuance, sale, offering for subscription or sale of securities as defined by the Act. This raises the vital question of what constitute securities. Section 315 ISA 2007 provides a blanket rather than a specific definition of securities by simply listing what it means. This definition will be explored keenly to identify its scope and limitations.

482 Nnona supra
483 Section 13(c) ISA 2007
Paragraphs (a) (b) (c) of this definition were directly lifted from Sec 264 of the ISA 1999 with slight modifications. There were also difficulties associated with the interpretation of the section in the 1999 Act because of the absence of guidelines as to what creates or regulates the various context and frameworks used in the identification of context.

The removal of the phrase (unless the context admits) in the 2007 Act, even though leaves the definition with some measured certainty; there are obvious problems with the use of the word ‘meaning’ as replacement. It is unclear therefore whether ‘meaning’ within the provision means that no context is admitted or whether where it exists, it lacks criteria for rationalisation. In other words, could such limitations or restrictions placed by the word ‘meaning,’ absorb no extension to the definition that the Section gives to the definition of securities? It is however worthy to note that the nature of securities resist compartmentalised approach in the understanding of its scope and operations. There are potential challenges in this method as it runs the risk of excluding vital components of a security instrument by the mere fact of a crystallised definition. The practical challenges are herein explored in numbered paragraphs and in line with the manner the definition has been structured.

Paragraph (A) – Debentures, stocks, bonds issued or proposed to be issued by a government

Although this paragraph does not give full details of the government in question, Section 315 of ISA 2007 has defined government security to mean ‘security which are direct obligation of and guaranteed as to principal and interest repayment by the Federal Government of Nigeria or a State government’. While one might read the definition of government security as constituting or explaining this paragraph, reference was however not made to this paragraph in that section especially where it seems to have used the word ‘…issued by a government’, which could include government of Nigeria or outside Nigeria. The question of clarity in this area was a subject of disagreement amongst interviewees. While majority of opinion agreed that this question has never arisen within the context of work, given the size and non-sophistication practices in the market, this is a potential problem that could affect investors and operators as market begins to develop. Mr Onose agreed with Mr Inyang when he called this “An inconsistency time bomb that is self-limiting” “Who says we cannot open up our laws to accommodate a variety of issuers? Why is our law so limiting and closing the door to participation? Why is it so undemocratic? These statements explain the nature and capacity of legal language to create inactivity and curtail market participation. Such limitation extends from the issuers to the instrument themselves.

This paragraph, even though identifying debentures, stocks, bonds, has omitted notes. It is not clear why stocks are included and Notes omitted. There are uncertainties as to whether this suggests an

485 Removal of the phrase ‘… unless the context admits….’. this may be unconnected with the controversies associated with the interpretation of the phrase to suggest that different contexts exists in the interpretation of what constitute securities and that such context must admit for interpretation to exist (Nnona GC).

486 Nnona supra

487 This speaks to the etymology of language I explaining legal language

488 Securities that do not fit expressly with the definition of the Act are automatically excluded from registration requirement. This is however subject to passage by other uncertain criteria administered by the courts and Securities rules.
express exclusion of notes issued by government from registration. Nnona suggested that the Act might have read bonds loosely to include Notes. There is however no evidence to suggest this is the case because in paragraph (b), ‘bonds or notes’ was expressly mentioned. Even if wanting to suggest interchange-ability of both instruments, they were all the same captured in the paragraph.

A basic question could therefore be whether such omission might be attributed to the general feeling by the review panel of ISA that governments have limited appetite for notes issuance and therefore may have decided to exclude them all the same? Another suggestion is whether it was a deliberate exclusion as a quid pro quo to the government’s regulatory support in other areas of enforcement? The basis for highlighting this anomaly is in the challenge and inability to differentiate a bond from a note for purpose of registration. The discussion of Mr Aaron Ihide, a staff of the Securities and Exchange Commission is quite revealing –

“Notes generally seen as short term instrument and this reason, do not factor strongly on government investment horizon”

Exploring Mr Onose’s view in relation to that of Mr Inyang reveals a subtle disagreement. Apart from the fact that SEC seems to have no direct powers over instruments issued by government, the silence about notes with respect to governments is unexplained in the Act. Instead, the researcher observed that government places heavy reliance on government bonds and treasury bills to fund Nigeria’s current account deficit. This raises the question of whether the government could by this omission in the Act be underestimating the importance and potentials of notes. Again, could the law by such omission be inadvertently curtailing the development and growth of notes in the Nigerian market? These questions had no answers from the interviewees; however personal observation shows limited understanding of notes and their potentials within the Nigerian market.

Paragraph B – Debentures, stocks, shares, bonds or notes issued or proposed to be issued by a body corporate

This section deliberately includes notes issued or proposed to be issued by body corporate. It removed the word ‘unincorporated’ used in Section 264 of the ISA 1999. This thus suggests that the omission of note in paragraph (a) was deliberate and intended to be excluded from registration requirement. It also suggests that notes issued by government are distinct from notes issued by body corporate. It also shows that notes issued by unincorporated entities are also expressly excluded by the ISA 2007. This omission is further elucidated by absence of promissory notes, certificate of deposits and other interests defined by Section 106 of the Companies and Allied Matters Act 1990 as was the case in the ISA 1999.

It is clear that notes in this regard refer to those issued by corporate bodies. This therefore means that notes of unincorporated bodies are excluded but does not state what would happen in circumstances where the notes are issued by unincorporated entities with significant exposures to corporate bodies or vice versa. Section 315 of ISA 2007 has not defined incorporated or

489 The question of whether governments issue ‘notes’ and the cloud hanging around the Section 315 ISA definition that seems to define government securities without including notes, is an area demanding further exploration.
490 Nnona supra
491 Aaron Ihide interview 2016
unincorporated bodies. CAMA lays out the procedure for incorporation of companies and incorporated trustees in Part B and C respectively. What is however unclear is what unincorporated bodies entail. It is not certain if a partnership as incorporation where it is created to facilitate investments between two incorporated entities.

It is unclear if notes generally would include promissory notes. If it is the case, then one would further question the logic of its inclusion in paragraph (g) of the ISA 1999, despite the inclusion of note in paragraph (b) of the same Act and outright exclusion altogether from the 2007 Act. It is also not certain whether to draw a distinction between promissory note and government note since both are short term obligations and backed by either government revenue or banks with strict guidelines especially for the purpose of determining what is included or excluded from registration. These are the uncertainties that pose significant challenge to a regular determination of what is registrable as securities. It also appears that the parties issuing the securities under the 2007 Act technically determines whether such securities are excluded from registration requirements or not. This is especially true of paragraphs (a) and (b). This position is slightly different with respect to paragraphs (c) and (d). In other words, individual issuances are more likely to be excluded more than corporate and certain governments. It is unclear the policy justification for this. Nnona492 attempts to provide a policy explanation thus:

‘Since promissory notes and government notes are short term debt obligations issued by entities with the highest credit rating, government because they are backed by the credit of public revenue and banks because they are subjected to strict guidelines and supervision of the Central Bank, it thus makes sense to permanently exempt these securities from ISA registration by not including them ab initio in the definition of securities. In deed Central Bank supervision and prudential guidelines provide a regulatory regime for banks parallel to the regulatory regime for the securities administered by SEC. The supervision is aimed at ensuring the financial soundness of banks and thus provides some assurance to the investing public that the banks whose securities they purchased are not fundamentally impaired’.

Nnona493 should have at this point drawn a clear demarcation between exemptions as provided under Rule 8 of SEC Rules494 and outright exclusions. The lack of clarity in this area creates uncertainties that affect investment decisions.

There are difficulties in the wholesale admittance of individual/corporate criteria as the determinant of inclusion or exclusion from registration. This is because every corporate entity has individual components as its constituent and beneficiary.495 This exposes the fallibility inherent in hinging registration of securities on the balance sheet status of corporate entities alone. The several possibilities that exist with regards to the application and management of securities make a binary categorisation ineffective. Therefore, securities are an amalgam and conceptual embodiment of title and transactions existing side by side.

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493 Nnona supra
495 The doctrine of lifting the corporate veil articulates the usefulness of individual solvency in the determination of corporate solvency.
Figure 14 above shows the fundamental questions and problems that could arise when an attempt is made to categorise securities on a binary basis. This problem could be practical and conceptual. For the practical issues as observed in the field, (a) there is lack of technical clarity between transaction and security. This has accounting, tax and regulatory implications where an attempt is made to separate securities and non-securities proceeds and profits. (b) There are no delineating factors to separate exclusions from inclusions in the determination of transactions as distinct from securities. For the excluded securities, it is unclear the impact an included transaction would have on its excluded nature. (c) On the conceptual and more practical front, there is also uncertainty as to the exclusion nature where a duly authorised operator on a particular excluded security engage in an included transaction or unauthorised operator engages in excluded securities participate in included transactions. (d) There are also issues with respect to product not considered as security now used by either authorised or unauthorised operator in a non-exempt transaction. (e) For the non-exempt securities, the basis of the non-exemption should be clarified. There should also be clarity as to its nature where it includes either excluded or included transactions. (f) Finally, the issues around a comingling of non-exempt securities with exempt transactions carried out by either an authorised or unauthorised operator also needs exploring. In order to clarify these anomalies, it is important to put the concept of securities in perspective.
Paragraph C – Any right or option in respect of any such debenture stocks, share, bonds or notes or

This category does not seem to disclose the category of issuing party. It therefore means that it could be a segment that caters for individual issuance. The word ‘any right or option’ seem to have been omitted from paragraph (a) and (b). This was however captured in paragraph (d) that made reference to paragraph (a) and (b). Interestingly, such reference was not to securities as standalone but one transferred in electronic mode so approve by SEC and stored with licensed depositary or Custodian Company provided under the Act. It therefore becomes doubtful whether paragraph (d) only applies to (a) and (b) by reference to it being in electronic form only or inclusive of the form indicated in paragraph (c).

If the discussion above is anything to go by, there is then however, insufficient evidence to suggest that paragraph (c) refers to all categories of issuers. It is also unclear whether the provision applies to other paragraph specifically or collectively. What creates the level of confusion however, is the use of the word ‘or’ after paragraph (c). It is unclear if this used conjunctively or disjunctively. It must be noted that ‘or’ was not used in the preceding paragraphs. In the case of conjunctive construction, this could mean that the effect of paragraph (c) must be read into the meaning of paragraph (d) with the attendant confusion as to the absence of supportive linkage to justify a combined reading of both paragraphs. Given the unique nature of most securities, there is the temptation to read both paragraphs together in order to achieve scope and wider coverage of all securities, but such wholesale construction could potentially run the risk non-registration or over registration with all its enforcement difficulties. Also, if they are to be read disjunctively as the Interpretation Act seems to suggest, it will lead to even greater confusion because both segments of the provision run the risk of dismemberment. This means both segments of the provision will then be made to stand on their own weight.

Equally disturbing is the non-definition or description of the term ‘other derivatives’ as captured in paragraph (d). There is however no obvious explanation for such definitive omission. A possible inference could be the creation of a window for numerous guess work or assumptions as to what constitutes ‘other derivatives’ in order to cover the field. The problem seems exacerbated by the absence of securities specifically listed in paragraph (d) within the definition in paragraph (c). This is even where the nature of those described in (d) seems to differ considerably from the securities captured in paragraph (c). The result of such omission has led to two conflicting scenarios. The first one is whether paragraph (c) if read disjunctively is meant to exempt individuals from registration? If this is the case, it is therefore unclear whether such position is tenable when read conjunctively with paragraph (d). That is, would individual issue still enjoy exemption status where such securities satisfy the requirement of paragraph (d)? If this is the case, does it not bring individual exemption within the registrable category by virtue of the connection between paragraph (d) and paragraphs (a) and (b)? How can connections between paragraph (a), (b) and (c) justify the character of securities when “OR” is read disjunctively? All interviewees simply did not know the

496 There are no guidelines as to whether the words ‘rights or options’ can be used interchangeably or distinctively. One also questions the basis creating a separate paragraph for ‘any rights or options’. For example, the basis of capturing stocks as a registration where the right appertaining thereto is captured is unclear.

497 This question is raised because there are currently no qualifications within the Act to distinguish corporates from non-corporates.
likely effect of this lack of certainty in registration and exemption. Mr Adelaja’s comment stood out “In all honesty, I have never thought about this in my seventeen years as a lawyer in the capital market. The courts are yet to visit this area. This is a potential problem.”

Apart the obvious admissions by Mr Adelaja and colleagues, there are manifest practical problems with the confusion as to conjunctive and disjunctive interpretation of paragraphs (c) and (d). They include:

- Lack of clear determination of a coherent framework for the characterisation of securities under Section 315 ISA 2007.
- A shift from the functional to formal categorisation of securities issues especially where such securities are somewhat separate from the rights or options appertaining to them. This may result in confusion in terms of product and proceeds therefrom.
- The above regulatory distinction increases the understanding of the nature of securities but limits ones comprehension of the character and capacity of the issuers to manage them.
- The nature of registration and the status of successive rights that are subject of the instruments mentioned within the Act and where they arise are not clear.
- The formalist approach adopted in the Act now makes the exempt or non-exempt nature of individual securities even more confusing.

As stated above, the interpretive difficulties associated with the entire provision have registration and enforcement implications. This has therefore heightened the need to encourage robust characterisation of instruments to ascertain their true status to allay investors’ concerns.

The desire to achieve a well-rounded definition of securities and the perceived difficulties at sustaining an all-embracing definition within statute has necessitated judicial explanation of the concept. Investors, regulators and operators in the market have however shouldered the pains of lack of an all-embracing definition of securities especially given the heightened risk derived from the nature of securities. The potency of such dangers is made manifest where they seek access to funds of others in situations where the fund owners exercise no control over where their funds are committed.

The Nigerian court have not had the opportunity of attempting a definition of securities for the purpose of determining a framework of what is registrable from what is not. Even foreign decisions that enjoy persuasion status in Nigerian legal jurisprudence seem to be at crossroads over the same issue. The Supreme Court of the United States in SEC v W.J. Howey &Co attempts to clarify this point when confronted with the determination of whether a sale of plots of citrus groves to investors coupled with a servicer agreement between the purchaser and seller, amounts to a sale of an investment contract and whether such sale infringed Section 5 of SEC Act 1933 – which prohibits such sale without registration. The court defined an investment contract as ‘a transaction or scheme where money invested leads to expectation of profit solely from the effort of promoter or 3rd party’.

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498 Mr Adelaja’s interview 2016
499 Personal observation revealed that certificate of exemption is only issued on the satisfaction that the instrument meets the basic requirement for exemption. Issues around technicality of the Act in relation to the product is not addressed frontally
500 SEC v Howey 328 U.S. 293(1946)
However, a later decision by the same court Landreth Timber v Landreth\textsuperscript{501}, watered down its effect as merely a characterisation of investment contract and not securities.

From the foregoing, it is unclear how both cases clarify the unique nature of securities.\textsuperscript{502} This is true especially where a wholesale application of Howey’s case has the likelihood of different outcomes (while it has a tendency to include some product, others could be excluded). A mixed result from the application of this rule increases the level of uncertainty currently experienced. What is the likely outcome in situations where products encapsulated in Sec 315 meet the specification of Howey test but are excluded by virtue of the fact that the Act considers it not a security? What happens in situations where the Act considers a security as registrable but not covered by Howey test (as in the case of Notes)? Can SEC rules as subordinate legislation overreach the ISA on what amounts to securities for purpose of registration? These questions raise the issue of context which was present in the 1999 Act but removed in the 2007 ISA to relieve the provision of its restrictiveness (as was criticised). However, even with such removal, issues of context still surfaces especially where the determination of what is securities from what is not for the purpose of registration is clouded in uncertainty.

Nnona\textsuperscript{503} suggests that the usefulness of context as an interpretative factor given the unique nature of securities is to ‘provide a subsidiary mechanism for capturing items which though not formally qualifying as securities but implicate the very investment dangers for which securities are regulated’. In other words, Howey test would instinctively strike down a transaction as registrable even when not captured by the Act. Such an action has the potential of not just further tightening the regulation around securities (product), but also increasing the level of uncertainty with respect to what they court could likely strike down as registrable. Further difficulty essentially is with respect to the uncertainty and lack of clarity the Howey test criteria present. It would therefore be absurd that any contract which potentially has a third party benefit is automatically struck down as registrable. Also, Howey test did not draw the distinction between the types of issuers in the determination of what is registrable. This seems to have been left to the context of such transactions and discretion of the court.

With the emphasis on context by the court, it seems that statute merely abandoned the determination of context to the court. One wonders the benefit achieved from such abandonment. From the analysis therefore, the removal of the term ‘context’ has not simplified the definition of securities within the Act. It has only abdicated terms that should ordinarily secure a restrictive definition for a broader one while increasing the level of uncertainty within the statute and the courts.

So therefore, does taking us back to the definition of securities as those listed instruments and their derivatives issued by either corporate or government in paper or electronic form satisfy the intendment of the Howey test? In other words, are the courts free to re-characterise transactions as constituting securities under ISA notwithstanding they are unlisted or fall outside those listed in ISA

\textsuperscript{501} Landreth Timber v Landreth, 471 U.S. 681 (1985)

\textsuperscript{502} It does this by situating the character of securities within the realms of functionality and against set criteria. This has helped product development.

2007? Does the wholesale interpretative discretion granted to the court represent the usefulness or importance of context? Has the removal of the phrase from the 2007 Act achieved the purpose intended?

Nnona\(^{504}\) argues that issue of context is not just about the underlying reality of the transaction or investment in terms of the Howey test criteria, it also must be interpreted to take account of the relationship between investment, transaction and others elements not specifically mentioned in Sec 315 ISA 2007. If this is the case, there is therefore a logical case to assume that those other elements not mentioned in the Act as constituting securities are excluded for the purpose of the court. It is unclear if the courts will be willing to exclude simpliciter, even though the intention of the legislature in expressly mentioning some securities in the Act, discloses on their part, the desire to exclude those not mentioned from the definition of others. It is now becoming clear that context is material in determining securities especially where an extraordinary case has to be made for any novel securities that may be dissimilar to well established ones.

If the above is true, one wonders how paragraphs (a) are (b) are catered for within this scheme. Whether they can be read conjunctively to include this principle or disjunctively to achieve an acceptable premise? This raises further issues as to the nature of legal treatment especially where there is the absence of certain features and the court is called upon to expunge an aspect of a security as not conforming to the Howey’s Test. How then will the court accommodate semantic errors in its determination of items that constitute securities for the purpose of the Howey’s Test? Does the label that issuers place on the securities represent its true nature? What other guideline(s) is/are available to the court in making this determination? These are questions that came up during the interview session with recognition that the ISA 2007 cannot be of much help especially when it is far more recent and out of sync with CAMA 1990. Mr A. Inyang also recognised this challenge when he stated “I am not so sure of how the courts will interpret concepts, words, phrases and the entire language of the Section 315 ISA definition of securities provision. The opportunities opened to explore deeply what various concepts are about, seems to be unsupported by the provisions within the Act and other enactments. Mr Olawuyin, while agreeing with Inyang, made the suggestion that “At least reform is needed because investors want to see CAMA complement ISA to ensure market certainty and clarity.” Mr Ihide further posits that “It may be difficult to adopt a test at this stage. The system in operation will determine whether the Howey Test is suitable for the Nigeria investment environment. The basic requirement for registration and exemption are followed religiously and on instrument by instrument basis.”

It must be noted that such lackadaisical approach to managing the process reduces the level of understanding of the nature and capacities of these instruments, it limits the regulators opportunity to carry out effective regulation and oversight and in some sense understand the nature of exposure of these instruments. A look at certain products and transactions for instance, would give an idea of their legal implication when before a court.

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\(^{504}\) Nnona (2006) supra page 170
‘A house developer’s sale of property interests in a housing project to purchaser, with the expectation of financial returns to the purchaser through the active management of the project by the seller would not involve securities, given what has been sold are not stocks, shares, bonds, notes, future contracts or others as enumerated in Sec 315505.

What is however unclear is how the court would characterise a situation where consideration for the servicing agreement is in the form of equity in the housing project or a release on a prior debt obligation or a setoff of pre-existing obligation. Would the case be different if the exercise of the above servicing agreement is contingent on options tied to the housing project? This raises serious legal arguments. The graph below represents the nature of response received.

![Graphical representation of responses to practical application of Section 315 ISA 2007](image)

Figure 15 – Graphical representation of responses to practical application of Section 315 ISA 2007

Key to Figure 15 above

Series 1 – represents stockbrokers and staff of CSCS in the Nigerian Market

Series 2 – represents regulators of the Nigerian Market

Series 3 – staff of Issuing Houses, Trustees and Lawyers

Series 1 which is coloured blue represents

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505 My hypothetical example
This data shows in Figure 16 that the variability in views when it comes to interpreting the language of the Section 315 ISA definition is more pronounced with practical scenarios.

Considering the definition of securities and the view canvassed in data above, the court might have issues contending with interpretation especially where notes and other instruments issued by government or corporates are not covered or defined by the Act. This difficulty operates on the presumption that paragraphs (a) and (b) are read disjunctively.

There is another scenario ‘where a property company sells unit of stocks to investors with the stock being expressly stated to entitle the purchaser to no more than a right to personally occupy the allotted apartment, with the investor having no right to let the apartment to 3rd parties. The number of stock purchased by each investor is important in determining the size of the apartment to be assigned to him’. This circumstance has the same effect as the former where the Act is not so explicit about the characterisation of these instruments. Nnona⁵⁰⁶ argues that ‘notwithstanding the use of the term ‘stock’ here, the reality of the transaction is that it is no more than a consumer transaction in which the investors have no expectation of profit from the managerial efforts of another, but rather an expectation of use and enjoyment of a definite consumer item – an apartment. Therefore,

⁵⁰⁶ Nnona (2006) supra page 170
the use of the term ‘stock’ in these circumstances would be a semantic error and the court might want to strike it down as security under the Howey Test”.

From the above scenario, it is difficult to rationalise how expectation of use and enjoyment of premises cannot be quantified in monetary terms to sufficiently fall within the reach of the ISA’s registration requirement of items expressly listed as securities in paragraph (a) to (d) of the definition in Sec 315 ISA 2007. Indeed, the prospect of this happening seems less than the prospect of an item not included in the list being adjudged to be amenable to inclusion by virtue of the Howey test.

Excluded Securities

Even when it is established that an instrument is a security does not mean it is automatically registrable. This is because the ISA impliedly exclude certain types of securities, either by virtue of the issue or the very nature of the instrument itself. Other instruments may be exempted. It is important to understand the difference between exclusion and exemption. The differences are relevant because they go to the heart of what is a security and what is not.


The 2007 Act seems to have omitted these dichotomies, but rather remain silent over securities issued by bodies other than governments and corporate bodies. The express mention of these however should lead to the conclusion that others are excluded. This implied exclusion raises the following problems or questions:

1. Is there a difference between securities issued by individuals, partnerships and other unincorporated bodies and is this distinction relevant in the determination of the dichotomies between registrable instrument and registrable transactions? This question is important in the determination of context.
2. How can the exemption of securities issued by unincorporated entities or individuals be justified?
3. What is the nature of protection available to potential or current investors who have exposures to securities and transactions issued by unincorporated entities and/or individuals? Even if in such circumstances the anti-fraud provision takes effect, to what extent does the Nigerian anti-fraud law protect investors and provide for civil recovery?
4. Although CAMA limits the number of partners to maximum of 20, is there any legislation that limits the value of investment or exposures they are allowed to undertake or guarantee. In other words, when used as investment vehicles in structured deals, are there express

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507 There is nothing within the Howey’s criteria that makes the nature of proceeds of transaction the determinant for securities registration

508 Nnona (2006) supra page 170; Also Rule 8 of SEC Rules highlights securities that are exempt from registration.
limits to the value of business they can undertake? How effective are the anti-assignment (of partnership interest) clauses? Does this extend to other clauses that tend to prohibit the placing of such interests under trust, charge or lien?

5. The mere fact that partnership does not possess shares that are fungible or transferable does not preclude the sale of partnership interest or issuance of guarantee over and above threshold backed by interests in the partnership. In the above situation, where are the inbuilt legal safeguards to prevent abuse of exempt status by unincorporated entities especially when used as investment vehicles?

6. What about circumstances where the interests generated from an unincorporated issuer form the underlying security for further issuance by a corporate body or the corporate body acquires an exposure to this pool of asset? Even though one might think that their unlimited liability nature increases the due diligence threshold on their personal and joint financial muscle, however these days most vehicles are secured on the receivables of obligor and as such, the financial capacity of the partnership is never relevant. The absence of limited liability does not prevent the sale of partnership rights and interests. It also does not stop exposures to other assets through security, trust, guarantees, purchase of options and assignment. An attempt to limit the capacity to which partnership can accept value could disrupt the concept of overcollateralization of the Special Purpose Vehicle (SPV) in financing and risk management.

7. If these risks still exist, what then is the policy justification for allowing a sizable chunk of issuers escape the registration requirement?

8. Why is this low level of protection with ISA 2007 accorded to investors given the significant risk posed by the industry? This even becomes more dangerous where corporate or government investors hold securities of unincorporated entities. Does ISA 2007 provide protection and recourse to corporate or government issuers who have exposures to securities issued by one partner and confer them rights to claim from others if the first partner fails? Is the right and recourse to personal asset of partners automatic? Does it include commingled assets of partners and non-partners? To what extent then does Section 19 of CAMA protect investors?509

509 It is yet to be seen how the framework of CAMA 1990 synergise with that of the ISA 2007 to guarantee investors’ protection

175
4.4 Political Economy and Impact on Nigerian Securities Law

The Structure of the Nigerian ISA 2007 and Factors that contribute to the Formalist Structure:

An examination of the language of the law and the character of jurisprudence is embedded in the history that shaped its experiences. A discussion of these contextual issues that have contributed to the incoherence of definition of securities within the ISA 2007 cannot be had without exploring the political, social, economic and historical factors that have shape legislation in Nigeria (with securities law inclusive) and how the law function within this mix. Therefore, this section argues that language of the law is partly shaped by the historical context which has influenced and impacted both legal and non-legal theme. Generally, there are four main factors that have influence Nigeria’s legal structure, compliance and development. These include colonial experience, military incursion, ethno-rivalry/class competition, and religious sentiments. This section therefore assesses the impact of these factors on legal compliance and argues that formalism in legal design is a creation of the political class to facilitate and perpetuate its perchance for personal accumulation of national resources. This strategy has historical and political nexus.

4.4.1 Colonial experience: Political class and the Law

Historically, the area now called Nigeria was littered with empires of varied sizes and degrees of successes. The social economic and political institutions were unique and predominantly traditional. Each entity had distinct political systems in terms of structure and composition. A common theme of monarchy ran through all the systems that gave face to their cultural and socio-economic practices. Inter-trade (predominantly by barter), marriages and festivals, formed the core of their activities. The advent of colonialism altered these social-economic colourations and replaced it with an established economic system. With the creation of these economic entities dominated and controlled by the colonialist, the adoption of a new system soon gave way to conflict. A new system with radically different social formations filtered existing traditional nuances. This meant the collapse of pre-existing political structures, economic relations and production patterns. It also evinced a conversion of population towards production to meet the cash crops/export needs of colonialists while at the same time dismantling the indigenous trade networks. A new form of social structure emerged that took the form of new governments, new rules/regulations, new justice system, class differentials, spatial inequalities, and new patterns and modes of accumulation.

The fallout of the search for new identity by competing forces in the new formation, gave rise to the politics of domination and accumulation. The perchance for personal wealth was a sign of ‘masculinity’ and ‘becoming’ with which individuals gain acceptance into groups recognised as local elite. The new local bourgeoisie armed with little or no location in the productive base of the

510 Professor Ihonvbere identified four main features of pre-colonial state as (1) political structure of states, (2) political conflicts in the form of inter and intra state wars and elite power struggle (3) intricate trade networks and (4) myths, beliefs, values and norms as a means of social reproduction
economy emerged on the back of political patrimony and struggle for foreign capital. This group includes the intelligential who on the basis of shaky statistics, reel out policies without planning, prescribe economic priorities without including the concept of socio-rural development, recommend domestic production without strategy and maintenance culture.\textsuperscript{515} Development of institutions and industries were far from the template, as these components were outsourced and externalised. This meant that laws, rules and regulations were either undeveloped or hastily built on a top-down and highly formalistic framework so as to make compliance seamless and enforcement expeditious.\textsuperscript{516} Such power in its narrowly defined form was kept and concentrated in the hands of political elites who make laws and appoint officers of the law. Despite ideological differences that existed, a greater proportion of political opportunism was rife. Excessive corruption by the political elite soon gave rise to internal unease and resistance. As a result, the military successively overthrew civil governments, established military decrees and all together altered Nigeria’s legal and social experiences.

4.4.2 The Military regime and the law

The military bifurcation of Nigeria’s political economy and social experience threw a different mix into her legal culture and created a far greater formalistic monster out of the laws. This was made possible through the enactment of draconian Decrees. Legislation were based on ‘command and control’,\textsuperscript{517} and highly regimented. Even the language of the laws, diction, their interpretation and enforcement were militarised and subject to subversive politics. Almost every appointee within the legal hierarchy performed in a certain way to ensure continuous access to resources and retention of allegiance to the ‘client’. Decisions of courts and sometimes enforcement of clear breaches are wallowed over by all sorts of legal rationalisation. Dudley\textsuperscript{518} clearly identified the role of dominant politics in all aspects of Nigerian institutions, especially as its strength seems tailored towards individual accumulation rather than for the collective good. This is what may have informed the seeming shift from military in ‘Khaki’ to military rule disguised as democratic civil rule which is the prevailing state of affairs till date.\textsuperscript{519} Such change in nomenclature is not surprising considering how highly lucrative politics has become. The continuous appetite by the political class within the military to usurp democratic institutions and leadership constantly haunted the capacity to fashion out a pure legal culture founded on creativity and institutional independence. This meant that Nigeria remains a rentier state without the capacity to generate wealth. The fallout of this therefore is a

\textsuperscript{516} That is make the rules formalistic so that there is no room for ambiguity- that is, the law is what the letters of the law say it is and not what it ought to be.
\textsuperscript{517} The Companies and Allied Matters Decree 1990; the Investment and Securities Decree; the Enterprise Decree 1972 – 1977 – Professor Ihonvbere argues the Enterprise Decree Of 1972 -1977 for example had nothing to do with enterprise growth in Nigeria. In fact it was created to protect foreign capital and regulate its relation with local capital. He further submitted that the Decree only succeeded in facilitating and consolidating foreign domination of local market by cherry picking sectors, perpetuating Nigeria’s dependence on the capitalist model inherited from the colonialist, increasing the space for accumulation by the local elite and minimising areas of potential tensions between foreign capital, domestic domination and accumulation. He concludes that it all became clear that laws, interpretation and enforcement were not meant to advance the course of economic development, but to elevate the anarchic capitalist character of a rentier state.
\textsuperscript{519} This political group is now populated by retired military generals masquerading as new born democrats.
country that merely relies on commodity income, neglect productive sectors, ignore calls for human
capital development, outsource productive capacities and rely on inflows of foreign capital. Such
structure means that all sectors are locked into a political and economic cycle that is self-
perpetuating and internally injurious to the development of credible institutions. The weakness of
these institutions exacerbated the tenuous hegemony of local bourgeois of which law enforcers
form a vital part. This has created limited capacities for social and economic advancement
because low capacities within these institutions mean continuous reliance on foreign capital and
consolidation of control by foreign expertise. Apart from this external dimension to the twist in
political economy, the social sphere is plagued by internal wrangling and jostle for limited resources.
The whaling pursuits of opportunities have given rise to all forms of internal competition for
space.

4.4.3 Ethno-rivalry and the Law

The continuous competition for foreign capital, increase division in the ethnic rivalry, political
intolerance, nepotism, resource wastage and class competition. All these challenges meant no
attention was paid to the productive activities and development of institutions. Instead, the political
class saw government institutions as vehicles for patronage and personal enrichment. The local
political elite so content with the status quo has sustained this unequal alliance and made laws both
during the military and civil rule to protect themselves and gain superior access to petro-dollar and
foreign capital. This therefore meant that the Nigerian capital market became a conduit through
which the political elite access government patronage. Despite the ethnicity, religious affiliation
also presented a vehicle upon which the political elite and their followers negotiated support and
control of state apparatus in the internal struggle for resources.

4.4.4 Religious incursion, a new Political class and the Law

The introduction of religion into the mix further created a dislocation and widened the path created
by formalistic history and military bifurcation; an approach that meant that laws can no longer be
passed in Nigeria without considering religious sensitivities. This was especially so given that a
sizeable chunk of political elite are Muslims from Northern Nigeria and there was a need to guide
the law painstakingly and safeguard its provision sensitive imputations. Investment and Securities
Act is one of the greatest casualties of this formalistic influence. The idea that interest yielding
instrument could offend sharia was a great consideration in the formulation of a definition of
securities and by extension, product development within the capital market. Therefore, the capital
market seems to be a victim of the political power play of intensely divisive political elite in Nigeria.
Even the social agents like churches, mosques, traditional institution and Non-governmental bodies

520 There is the proliferation of primordial loyalties and degradation of institutions and social psyches through
nationalisation of economic policies to compete for petro-dollar and foreign capital. The politicisation of the
Police, Army, Judiciary and Anti-Corruption agencies compromise law making and enforcement.
521 This therefore means that design and interpretation of the law are at the behest of the overlord
522 The competition is in the form of ethnicity, tribalism, religious segregation
523 The fact the capital market is used as a conduit for political patronage can be seen in the reports leading to
the failure of Nigerian capital market between 2008 to 2010 where banks took centre stage in racketeering,
round tripping, insider dealings, foreign exchange manipulations through bureau de change and the
continuous funding of current account deficit by issuing government securities through the market.
that were once regarded as the bastion of purity are now conduit for personal accumulation. This is why Ihonvbere describes Nigeria as:

“A great promise and massive expenditure but disproportionately slim delivery and reliability; Nigeria a larger than life, but smaller than self-image; perhaps the analogy which best captures the country’s illusion is that of a masquerade: a traditional yet modernised public celebration involving disguised dancers and noisy musicians which frequently become coercive... it is called the Nigerian Halloween. Likewise the political culture and economy as a whole; the apparent masquerade of development, democracy and direction is a façade hiding real stagnation with consumerism, corporatism and arbitrariness: dreams rather than plans. The traditional structure of Nigeria, like its dance, has been fundamentally modified since independence without any widespread or sustained agreement on basic values and goals, despite years of military rule and then adjustment and reform... Therefore, development is undirected, sporadic and uneven. The masquerade has to be orchestrated if it is to be transcended and superseded, giving way to a less disorganised and more directed political economy in the twenty-first century.”

This call is not only apt, but extremely relevant, given the need to ensure laws put in place are sufficiently coherent to galvanise economic growth. The failure of Nigeria’s conceptualisation of security is not so much about the structure of the definition alone, but the absence of strategic fit between the definition and non-legal themes that supports its design and implementation. Therefore, the adoption of law on the basis of historical nexus does not guarantee it workability. It is also the case the sameness or similarity of legal provision does not mean similar outcomes. Therefore, the adoption of law on the basis of historical nexus does not guarantee its workability. It is also the case that sameness or similarity in legal provision The UK’s definition of securities bears some semblance with the Nigerian structure. Although not budged down by similar challenges plaguing the Nigerian model, the country has been able to develop and modify its model even further within the European Union regulatory structure to stimulate market development. Armed with a raft of EU Directives, Statute and Rules, the United Kingdom has been able to navigate the ocean of formalism in the EU to develop its own specie of formalism. The FSMA RAO has carefully harmonised provisions within the EU Directives and the UK Companies Act of 2006 to create some level of flexibility

From the foregoing, several gaps and inconsistencies can be identified. These include:

1. There are inconsistencies and conflicts between the ISA 2007 definition of securities and the categories excluded from registration requirement.
2. The distinction between securities and financial instruments within the Act is unclear.
3. There are inconsistencies in categorising shares of partnership outside the Howe’s test and the interpretation of stocks within the ISA 2007. The basis for such exclusion is unclear.

526 The adoption of Howey Test is nowhere reflected in Nigerian statutes, ISA 2007 or case law. There the suggestion of the Howey Test here is merely persuasive
4. The legal uncertainty inherent in the overreaching nature of SEC rules with regards to registration or non-registration and registration under the ISA 2007 and Howey’s Test. This has the effect of:
   a. Creating extremely elaborate disclosure obligations on trading and distribution activities with prohibitive compliance/documentation costs.
   b. Increases uncertainties in legal provisions on categorisation, exemptions from disclosure requirements with confusing overlaps, gaps and inconsistencies.
   c. It creates uncertainty in the relationship between disclosure requirements and anti-fraud legislation with attendant enforcement difficulties.
   d. Causes serious challenge in cross border application and enforcement of Nigerian securities law/rules that makes the capital market very unattractive to investors.

Summary

This chapter has presented the central arguments and identified the critical gaps created by the formalist legal design of securities law in Nigeria. This research commenced with a central argument around the question of why operators and issuers in the market are unable to leverage the potentials of the law to create investment products in the Nigerian Capital Market. It sought for answers by exploring the concepts that constitute securities universally in relation to how it sits within the Nigerian framework. The research found it inchoate. While searching for the extent of the incompleteness, the research embarked on a voyage into the history of securities law in Nigeria. It found that lack of uniformity and coherence in its underlying framework is inextricably linked to its formalistic structure. Therefore, drawing on interview data from issuers and market operators, the paper was able to demonstrate the connection between interpretative incoherence of the definition and conceptualisation of securities, and poor product development which has resulted in lack of market development.

By contrasting interview data from a number of operators and practitioners, this study explored the network of causalities to demonstrate how conflict in the structure and language of a definition of securities can radically inhibit its interpretation and by extension its utilisation for the purpose of product development.

The exploration of the structure and content of the definition, the following crucial data points revealed and supports the argument that formalistic approach to the definition of securities contribute to the incoherence in its conceptualisation under Nigerian law. They include:

1. What type of proprietary interest is warehoused within shares, bonds, debentures, notes and other debt instruments? What is their common nature and legal effect? At what point do these rights or interests attach to these assets? How do these interests pass from one party to another?
2. By ascribing the features of property to shares, does this invoke the incidence of property law?

527 The interviewees are from diverse backgrounds and different levels of competences within the market
528 The causalities include: (1) structural incoherence, (2) language and etymological incoherence (3) transactional and practical incoherence
3. If property law therefore does not apply, where is the place of contract and company law in determining the legal nature and effect of distinctly different slices of legal rights
4. Can a shareholder or an investor in shares within the capital market acquire proprietary interest in the share capital of a company by virtue of purchase of shares in an authorised exchange?
5. Are shares fungible? Can individual investors acquire an identifiable piece of the share capital of a company by virtue of share purchase in an authorised exchange?
6. Does shares in this category extend to other equity types or merely restricted to company share?
7. The increasing disagreement on whether more emphasis should be placed on function rather than form; especially given the lack of inter-connectedness between and within provisions in the ISA 2007.
8. What is the meaning of “Issue” and the purpose of the said issuance under this definition? How does this meaning explain or support an understanding of the mentioned instrument? What is the place of listing within the context of issuance? What is the place and purpose of the verb “Transfer” in the mix?
9. Does it take a custodian to hold these instruments for them to be characterised as securities?
10. Does it matter that the custodian is a 3rd party to the transaction?
11. What is the legal relationship between the issuer and the custodian?
12. Does it matter what the custodian do with assets in its custody?
13. Are the activities of the custodian on the asset in its custody factored into the characterisation of instrument as security?
14. Does the Section 315 ISA 2007 provision attempt to reduce the position of a custodian to one of intermediary or promoter akin to the United States’ Investment Contract Test Model (Howey Test).

Apart from the connection that has been drawn above between the formalistic languages of the definitional incoherence, this research also used a combination of personal observation, structured and semi-structured interview to support the argument that lack of conceptual coherence in the definition of securities contributes to low understanding of the products which in effect discourages their innovation. By exploring the practical application of securities in transactions, this study demonstrated through data, the tensions that exist between the practicalities of statutory language and the impact language structures have on institutional structures and legal compliance.

These stresses were unequivocally demonstrated in crucial data points that revealed the following:

1. Lack of clarity and demarcation between excluded securities and registrable securities
2. Uncertainty in the differences between excluded transactions and excluded securities
3. Lack of clarity between excluded securities and included transactions
4. Lack of certainty between included and excluded transaction
5. The incoherence in the conceptualisation of financial instruments themselves and the absence of nexus between the instruments identified in the definition and incoherent conceptual framework for their characterisation as security also made evident.
Conclusion

It is no longer in doubt that the legal philosophy of a country impacts its legal design and interpretative structure. This chapter demonstrates the inhibitions placed by formalism on the capacity of regulators to leverage the instrumentality of statutory language to galvanise product development in Nigeria’s capital market. It shows the effect a lack of conceptual or jurisprudential foundation has on the ability of market participants to generate investment momentum needed for economic growth. Apart from the lack of agreement on the basic components that constitute securities in the definition, the poor understanding of the operating words and language of the definition, prevent proper understanding of the concept.

To address these concerns, this research argues for a functionalist court-centred context-sensitive model for the conceptualisation of securities in the Nigerian capital market. Such an approach is not only capable of utilising the court system to harness empirical data for the purpose of understanding the unique contexts of every transaction and market; it also has the capacity to weave together other related legal and non-legal contexts to deepen the understanding of these products. This provides greater opportunity for the regulators to work with the market on a continuous basis so as to achieve effective regulation.

Furthermore, this research argues that uncertainties created by the definitional incoherence of Section 315 ISA with regards to securities, place significant constraints on their understanding which in turn limits the capacity of market participants to develop products in the market.

Finally, the effect of non-legal themes in the characterisation of securities is eloquent. The research found that apart from language/structural contradictions in the Investment and Securities Act, the absence of a strategic fit between the structure of securities laws in Nigeria and the non-legal themes are a major source of its definitional incoherence.

\[529\] The non-legal themes include history, politics, economics, socio-cultural and technology
Chapter 5 – Securities in Nigeria: Fashioning a Framework Part 2

5.0 Further digging into data

In continuation of Chapter 4, this chapter looks specifically into data generated from the internal participants'-led discussions, legal arguments and personal observation of contending views for and against the legal questions asked. Unlike the previous chapter which essentially relied on data to describe the inconsistencies, loopholes and difficulties created by definitional incoherence of securities, this chapter drills down to the normative arguments and legal technicalities that either stand in the way or promote transferability and circularity. Firstly, it commences by looking at four principal legal issues put forward to the participants based on a UK case of Secure Finance v Credit Suisse,\(^ {530}\) and from where several questions emanate. The choice of a UK case is informed by the following: (a) the absence of Nigeria case law on this issue due to the current statutory formalist adopted by the Nigerian system, (b) the persuasive effect of UK case law in Nigeria given her historical linkages and similarities between UK law and Nigerian law, (c) more specifically the similarities between the definitions of securities in UK law and Nigerian law.

The choice of UK case law is followed by detailed discussion on the basis of data obtained from interviews and personal observation. Secondly, the result is then analysed with literature review and objectives to arrive at a framework for the conceptualisation of securities in the Nigerian capital market. The interpretation of data obtained from group interviews conducted in March 2014, June 2015 and October 2016 where all the interviewees attended ultimately at different sessions, is achieved through analysis of direct quotes drawn from treatment of the hypothetical case. The attendees were lawyers and non-lawyers with different levels of expertise within the market. Researcher’s choice of group interviews was to provide opportunity for debates so as to effectively tease out the real issues and problems.

5.1 Summary of questions and response rate

Questions and responses received from the hypothetical case relates to issues about:

a. Specificity of instruments in the face of multi-layered intermediation and its legal effect on transferability and circularity

b. The legal effect of capacity within the purview of Agency and/or Trust relationships in the quest to ensure clean break (clean transfer or sale), transferability and circularity. The legal effect of Agency contract and Trust Deed in the market.

c. The legal effect of holder in due course within the context of transfer and circularity

d. Identification of borderline instruments and how their respective legal treatment constrains transferability and circularity.

\(^ {530}\) (2015) EWHC 388 (comm); (2017) EWCA Civ 1486
The Figures below represent a cross-section of interviewees:

**Figure 17 – Cross-Section of Interviewees**

<table>
<thead>
<tr>
<th>Category</th>
<th>Group</th>
<th>Number of Interviewees</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSCS</td>
<td>3 lawyers + 1 non-lawyer</td>
<td></td>
</tr>
<tr>
<td>Stock brokers</td>
<td>3 lawyers + 11 non-lawyers</td>
<td></td>
</tr>
<tr>
<td>SEC / NSE</td>
<td>7 lawyers + 1 non-lawyer</td>
<td></td>
</tr>
<tr>
<td>Custodian</td>
<td>5 lawyers</td>
<td></td>
</tr>
<tr>
<td>Sub-Custodian / Nominee</td>
<td>2 lawyers</td>
<td></td>
</tr>
<tr>
<td>Investor</td>
<td>10 lawyers</td>
<td></td>
</tr>
<tr>
<td>Banks</td>
<td>3 lawyers</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Category</th>
<th>Group</th>
<th>Number of Interviewees</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSCS</td>
<td>1 lawyer + 3 non-lawyers</td>
<td></td>
</tr>
<tr>
<td>Settlement</td>
<td>3 lawyers + 10 non-lawyers</td>
<td></td>
</tr>
<tr>
<td>SEC / NSE</td>
<td>5 lawyers + 4 non-lawyers</td>
<td></td>
</tr>
<tr>
<td>Investors</td>
<td>1 lawyer + 10 non-lawyers</td>
<td></td>
</tr>
<tr>
<td>Registrar</td>
<td>4 lawyers + 1 non-lawyer</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Category</th>
<th>Group</th>
<th>Number of Interviewees</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSCS</td>
<td>3 lawyers + 2 non-lawyers</td>
<td></td>
</tr>
<tr>
<td>Sub-Custodian</td>
<td>1 lawyer + 7 non-lawyers</td>
<td></td>
</tr>
<tr>
<td>Settlement Bank</td>
<td>6 lawyers + 3 non-lawyers</td>
<td></td>
</tr>
<tr>
<td>Custodian</td>
<td>6 lawyers + 1 non-lawyer</td>
<td></td>
</tr>
<tr>
<td>SEC / NSE</td>
<td>4 lawyers + 3 non-lawyers</td>
<td></td>
</tr>
</tbody>
</table>

5.2 Case Law

Secure Capital v Credit Suisse (2015) EWHC 388 (Comm); (2017) EWCA Civ 1486

Facts:

Credit Suisse issued two sets of Notes [Coupon Notes on the 21st July 2008] and [Zero Coupon Notes on the 25th August 2008] and deemed both Notes as materially on similar terms for the purpose of the court application. Each of the Note is also represented by a Permanent Global Security document (PGS) which makes the said Notes ‘bearer documents and negotiable’. The PGS further provides that the Notes are freely transferable by delivery ‘and such transfer shall operate to confer upon the transferee all rights and benefits appertaining hereto’. The PGS provisions were made subject to pre-existing conditions in the Programme Memorandum (PM), the Product Supplement and Pricing Supplement. The PGS was to be governed and construed in accordance with English Law.

The Programme Memorandum (PM) provides standard terms upon which Credit Suisse can rely in issuing Notes of various specifications and tranches. On this occasion, the Programme Memorandum made reference to possible existence of different tranches which together forms a series. With
respect to this series however, each Note as in one tranche equal to the total amount of the Note. The Programme Memorandum also provides as follows:

i. PGS must be warehoused with the Euclear (like the Nigerian CSCS) where account of each purchase of the Note is credited with a nominal amount for such purchase

ii. Securities are fungible

iii. Title is to pass by delivery to the bearer of the bearer security and holder of such security to be deemed and treated as absolute owner for all purposes

iv. Transaction to be governed by English law and jurisdiction of English courts

v. The Euclear should be the sole medium for the sharing of payments from the Bank in relation to rights emanating from Global Security. This however must be subject to the express procedures and rules of the Euroclear. This provision is what is called ‘No Look Through’ provision. This provision means that the PGS and the Global Securities itself is subject to the rules and procedure of Euroclear. *(This raises legal issues of lex situs – which brings to the fore the controversies whether securities is under property law, contract law or whether it exists as instrument of a special kind), (issues of conflict of laws, and (problem of intermediation).*

vi. Subject to express permission of Euroclear rules, the notes are tradable up to a limit specified.

vii. Where the Euclear is closed for a continuous period of 14 days or shut in perpetuity, the PGS is to be exchangeable as a definitive security which is to be enforceable as such and interests in the said Notes must be settled through the Euroclear.

viii. The PGS is also exchangeable for definitive security where principal in respect of any Notes is left unpaid as at when due by holder giving notice to the fiscal agent for such exchange.

The CSCS the Clearing House in Nigeria and based in Lagos, which was established in 1992, was set up to enable transferability and circularity of instruments in the market. For the purpose of this study, the researcher has developed a diagrammatic representation of flows within the market and the place of CSCS as captured in CSCS rules. The nature of flows in the market and the role of CSCS are herein described in diagram below:
The Euclear Rule provides as follows:

i. Rights within securities are electronically traded between members/account holders with Euroclear, rather than the securities themselves.

ii. Members/account holder can act for themselves or hold interests for clients who either hold the said interests for themselves or for their clients. So in this, Secure Capital (plaintiff in this case) as a member of Euroclear holds the interest for JP Morgan Chase Bank NA London.

iii. Given that these bearer note issuance are represented by PGS, issuer is expected to deposit same in depository for Euroclear as provided within the Notes themselves and the Agency Agreement, so that all interests within these Notes are managed within the Euroclear. So that the physical PGS stays with the common depository in an immobilised form in perpetuity.

531 Similar to Article 27 and Article 17 of CSCS Rules in Nigeria
532 Similar to Article 27, 28, 29 of CSCS Rules in Nigeria
iv. Issuer therefore makes payment towards the Notes directly to the Euroclear. Then the Euroclear thereafter makes payments from the received funds to members and payments by dealing members are paid to Euroclear. The Euroclear in turn pays the issuer.533

v. The purchaser of interest in Notes must have an account directly or indirectly with the Euroclear through its dealing member. Such dealing member’s account must be governed by Euroclear General Terms and Conditions and Handbook which provides inter-alia that it sees all securities as fungible. This therefore means that effective transfer to and from member is achieved through book entry on dealing members’ account. In this case, dealing members have no right to specific securities, but a right to demand from Euroclear a delivery of securities of equivalent status to that entered in the books.534

vi. The common depository is to support this process by receiving, holding the PGS in safe custody and servicing same on behalf of Euroclear.

NB: It is unclear what law in Nigeria applies to circularity and transferability of securities within Euroclear. Each note had a Price Supplement that clarified the life settlements and risks that formed the basis of investment. Although it set out the terms of the Note and general information, the Price Supplement did not provide details.

Both Notes were supported by a prior Agency Agreement between Credit Suisse and JP Morgan Chase Bank NA London and a Deed of Covenant done on the 2nd of August 2006. The Deed of the Covenant provided direct rights in favour of the ‘Relevant Account Holder’ against Credit Suisse.535 The Relevant Account Holder in this case is an entity holding a security account with the Euroclear in which there is an entry relating to the security. The Agency Agreement between Credit Suisse and JP Morgan Chase NA London (fiscal agent) and JP Morgan Luxembourg SA is to the effect that agents are expected to preside as paying agent over matters of issuance and administration of the Notes for Credit Suisse and deal with any payments, interests and generally report back to Credit Suisse. The fiscal agent’s duties536 are clearly spelt out in the agency agreement to include:

- Preparing the PGS and depositing it with the common depository with clear mandate to Euroclear to ‘credit underlying securities represented by the Global Security to the securities account at Euroclear on a delivery against payment basis’.
- In addition, the fiscal agent is authorised to ‘instruct the Euroclear to hold Notes to its order pending transfer to Euroclear account’. When it eventually receives payments towards the Note, it can then pay Credit Suisse.

The Deed which is governed by English law empowers Euroclear to acquire all rights of the security interest holder (both actual and prospective) if Credit Suisse failed to pay principal due on the Notes and the Depository (which is the holder of the PGS) give such default notice. There was nothing in the agreement that makes Credit Suisse liable for any breach with respect to term of Notes.

Secure Capital Limited as the plaintiff in the case claimed that Credit Suisse was in breach of its duty to reasonably ensure information provided in Pricing Supplements is true and not misleading. Secure Capital argued in the suit brought against Credit Suisse that the information provided in the issuance

533 Similar to Articles 17, 32, 41, 55 and 59 of CSCS Rules in Nigeria
534 Similar to Articles 23 and 24 of the CSCS Rules in Nigeria
535 The deed of covenant that empowers individual to enforce direct rights as if it was the owner of the asset
536 Similar to those captured in Article 57 CSCS Rules in Nigeria
document were materially inaccurate and misleading as the ‘mortality table’ which was used in estimating life expectancies, produced a result that over-inflated the life expectancies of reference individuals. This thereby rendered the Notes valueless. Pursuant to Article 8 of Luxembourg Law of Circulation of Securities 2001, Secure Capital sought to exercise the rights linked to the possession of the Notes including the right to institute and maintain an action for breach of the terms of the Notes.

Credit Suisse applied to the court for summary judgment and an order to strike out Secure Capital’s claim on the ground that Secure Capital is not the bearer of the Notes and not in any contractual relationship with Credit Suisse. Credit Suisse further maintained that Secure Capital is merely interloping in a contract it is not a party to and at the same time seeks to import a law that is foreign to the contract in order to achieve its purpose. He maintained that under Nigerian law, Secure Capital has no leg to stand on with respect to a contract he is not privy to.

This fact provides a rich illustration of issues around negotiability/transferability and circularity of securities. In view of the current fact that securities are now dematerialised, participants were firstly requested to identify the relevant legal issues in this fact.

1. In view of the capacity for multi-layers, multi-party and multi-jurisdictional intermediation of dematerialised securities in Nigeria, what is the legal effect of a contextual interpretation of ‘No Look Through’ provision in the CSCS rule and how can this promote or inhibit negotiability/transferability and circularity?

2. For the purpose of seamless transferability and circularity, are securities governed by law of contract or property law? If securities are neither contracts nor property, but statutory creation of a special kind for the purpose of circularity, what about ancillary instruments like Agency Agreement and Trust Deed that bring about their seamless transfers and circularity? Could they be described as contract? Are Trust Deeds and Agency Agreements also governed by special rules outside the law of contract and property law? Does the contract law foreclose the ultimate investors’ claim rights in cases of intermediated instrument? How does context clarify these?

3. In cases where the quality, quantity and interests within securities are so interwoven within multi-layered intermediation chains that it becomes difficult for the transferor to discharge its obligation to transferee, can contextual application of the law address this? How does context resolve holder in due course principle?

4. Given the lack of linkages between Section 315 ISA and Section 304 Part 2 of ISA, how does the legal treatment of borderline instruments constrain transferability and circularity? To what extent can contextual interpretation cure this?
5.3 Responses from Focus Group Structured Interview

5.3.1 The ‘No Look-Through Provision’, Context and Transferability/Circularity

The formalist structure of the market and which also shapes the characterisation of ‘No Look Through’ provision confront market participants on a daily basis. Reactions from market participants and regulators demonstrate the limitations occasioned by the definition of securities under Section 315 ISA 2007. No Look Through provision is a legal mechanism created as a result of dematerialisation and intermediation that ensures no privity of contract between investors and issuers. It also prevents any form of enforcement right between the issuer and investor. It therefore means that investor have no recourse to issuer except through the CSCS or account holder with CSCS.

As shown in the data below, the acceptance of context sensitive judicial functionalism has received greater recommendation as the only means to navigate the demerits occasioned by formalism on the No Look Through provision.

Figure 19 – Responses from interviewees on whether look-through support circularity/transferability

<table>
<thead>
<tr>
<th>Interviewee</th>
<th>Number of Interviewees</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>Q1</th>
<th>Q2</th>
<th>Q3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Custodian</td>
<td>6</td>
<td>2Yes</td>
<td>3 Yes</td>
<td>6 Yes</td>
<td>* Yes</td>
<td>* Yes</td>
<td>* Yes</td>
</tr>
<tr>
<td>Sub-Custodian</td>
<td>7</td>
<td>1 Yes</td>
<td>3 Yes</td>
<td>4Yes</td>
<td>* Yes</td>
<td>* Yes</td>
<td>* Yes</td>
</tr>
<tr>
<td>Registrar</td>
<td>3</td>
<td>0 Yes</td>
<td>2 Yes</td>
<td>2 Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Brokers</td>
<td>7</td>
<td>4Yes</td>
<td>7 Yes</td>
<td>7 Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>SEC</td>
<td>4</td>
<td>0 Yes</td>
<td>0 Yes</td>
<td>0 Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>NSE</td>
<td>5</td>
<td>0 Yes</td>
<td>1 Yes</td>
<td>2 Yes</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
<tr>
<td>OTC NASD</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>OTC FMDQ</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CSCS</td>
<td>3</td>
<td>0 Yes</td>
<td>0 Yes</td>
<td>2 Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
<tr>
<td>Investors</td>
<td>11</td>
<td>11 Yes</td>
<td>11 Yes</td>
<td>11 Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
</tr>
</tbody>
</table>

Figure 20 – Table of interview questions asked (Key to Figure 19)

<table>
<thead>
<tr>
<th>Questions</th>
<th>Details of questions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Question 1 (Q1)</td>
<td>Data on whether they think No Look Through provisions affect transferability and circularity</td>
</tr>
<tr>
<td>Question 2 (Q2)</td>
<td>Data on whether participants have legal ability to effect securities transfer in an atmosphere of formalist conceptualisation of transfer rules</td>
</tr>
<tr>
<td>Question 3 (Q3)</td>
<td>Data on whether operating words within legislation constrain the conceptualisation of securities</td>
</tr>
</tbody>
</table>
5.3.2 Form versus Function: The impact on the controversy as to whether securities is property or contract

To what extent does the formalism in the conceptualisation of securities make it difficult to determine whether securities is still categorised under contract law, property law or of a special kind. Does the presence of ancillary agreement like Agency Agreement and Trust Deed change the characterisation? To what extent can context sensitive judicial functionalism help in clarifying these confusion? Does ‘holder in due course principle’ have any role to play?

Between the period April 2014 to February 2017, market participants were engaged in group semi-structured interview, structured interview and series of personal observations and interactions. Out of 54 interviewees engaged in this research process, a total of 49 interviewees responded. In September 2015, a discussion as to what extent the ‘No Look Through’ provision undermines the very essence of dematerialisation and intermediation by insisting on the CSCS rules to govern transfer. This is reminiscent of Lex Situs in property law. 59% of participants believe that securities are contracts, while 36% agree that they are property. 5% of participants stayed undecided. The chart below represents the data.

Figure 21 – Data on whether security is property or contract

5.3.3 Judicial context-sensitive functionalism versus intermediation chains in furtherance of circularity

To what extent can context-sensitive judicial functionalist interpretation of rules governing intermediation chains promote transferability, negotiability and circularity? Naturally, a significant part of intermediation, circularity and transfer of securities happen within the market and most of
the time is governed by the CSCS rules. Therefore, the way and manner instruments are viewed by the CSCS is partly based on the nature and structure of their definition. Whereas, various participants have their views on the effectiveness of judicial formalism vis-à-vis formalism as a whole, the sum total of views weighed heavily in favour of context sensitive judicial functionalism.

The diagrams below represent data obtained from a cross section of participants from the market between 2014 and 2017 on the question about the best approach.

Figure 22 – Impact of Judicial Context-Sensitive Functionalism on Circularity

![Data on Approaches](image-url)
The result of this data explains the hypothetical case and how they reached these decisions. For Chart A, an average of 60% of participants wants the Context-Sensitive Judicial Functionalism, 26% recommends Statutory Functionalism, 9% wants Judicial Formalism and 5% makes the case for Statutory Formalism. More specifically as is the case in Chart B which covered the overall sectorial responses for the Context Sensitive Judicial Functionalism, CSCS accounted for 24%, Sub-Custodians 20%, Custodian 18%, Investors 18%, NSE 7% and Registrar 13%. Within the respective sectors, a total of 86% of CSCS staff prefer Context Sensitive Judicial Functionalism to other approaches. The same applied to 79% of Sub-Custodians, 78% of Investors, 73% of Custodians, 8% of SEC and 10% of NSE.

5.3.4 To what extent does the context-sensitive judicial functionalist conceptualisation of securities and legal treatment of borderline instruments promote or constrain transferability and circularity?

One of the most important discoveries in this empirical research is the role of language construction within statutory provision in the development or otherwise of instruments. In fact the relevance of the right operators and their locations within a particular provision affect their construction and meaning. This does not only in the understanding of these products; it also encourages their creation to meet diverse investment objectives.

In developing markets like Nigeria, rigidity in legal design and regulation pose significant challenges to product innovation. The straitjacketed nature of instruments is a function of the stiffness in legal language that enables their creation and adoption. This has precipitated the call for changes to legal in the structure and design of norms. The Table below shows ratios on the willingness of the market to adopt the context-sensitive judicial functionalism in helping to shape a flexible jurisprudence for securities conceptualisation and development.
Figure 24 – Judicial Context Sensitive Functionalism and Borderline Instruments

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Number of Interviewees</th>
<th>Responses</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>Variations in %</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSCS</td>
<td>3</td>
<td>Yes</td>
<td>10:0</td>
<td>10:0</td>
<td>8:2</td>
<td>10:1</td>
<td></td>
</tr>
<tr>
<td>Investors</td>
<td>11</td>
<td>Yes</td>
<td>9:1</td>
<td>10:0</td>
<td>10:0</td>
<td>10:0</td>
<td></td>
</tr>
<tr>
<td>Custodians</td>
<td>6</td>
<td>Yes</td>
<td>3:7</td>
<td>5:5</td>
<td>10:0</td>
<td>10:0</td>
<td></td>
</tr>
<tr>
<td>Stockbrokers</td>
<td>7</td>
<td>Yes</td>
<td>9:1</td>
<td>5:5</td>
<td>6:4</td>
<td>6:4</td>
<td></td>
</tr>
<tr>
<td>SEC</td>
<td>4</td>
<td>No</td>
<td>0:10</td>
<td>0:10</td>
<td>0:10</td>
<td>0:10</td>
<td></td>
</tr>
<tr>
<td>NSE</td>
<td>5</td>
<td>No</td>
<td>0:10</td>
<td>1:9</td>
<td>0:10</td>
<td>0:10</td>
<td></td>
</tr>
<tr>
<td>NASD</td>
<td>5</td>
<td>No</td>
<td>6:4</td>
<td>5:5</td>
<td>6:4</td>
<td>7:3</td>
<td></td>
</tr>
<tr>
<td>Registrar</td>
<td>2</td>
<td>Yes</td>
<td>6:4</td>
<td>8:2</td>
<td>6:4</td>
<td>6:4</td>
<td></td>
</tr>
<tr>
<td>Sub-custodian</td>
<td>7</td>
<td>Yes</td>
<td>5:5</td>
<td>3:7</td>
<td>10:0</td>
<td>10:0</td>
<td></td>
</tr>
</tbody>
</table>

Figure 24 above provides a picture of the current thinking of Capital Market operators in Nigeria. The data shows the increasing acceptance of a judicial functionalist approach as one sure way of facilitating product development in the Nigerian Capital Market. Despite incidences of protracted litigations, excessively procedural adjudicatory process and corruption in the system, there is a 68% variation in the view held by participants from April 2014 to February 2017. The positions of investing participants are radically different from views of regulators. This is presumably because of the positions they occupy and a clear desire to protect their spheres of regulatory powers. While as a regulator, there is the fear that judicial functionalism is likely to erode it. Similar opposition is voiced by the Self-Regulatory Organisations like the NSE, NASD and FMDQ OTC. Despite this opposition, the data show a positive shift in thinking and increasing buy-in by these regulatory bodies. The reason for this are: firstly, a proper examination of the rights and obligations of parties in line with the law, provides the basis to understand their effect in the market. This in turn influences the attitudes of operators. Secondly, the idea of a coherent test or standards for delineating the contours of these instruments helps in their classification and application with relative certainty, while providing room for innovation to meet diverse investment objectives. The choice of special courts with definite powers to act remains attractive. These views were also emphasised during the researcher’s in-depth probe using the hypothetical case.

5.4 Unstructured Interview Data

5.4.1 The No Look-Through Provision and Transferability/Circularity

The question is whether No Look-Through provisions in CSCS Rules obstruct transferability and circularity of securities? The responses during deliberations on the hypothetical case are as follows:
Figure 25 – No Look Through provision and Transferability/Circularity

<table>
<thead>
<tr>
<th>Interviewees</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investors</strong></td>
<td>The fact that investor’s rights of enforcement against Credit Suisse (Issuer) are abridged also has effect on the duty the Credit Suisse indirectly owes the investor. The enforcement of investor’s right through the CSCS (Account Holder) pursuant to a deed is a unique way of getting around the effect of loss of right by the investor.</td>
</tr>
<tr>
<td><strong>CSCS</strong></td>
<td>The nature and scope of enforcement right by the CSCS pursuant to the deed is a major concern if the CSCS is not the owner of the instrument as a matter of law. This is important because fungibility of securities leave investors with equitable interest in securities. Therefore, under the principle of nemo dat quo non habet, the CSCS cannot have a better title.</td>
</tr>
<tr>
<td><strong>Custodians</strong></td>
<td>I disagree with the last speaker. The CSCS can only assume ownership where the instruments are assigned or transferred through novation to the CSCS. Except this is done, the CSCS can at best enjoy limited proprietary rights of lien which is in itself insufficient to protect the investor against a default from issuer. This is because, changes in values of the instrument are likely to remove it from the legal protection of a lien and convert to equitable interests.</td>
</tr>
<tr>
<td><strong>Stockbrokers</strong></td>
<td>I agree with the last speaker to the extent that liens on their own cannot provide sufficient protection. The move to ensure the issuer also signs an undated letter authorising the sale of its asset in the event of default could protect investors. This however has the disadvantage of triggering sale of assets at the slightest default and standing in the way of achieving value for those assets. It also inhibits the effective use of assets within the market for capital formation and price discovery which can only be achieved through transfers and circularity. It reduces the appetite for enterprise and risk taking in the part of potential issuers.</td>
</tr>
<tr>
<td><strong>Investors</strong></td>
<td>The legal entitlement to the instrument of participants in the chain between the investor and the CSCS on the one hand, and between the investor and issuer on the other hand is also controversial. I want to take the view that they are equitable entitlements flowing from the CSCS. This could in effect restrict transfers where there are no sufficient hedge against default by participants and the CSCS who is the Account Holder.</td>
</tr>
<tr>
<td><strong>Banks</strong></td>
<td>I disagree with the last point from the last speaker. The very core of the operations of any capital market is its capacity to intermediate ‘Unhedged’ risks. While these risks exist, their regulation to create wealth and value is the hallmark of the capital market.</td>
</tr>
<tr>
<td><strong>Registrar</strong></td>
<td>While it is clear that investors’ right could be affected by the chains, the right of the investors against the primary custodian in a single or double chain could impede transferability of the asset amongst custodians. For example, the custodian’s duty to transfer to investor upon request in line with investor’s right to receive, could obstruct pre-existing commitments between custodians and sub-custodians or nominees.</td>
</tr>
</tbody>
</table>

The current structure created by the CSCS Rules does not support multiple chains. This is likely to crowd out custodians and sub-custodians thereby leading to restrictions in the flow of values with the market. Also the current chain initiated by CSCS has the capacity to modify right within the
securities which in effect also affects transferability. For example, the interest held by sub-custodians and other participants within the market could be affected by the relationship between the investor and custodian or by securities financing transactions entered into by sub-custodians either by mistake or pursuant to an agreement between custodian and sub-custodians. This is the case except there are express provisions in the CSCS Rules which insulate the rights held by the sub-custodians from the rights within the instruments so much so that commingling or erosion do not occur. Where this is the case, the second issue is whether the right of the sub-custodian to act on the instrument can be so remote that it does nothing to influence the nature of rights within the instruments.

The restriction of claim right against the sub-custodian by the rules could preserve the capacity of sub-custodian (privilege) to act with respect to the instrument in a manner as prescribed by the rules in the market. This absence of duty to the investor pursuant to these restrictions is significant in the transformation of rights within the instrument. While it may not affect the equitable interest it has conveyed by virtue of fungibility and intermediation, such interest is preserved on a FIFO basis in the event of the insolvency of CSCS.

5.4.2 Given the limitations placed by legal language on transferability and circularity as seen above, how does the form versus function dispute resolve the property law versus contract law divide in the conceptualisation of securities?

Figure 26 – Form versus Function resolves the property versus contract divide

<table>
<thead>
<tr>
<th>Interviewees</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stockbrokers</td>
<td>The identification of some instruments in Section 315 ISA as securities with certainty without stating what they convey or are capable of conveying, is a disservice to conceptualisation. The idea of whether these instruments should confer proprietary entitlement irrespective of location or designation, may just be an area that could inhibit circularity and transferability</td>
</tr>
<tr>
<td>Registrar</td>
<td></td>
</tr>
<tr>
<td>Investors</td>
<td>Also the lack of clarity in the law as to what the deed is capable of conferring on the account holder to justify effective enforcement against the issuer is another area of concern to transferability and circularity. All that also needs to be tested is whether equitable interest can be proprietary. Therefore, the use of the operator ‘Means’, is unlikely to help further interrogation of these issues through the courts.</td>
</tr>
<tr>
<td>Custodians</td>
<td></td>
</tr>
</tbody>
</table>
5.4.3 Can the operating word within a provision enable or constrain transferability?

Figure 27

<table>
<thead>
<tr>
<th>Interviewees</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSCS, Investors</td>
<td>The nature of rights and duties differ between custodians and other</td>
</tr>
<tr>
<td>Custodians, Stockbrokers, Commercial Banks</td>
<td>custodians, between custodians and issuer, and between sub-custodians</td>
</tr>
<tr>
<td></td>
<td>and issuers or custodians. This makes the language of laws or regulation</td>
</tr>
<tr>
<td></td>
<td>for the conceptualisation of securities very important and strengthens the</td>
</tr>
<tr>
<td></td>
<td>case for their flexibility.</td>
</tr>
<tr>
<td>Investors, Commercial Banks, Registrar, Stockbrokers, Broker dealers</td>
<td>Although the CSCS Rule commences with the word ‘unless the context ….’,</td>
</tr>
<tr>
<td></td>
<td>which shows some semblance of statutory functionalism, there are however</td>
</tr>
<tr>
<td></td>
<td>problems with the uneven application of this operator. Firstly, no policy</td>
</tr>
<tr>
<td></td>
<td>reasons have been adduced for the formalist definition of securities in</td>
</tr>
<tr>
<td></td>
<td>Section 315 ISA 2007 and the functionalist definition in Article 1 of the</td>
</tr>
<tr>
<td></td>
<td>CSCS Rules. This is particularly questionable especially where the new SEC</td>
</tr>
<tr>
<td></td>
<td>Rules also conceptualised securities using the formalist operator. The</td>
</tr>
<tr>
<td></td>
<td>lack of policy clarity on this has implications for product design and</td>
</tr>
<tr>
<td></td>
<td>development. Secondly, the follow up language of the provision of CSCS</td>
</tr>
<tr>
<td></td>
<td>Rules are in direct conflict with the operative word. While the operative</td>
</tr>
<tr>
<td></td>
<td>word context show divergence, the centralisation of powers around the</td>
</tr>
<tr>
<td></td>
<td>CSCS in concrete language, leaves no room for internal movements of the</td>
</tr>
<tr>
<td></td>
<td>component participants. This creates the basis for doubt as to whether</td>
</tr>
<tr>
<td></td>
<td>the CSCS Rule is truly functionalist. Only a court centred approach is</td>
</tr>
<tr>
<td></td>
<td>capable of making this determination.</td>
</tr>
</tbody>
</table>

5.4.4 To what extent context-sensitive judicial functionalist conceptualisation of securities and legal treatment of borderline instruments promote or constrain transferability and circularity?

Figure 28

<table>
<thead>
<tr>
<th>Interviewees</th>
<th>Responses</th>
</tr>
</thead>
<tbody>
<tr>
<td>CSCS, Investors, Custodians, Stockbrokers, Registrar, Commercial Banks</td>
<td>The extension and abridgment of rights and duties within instruments</td>
</tr>
<tr>
<td></td>
<td>characterised as securities to suit changing or varied contexts, underscores</td>
</tr>
<tr>
<td></td>
<td>and reinforces the context sensitive functionalist model.</td>
</tr>
<tr>
<td>Investors, Stockbrokers, Broker dealers, Banks</td>
<td>This extension and abridgment of rights/obligation also extends to the</td>
</tr>
<tr>
<td></td>
<td>instruments themselves. This is how borderline and hybrid instruments are</td>
</tr>
<tr>
<td></td>
<td>created. For instance, the right to receive interest and principal in a</td>
</tr>
<tr>
<td></td>
<td>debt could be extended by an option which is exercisable on the occurrence</td>
</tr>
<tr>
<td></td>
<td>of certain factors or contexts. Also the right to exercise such option</td>
</tr>
<tr>
<td></td>
<td>could be to sell (put) or defer sale (future); or buy (call) or defer</td>
</tr>
<tr>
<td></td>
<td>purchase (future). It takes flexibility in legal and regulatory language</td>
</tr>
<tr>
<td></td>
<td>to accommodate fluidity in instruments as they seek to transfer value and</td>
</tr>
<tr>
<td></td>
<td>decentralise risks.</td>
</tr>
</tbody>
</table>
5.5 Observation and Interview Data Analysis

5.5.1 This section of the research is for data analysis. It seeks to interrogate the data obtained through the interviews and personal observation. The researcher explores the questions in juxtaposition with the research objectives which are:

1. To conduct critical literature review of legal concepts, rules, legislation, principles, hypotheses, philosophies and frameworks of investment products (equities, debt and derivatives).
2. To thoroughly appraise through literature review those conditions that influences the development of equities, debts and derivatives products to stimulate growth within capital markets in countries and in Africa.
3. To develop an approach research methodology and justify the choice of research strategies that best answer research questions.
4. To conduct in-depth empirical research into the products growth driving forces and factors that inhibits their development within the Nigerian Capital Market.
5. To carryout studies of sectors within the Capital Market in Nigeria to understand their approaches, strategies, processes and challenges. This is to ensure a proper conduct of in-depth synthesis and thorough evaluation of research findings against literature on the regulation of equities, debts and derivatives in the Capital Market and the challenges therein. The aim is to validate the research.
6. To develop a practical legal model that is national in approach but with structures to suit the Nigerian Capital Market’s proposed engagement with cross border activities.
7. To conclude that different continents have their unique conceptualisation structures that underpins their understanding of securities. Consequently, the effectiveness of a country’s structure for conceptualisation depends on how it sits within the context of the continental and global framework.

5.5.2 On the question about how formalist approach applied on No Look Through provision impede transferability and circularity of instruments, and whether a context-sensitive judicial functionalism can address these problems.

Responses indicate that the formalist language of statute with regards to the framing and definition of securities actually impedes transferability and circularity. The No Look Through provisions contained in the combined provisions Article 42, Article 3, Article 7, Articles 15-17, Article 27-29, Article 2, Article 2, Article 44, Article 51 of CSCS Rules have been formalistic in outlook and application. For instance, the vesting of lien solely on the CSCS with respect to all rights registered therein has grave implications for circularity, transferability and enforceability of rights for the benefit of investors. This includes firstly, incapacity of investors to enforce rights against issuer if CSCS is unwilling to do so. The refusal/failure of Euroclear’s to act against the issuer (Credit Suisse) for contractual infringements against investors, led to the unsuccessful claim by Secure Capital Ltd. The court simply held that the appellant (Secure Capital) who was acting for the investors, has no

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537 Interview data (summary) from custodians, stockbrokers, investors, banks and registrars in 2014 to 2017 as captured in sub-paragraph 5.4.1
contract with the respondent (issuer) - Credit Suisse. Therefore, the effect of concentration of all rights in the CSCS means that all participants are at the mercy of the CSCS if they must transact or enforce their contractual rights.\textsuperscript{538} This is clearly a disincentive to innovation, circularity and value creation in the market as highlighted by interview. It also offends the principles distributive justice.\textsuperscript{539} This abridgment of rights also applies to all other market participants with the final consequence of an overly rigid and highly formalistic marketplace.\textsuperscript{540} The court-centred context sensitive judicial interpretation of those provisions on the other hand sees the legal relations between the CSCS and other participants as Hohfeldian-type personal contracts where rights and obligations are equally shared and distributed. In that case therefore, the CSCS is under a duty to transfer those rights in its custody on the basis of a contract between CSCS and the participants.\textsuperscript{541}

Secondly, the provision of Article 15-17 CSCS Rule (Nigeria) confers proprietary rights on the CSCS. These rights include a lien over all rights registered with it. The CSCS also has right to exclude all market participants from those rights in its custody. The CSCS cannot take directives from the investors with respect to those rights and more importantly, it can exclude others including the custodian. The CSCS can authorise sub-custodians to use the registered rights in its custody to finance third party obligations. All these point to the fact that the CSCS enjoys ownership rights over and above other participant with respect to those registered rights. With the exercise of ownership right by CSCS, it also means that laws which created and regulate CSCS apply exclusively to all registered rights in its custody. This has the legal effect of Lex Situs since the laws and regulations that would apply are the ones in the jurisdiction of the CSCS irrespective of where other participants are situate. In the case of a court-centred context sensitive functionalist interpretation, the domestic law can only where the context dictates. Otherwise contract law of other jurisdictions should apply where significant elements of the transactions are outside the jurisdiction of the CSCS; this because the thought of property and Lex Situs clearly run against the grains of circularity, negotiability and transferability which form the core of securities. As securities dematerialise for the purpose of intermediation, cross-border application of multi-jurisdictional legal regimes are in operation. Therefore the formalist operationalisation of the CSCS Rule is likely to discourage flexible interaction amongst participants with the domestic market and foreign markets.

The court-centred context-sensitive functionalist through its flexible operation is likely to deliver multiple streams of legal relations with potentials for the development of more products. Hybrid equity, debt and derivative products can emanate to manage risks relations within networks of sub-custodian and custodians, issuer and investors, investors and custodians and issuer and CSCS. This could serve the market by deepening investment activities, providing multiple streams of income, providing greater pools of instruments for risk management, trading, payment and investment.

\textsuperscript{538} Interview data (summary) from investors in sub-paragraph 5.4.1
\textsuperscript{540} Interview data (summary) from investors in sub-paragraph 5.4.1 and Interview data from Investors, Stockbrokers, banks in sub-paragraph 5.4.4
\textsuperscript{541} This was the unanimous view of the majority of interviewees who believe that court centred context sensitive functionalist approach
5.5.3 Form versus Function as it relates to whether securities are property or contract

This question is important because of the following points. First, the application of the CSCS Rule of a particular country to all instruments exchanged within the market, indicate the application of a system akin to the Lex Situs rule. Second, the capacity to apportion rights to the account holder by mere registration with the CSCS in such a way that the right of such account holder could be in many respect greater than that of the investor within an intermediated chain, points to the ultimate ownership right of the CSCS over investor’s assets registered with it. This is the substance of the interpretation and not the mere legal formality that describes CSCS as a servicer or administrator of registered title/interests. The controversies between the formalist and functionalist are captured as follows:

According to the functionalist, the powers conferred on the CSCS via the formalist rules, coupled with the lack of clarity in the definition of securities in Section 315 ISA, confers ownership rights on the CSCS with respect to CSCS’ registered titles. This is why the CSCS can override any contract entered into between the investor and custodian and between custodian and sub-custodians. The CSCS also has power to restrict, abridge and extend the rights of the investors, custodian and sub-custodian. The CSCS makes it compulsory for its rules to form part of the agreement between the investor and custodian, and between the custodian and sub-custodian. The functionalist also argues that the capacity to enforce the CSCS rules must be part of any contract between investor and custodian and sub-custodian is evidence of proprietariness. The CSCS can choose who to sue, the circumstances and whether or not to sue as in the case with Credit Suisse and the Euroclear.

All these have the trappings of proprietary interest of CSCS in the registered interest, however a formalist character of property and application of Lex Situs rule means only Nigerian law will apply. This could lead to the following adverse consequences in the market: (1) low patronage of market by foreign participants who are not comfortable with the structure of Nigerian law, (2) lack of innovation on the part of market participants who recognises the restrictive nature of Nigerian law. The contextual functionalist approach will make it possible for the rule to be interpreted as providing a proprietary interest to CSCS over rights, but also liberty to parties to enter into in-personam contracts.

5.5.4 To what extent can context-sensitive judicial functionalist interpretation of rules governing rules governing rules of intermediation chains promote transferability, negotiability and circularity?

Firstly, the specific rights or the relationship between investors and CSCS are not captured within the rules. Therefore, it has been difficult to clarify where the rights and obligations lie. This makes a strong case for judicial functionalism to close the loopholes that currently exist; although a case could be made for such omission because investors are classified as constituting part of participants

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542 Interview data (summary) from CSCS, Investors, Custodians, Stockbrokers, Commercial banks as captured in sub-paragraph 5.4.3
543 Article 21 CSCS Rule Nigeria
544 Article 15-17, 21 CSCS Rule Nigeria
545 Article 15, 51 CSCS Rule Nigeria
546 Interview data (summary) from Investors, Custodians, Stockbrokers, Banks as captured in sub-paragraph 5.4.3
547 H.L.A Hart supra page 145
in the market when they are registered as account holders. This is not to say that it is bad practice to spell out the possible rights and obligations of participants. The idea of clustering all their rights and obligations together, believing that contract will separate them is bad drafting. Interview data makes it clear that contracts can help support clarity in formal rules if support by court centred context sensitive operationalisation of contractual terms and legal principles.\textsuperscript{548} Secondly, the definition of securities in the CSCS is statutory functionalist and different from the formalist approach in Section 315 ISA 2007.\textsuperscript{549} This is a major source of confusion because there is no policy justification for the difference in statutory approach between two important legal instruments that are meant to regulate transferability and circularity in the market. These controversies further strengthen the case for a context sensitive judicial functionalism to close these loopholes and create the needed clarity.

In terms of the rights of participants within the market, the extent to which claim right of an investor conflict with the CSCS rules in terms of power to enforce such right is a legal one. This is especially the case because the CSCS is not definite on the type of right that investors can hold. It however provides certain privileges to the custodian and sub-custodians. The context-sensitive judicial functionalism is attractive because it is capable of resolving questions that bother on (1) whether sub-custodian can attach securities interest for their benefit to client assets, (2) whether sub-custodian can create security interest over all assets of another sub-custodian to the extent that the other sub-custodian transfer of asset within the market is restricted. The CSCS is one sub-custodian that is so empowered to do the above. However, it is unclear whether other sub-custodian has equal powers even where they may attempt to use extended language in terms to create this effect.

The functionalist versus formalist debate is also important in making the right clarifications where an automatic internal funding mechanism is set up which mistakenly segregate account without client’s consent and client asset and investor’s asset and attached, due to pre-existing arrangement made by other departments in relation to the account unknown to the party that is managing client money. The determination of whether such provision is capable of hampering circularity and transferability is a legal one which is to be determined by the courts. Also in situations where custodian accept terms which creates security interest to the benefit of third party, the determination of whether he is in breach of a contract where the investor has not perfected such contract, is also a legal one. The context-sensitive judicial functionalism is important in this determination. This is also the case where 3\textsuperscript{rd} party attaches the asset regardless of whether the client of the custodian or investor permitted it or not.

5.5.5 To what extent context-sensitive judicial functionalist definition of securities and legal treatment of borderline instruments promote or constrain transferability and circularity?

One of the most important discoveries in this empirical research is the role of language construction within statutory provisions in the development or otherwise of instruments. In fact, the relevance of the right operators and their locations within a particular provision affect their construction and meaning. This is not only useful in the understanding of these products, but also encourages their creation to meet diverse investment objectives. In developing markets like Nigeria, poor product innovation borne out of rigidity in regulation, pose significant challenges. The straitjacketed nature of instruments is a function of the stiffness in laws and regulation that enables their creation and

\textsuperscript{548} Interview data (summary) from Investors, Banks, Registrar, Stockbrokers as captured in sub-paragraph 5.4.3
\textsuperscript{549} Article 1 CSCS Rule Nigeria
adoption. Therefore, the table below shows the increasing popularity of context-sensitive functionalism that is spearheaded by courts in helping to shape a flexible jurisprudence for securities conceptualisation and development.

Figure 29 – Context-Sensitive Judicial Functionalism and legal treatment of borderline instruments

<table>
<thead>
<tr>
<th>Sectors</th>
<th>Number of intermediaries</th>
<th>Number of YES</th>
<th>Number of NOs</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>Variations in percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Custodian</td>
<td>6</td>
<td>17</td>
<td>7</td>
<td>2 Yes 4 No</td>
<td>3 Yes 3 No</td>
<td>6 Yes 0 No</td>
<td>6 Yes 0 No</td>
<td></td>
</tr>
<tr>
<td>Sub-Custodian</td>
<td>7</td>
<td>17</td>
<td>3</td>
<td>1 Yes 3 No</td>
<td>4 Yes 0 No</td>
<td>5 Yes 0 No</td>
<td>3 Yes 0 No</td>
<td></td>
</tr>
<tr>
<td>Registrar</td>
<td>3</td>
<td>1</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
<td>1 Yes 2 No</td>
<td></td>
</tr>
<tr>
<td>Broker</td>
<td>7</td>
<td>10</td>
<td>3</td>
<td></td>
<td></td>
<td>6 Yes 3 No</td>
<td>7 Yes 0 No</td>
<td></td>
</tr>
<tr>
<td>SEC/NSE</td>
<td>9</td>
<td>0</td>
<td>9</td>
<td>0 Yes 4 No</td>
<td>0 Yes 5 No</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>CSCS</td>
<td>3</td>
<td>2</td>
<td>1</td>
<td></td>
<td></td>
<td>2 Yes 1 No</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investors</td>
<td>11</td>
<td>34</td>
<td>4</td>
<td>8 Yes 0 No</td>
<td>10 Yes 0 No</td>
<td>7 Yes 4 No</td>
<td>9 Yes 0 No</td>
<td></td>
</tr>
</tbody>
</table>

The Figure 29 above shows that a number of practitioners within the group do favour a court centred context-sensitive approaches despite the incidence of protracted litigation, excessive procedural adjudicatory process and corruption in the system. The data show the variations in views held by different practitioners within the market. While lawyers in the Securities and Exchange Commission favour statutory formalism, lawyers within the CSCS, custodian, stockbroking and investor community favour judicial functionalism; the reasons for this may not be farfetched. The retention of regulatory control may have been informed by choice of lawyers in the Commission. Market participants relish the freedom to innovate within standards and test applied on a flexible basis by a specialised securities court.

Other reasons for these decisions are: firstly, a proper examination of the rights and obligation of parties in line with the law provides the basis to understand their effect in the market. This in turn influences the attitudes of operators. Secondly, the idea of coherent standards for delineating the contours of these instruments helps in their classification and application with relative certainty, while providing room for innovations to meet diverse investment objectives. This is to be made possible by setting up specialised courts with incontestable powers to act. Therefore to resolve the myriads of challenges created by the definitional incoherence, this research proposes a definition that captures the following terms that show:

1. How the conceptual meaning of the instrument connect with the recognisable central framework for delineating securities. This entails the identification of the underlying concept
on which securities is built and operate the supporting mechanisms. This research proposes
the central core of the concept of securities to be based on “un-hedged risk” with
negotiability and transferability as enablers.
2. Negotiability and Transferability should be piloted by flexible rules of Transfer of Proprietary
Intangibles which should be enacted and made to apply side by side the ISA 2007, SEC Rules
and other guidelines.
3. The character/nature of negotiability and transferability must be prominent within the
structure and language of the Section 315 ISA definition of securities.
4. The role of the intermediary should mediate the risk between investors and market
5. Proper qualification of the financial instruments to reflect their distinct but interrelated
character while also cross-referencing within the ISA. This is to create a better picture of the
scope and application of these instruments. (Cross-referencing of Section 315 ISA2007
definition of security and Section 304 ISA 2007).
6. The use of the word “means” should be removed and replaced with the phrase “.. context
...”. this should then be followed by clearly laid out guidelines for the regulators and courts
to follow.
7. The definition section ‘Section 315 ISA 2007’, should expressly define the following
operating words within the definition of securities. These include: ‘Issue’,
8. There is need to develop new Rules and Guidelines on the ‘Transferability of Securities’.
9. The use of the term “OR” should be inserted in the definitional section to be read
conjunctively where the context permits. The status of the interpretations Act Section 18(3)
should be clarified and made subject to the provisions of the ISA 2007 for the purpose of this
construction

5.5.6 With these suggestions above, the recommended definition of securities for Nigeria’s
Investment and Securities Act should be as follows:

Unless the context otherwise admits, securities means

1. Those financial instruments herein listed in Section 304 Part II of the Investment and
Securities Act 2007 whether in physical or dematerialised form
2. In so far as they are issued by incorporated, unincorporated entities, whether by domestic or
foreign bodies
3. and provided they are made negotiable and transferable either physically or through
electronic means within the market either through issuance and/or listing or any other
means to be determined by law.
4. This does not include financial instruments that are:
   a. Specifically listed in Rule 8 and any other provision within the SEC Rules that so
designate any instrument(s) as excluded.
Summary

The chapter shows that formalistic legal design truly places constraints on legal language and conceptualisation of securities. This is shown by its language construction and inability to accommodate diverse contexts which securities represent. Therefore, the inability to capture the network of interaction between these legal and non-legal themes, significantly limits the understanding of the nature and scope of securities. Poor appreciation of these features means faulty application and regulation. It however goes ahead to practically demonstrate the capacity of functionalist effect to create and facilitate product development by identifying and explaining various flexible products that are operational in functionalist markets across the globe.

This research explores the Nigerian model and makes the case that a context-sensitive strategic fit must be achieved between structure/language of the law and non-legal themes within a particular systems. In other words, there is a need to understand the effect of political economy, historical, social and technological contexts in the conceptualisation of securities law.

The research therefore goes ahead to identify the building blocks for the development of a functional context sensitive definition and conceptualisation of securities. These include:

a. Reverting to the phrase ‘unless the context otherwise admits, securities means...’ On this basis, the court should be empowered to determine ‘contexts’ in the circumstance. This is because it is undemocratic to confer regulatory, administrative and adjudicatory powers solely in the hands of regulators. It is also the case that the regulators are ill-equipped to capture the relevant empirical data needed to determine the requisite contexts. The evidential value of data obtained from litigants and the specialist skill of the court at weaving them into legal and non-legal contexts is extremely useful. Therefore the courts should be provided with guidelines to follow.

b. The research proposes that flexible rules on Transfer of Proprietary Intangibles be enacted and made to apply side by side with the Investment and Securities Act (ISA) 2007, SEC Rules and Guidelines. This Rule should set the nature and scope of the terms ‘Negotiability’ and ‘Transferability’.

c. The definition section of the ISA 2007 and/or this proposed rule should clarify the nature and scope of these terms.

d. There is the need to cross-reference Section 315 ISA 2007 definition of securities and Part II Section 304 ISA 2007 which identifies the types of financial instruments. The definition also proposes exceptions.


f. The use of the word ‘or’ should be read into the definition ‘conjunctively’ where the context permits. This will mean making Section 18(3) of the Interpretation Act inapplicable or subservient to the ISA 2007.

On the basis of these building blocks, the research proposes a context-sensitive and functionalist definition of securities for the Nigerian Capital Market.
Conclusion

The impact of language construction within legal contexts in the conceptualisation of securities can no longer be isolated. In fact, this chapter illustrates the importance of strategic fit between this theme, philosophy and letters of the law in the understanding of securities as a concept. As a follow-up to the need for strategic fit, it is now clear that similarities in legal structure are not determinative of sameness in outcomes. While explaining the deleterious effect of formalism, this research strengthens the need for a flexible, functionalist court-centred context-sensitive model for the conceptualisation of securities. By so doing, it suggests a definition of securities that should replace the current one under Section 315 ISA 2007 (Nigeria).
Chapter 6 – General Conclusion and Recommendations

6.1 Securities under wraps

It is slightly fashionable to characterise the self-preservative philosophical tensions between formalism and functionalism as the sinking voice of diminishing orthodoxy. Conflicts of this nature are sometimes underestimated when ingredients for measuring market productivity are developed.\(^{550}\) Generally, well-managed conceptual conflicts stimulate creativity by exposing new trends and patterns.\(^{551}\) However the poor understanding and application of these trends could have calamitous consequences. The law therefore exists as a tool to moderate these divides with the support of complementary philosophical understandings. In this chapter, the research sums up the findings of the entire thesis as a way of resolving questions that continuously create fractures around legal conceptualisation and application in the market. Scholars have debated some truths that form follows function.\(^{552}\) They situate their argument on idealism as a precursor for functionalism.\(^{553}\) This to them provides rare insights into identifying a concept in its natural form before an exploration into its competences and functionality. An opposing argument looks at function as preceding form because the utility of the concept is determined at the time of conception. Therefore, functionality determines the existence of an idea itself. This research examines key insights into this conflict and submits that form should exist within a function and not outside it. The conflict between formalism and functionalism is not only ideological; it has significant effect when explored through the lenses of contexts.

The case is made that ideological basis for supplanting arguments raises new expected problem of legal determinacy and indeterminacy.\(^{554}\) Legal scholars are divided on this point and questions around whether laws drive social forces in society or vice versa.\(^{555}\) This is hinged on the idea that

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\(^{550}\) The antithesis to the notion that stability is destabilising as conflicts within and between traditional structures are now being expanded and exploited by technology to create access to more participants.


\(^{554}\) Law determinacy is a philosophy that posits that law determine the world we live in today. The indeterminacy philosophy holds the view that the world determines the law that operates therein – ‘The Oxford Handbook of Language and Law (2012) edited by Peter M. Tiersma and Lawrence M. Solan, Oxford University Press

societal function is first determined by accepted social practices which eventually crystallises into laws. Others see laws as the principal initiator of social dispositions. They argue that societies function on the bases of social networks moderated by agreed norms and standards. Therefore, the idea that these norms are the architect of the network is as controversial as arguing that the networks can exist without the norms. This division represents the fundamental disagreement between formalism and functionalism. As arguments rage on both sides of the intellectual divide, a more disturbing question which seems to emerge is on whether or not the law should determine party autonomy. This question attempts to interrogate the very core of the prevailing ideological differences that persist without recourse to prevailing dynamism of markets. Such inverse questioning has elevated the dispute between formalism and functionalism and created fractious effects in market across the globe. In most part, the slow adoption of legal tradition which has inhibited enterprise growth is one of the outcomes. The effect hangs a fragmented regulatory market environment in the balance across the globe. Firstly, the quest to protect national sovereignty and identity by insisting on preserving historical legal traditions has created significant legal differences with less complementarity. The gaps emanating thereof are increasing sources of inefficiencies in the system. There are potent risks in ignoring controversies of this nature especially as they affect legal interpretation. The ease at which they are glazed over should be accompanied by attempts at understanding their impacts on history, culture and intellectual truths of the proponents. This to some extent should include their capacity to generate community consensus. Language which is one of the products of these historical exchanges is evidenced in prehistoric nature and practices of a people. This is why its interpretation is extremely controversial. Secondly, the incidence of technological disruption of the securities market is expanding and exploiting the gaps created by fragmented markets. Researchers have identified the impact of technology on language. They demonstrated through empirical research that the traditional structures of language are shifting and that today’s technologies are ‘linguistic machines’. The outcome of these therefore is a market and products are least understood and appreciated because the traditional metrics for their determination are now inadequate to capture new and evolving trends. This is therefore exacerbating domestic tensions as individual countries strive for opportunities and economic relevance. Consequently, the strains resulting from the above problems support the need for choice of legal systems that best appreciate these fast moving trends and patterns in global markets.


These are some of the challenges which this research attempts to resolve within securities market.  
So that, while on the one hand language is relevant, its interpretation on the other hand is more relevant as markets looks to a system that understands and capture its dynamic contexts. On these bases, therefore and in response to the research questions, this thesis makes three primary conclusions:

1. Markets gravitate towards a system that is flexible enough to understand their dynamism, capture their themes and accommodate their contexts. As a result, this research demonstrates that a court centred context sensitive functionalist model will help achieve this by drilling down empirical data obtained through court process to understand the nature of parties’ contractual intentions. It also clarifies the basis, scope and application of the components in relation to parties’ wishes.

2. Rigid or context insensitive interpretation of the language of legal texts place significant constraints on their ability to capture the dynamic dimensions and their functions within the securities market. Therefore this research demonstrates that formalism places limitations on statutory capacity. Although the formalist approach may be seen as democratic from the point of view of party autonomy, its rigidity makes the approach practically and procedurally undemocratic. This is because of its linear interpretative makeup.

3. A functionalist court centred context sensitive framework has the capacity to identify and weave together all the multi-lateral contexts that constitute securities as a concept. These contexts exist in silos because of fragmented markets and regulations. As a result, the understanding of these products is deeply inhibited and standing in the way of product innovation to address investors’ diverse objectives. Therefore, this study demonstrates that the framework is useful at helping to integrate all interests into a coherent whole so as to achieve strategic fit between these legal and non-legal themes in the conceptualisation process.

A case has been made that flexible framework is able to cater for the divergent interests, multi-lateral networks and dimensions that constitute securities. The research demonstrates that formalist approach is ill-equipped to accommodate the various contexts that constitute securities. Therefore, excessive and unsupported reliance on formalist structure and language, leads to definitional incoherence. Given the impact of non-legal themes in the structure and content of securities as established in this study, an opportunity has been created to also settle the age long debate between legal theorist on the question of legal determinacy and indeterminacy. It has also firmly confirmed the view that the purity of law is determined by its capacity to accommodate the shifting dynamics in contexts and variable that shape society.

559 With market disruptions from technology eroding the underlying dimensions of securities, a lot of the traditional valuation metrics are failing in their capacity to adequately measure value.

560 Securities as an economic tool are multi-dimensional. This is in line with Jeffery Sach’s comments that the field of economics and economic function includes history, politics, economics, philosophy, game theory, neuroscience, psychology and evolutionary biology. – Jeffery Sach’s Lionel Robbins Memorial Lecture titled ‘Economics and The Cultivation of Virtue’, London School of Economics and Political Science, 14th and 15th February 2017

6.2 Conflicts and Tensions in Conceptualisation

The history of legal interpretation has been one rooted in language interpretation without the necessity of exploring the constituents of language itself. Courts have seldom looked beyond the immediate legal text especially where they seem to make literary sense. The idea of ordinary meaning is distinct from its effect and implications on wider society. Like an emperor without clothes, language is dressed in its self-belief. This feeling that linguistic differences impacts interpretative differences which in turn creates divisions in legal characterisation of the components of securities is eloquently displayed by variations in current conceptualisation models. The risky effect therefore created is different in the understanding of securities as different jurisdictions warehouse unique components and language interpretation of these components.

This study examines the philosophical conflicts of two distinct schools that shape the conceptualisation debate. An examination of these conflicts and their outcomes reveals three unique models that more or less encapsulate the general conceptual understanding of securities. These are the UK model as it relates to the EU variant. This is very much mirrored by Mexico and other Latin American countries. The similarity is not so much about literal content, but in their rigid formalist structure. This is followed by the US in North America and South Africa in Africa; and then Singapore model in Asia. Although there seems to be general uniformity within these three distinct variants, there are however wide disparities in the specifics of individual countries’


564 Although the UK and some of the countries of Latin America like Mexico and have long before now started to dilute their model to introduce some level of flexibility; Latin America for instance are under subtle pressure from the US to water down the nature of rules to accommodate trade and investment. The UK on the other hand is working to reduce EU influence within its laws as it seeks to go global
understanding and application of the concepts. These differences which tend to overshadow the gains of a possible consensus achieved include:

1. Disagreement in the actual components that constitute securities, their understanding and application in the market which generally entail negotiability, transferability;
2. Differences in the practical interpretation and application of the underlying components that constitute securities;
3. Frictions arising from differences in individual country’s capacity to curtail the divergence between traditional building blocks of societies and new technological understandings

Therefore, the first chapter of this thesis introduces the research by identifying the above differences, gaps, contradictions and their origins. It also highlights their operational interactions and effects on the market. Chapter 2 takes the research further when it successfully demonstrates the capacity of functionalist court centred context sensitive model for the conceptualisation of securities to address the gaps, contradictions and incoherence created by the formalist approach. The incoherencies identified are (1) National divide on the nature of interest in securities as intangible, given the controversies as to whether they are treated as tangible. This is prominent when explored against its effect on cross-border engagements. Apart from cross-border disagreements, domestic markets are also conflicted within national boundaries as legislature and judiciary continuously grapple with the incidences of securities. These anomalies have both practical and theoretical implications. From the conflict and lack of understanding of the components that constitute securities to the disagreement on the choice of classification criteria, the concept of securities is entangled in intense controversies.

The confusion and gaps that emanates from these disagreements are traceable to the legal design and interpretative philosophies of respective countries. Controversies amongst systems stand in the way of understanding and interpreting the components of securities. The concept of negotiability and transferability means different things to different countries. In Europe, MiFID has failed to achieve efficient and effective harmony. Even where MiFID 2004/39 Art 4(18) defines

567 This is more prominent in the United States
568 On the practical level, poor coordination among nations leading to high transaction costs, slow pace of product adoption and increasing inefficiencies in markets due to its fragmentation. The theoretical level exposes the conceptual dilemma between adaptive and conformist regulation
569 The differences between conceptual purity (formalism) and market-focused approach (functionalism)
570 The securities components are negotiability, transferability, transferable securities
“Securities as transferable securities covering those classes of securities which are negotiable on the capital market except instruments of payment such as shares in companies and other securities equivalent to shares in companies, partnership or other entities and depository receipts in respect of shares; bonds or other form of securitised debt, including depositary receipts in respect of such securities. Any other securities giving the right to acquire or sell any such transferable securities or giving rise to a cash settlement by reference to transferable securities, currencies, interest rate or yields, commodities or other indices or measures.” This definition merely highlights the exception rather than the rule. It identifies distinctions between classes of securities that are negotiable in the capital market and those instruments of payment without clarifying the meaning of these concepts.

The absence of definition of the terms ‘negotiable in the capital market’ and ‘transferable securities’ create absolute confusion from conceptual and transactional perspectives; on the conceptual angle, attempts have been made to define securities generally to reflect regional consensus and inter-relationships on the concept. Article 1(1)(a) of the Convention of the aw Applicable to Certain Rights in Respect of Securities Held with Intermediaries (also known as the Hague Convention) defines securities to mean any shares, bond or other financial instruments or financial assets (other than cash), or any instrument which is not properly explained so as to identify the uniqueness and/or distinctions.

1. This Hague definition does not clarify disclose where it sits within the context of the MiFID definition (whether it refers to transferable securities or classes of securities which are negotiable in the market).

2. Like the MiFID definition which does not seem to clarify at what point classes of securities are deemed to be negotiable in the capital market, the Hague definition also failed to clarify to what extent the securities so defined in its definition represent instruments of payment rather than those investment. In addition, the specifics of those instruments named in the Hague definition of securities are not properly explained so as to identify the uniqueness and/or distinctions.

3. The conceptual confusion identified in numbers (1) and (2) makes the broad understanding of the nature of distinct pieces of instruments known as securities, very difficult. For instance, a preference share as perceived in Germany is conceptually different from the same product in the UK, France and Italy.

In the UK, a share is defined by reference to the share capital which is seen as personal property of members. However, Scottish law includes moveable property which is nowhere defined within the law. In fact, the distinction between personal property in the case of English law and moveable property under Scottish law needs further clarity. While Germany and Italy are conflicted

Investors fail to see benefits of MiFID Reform’, Financial Times, March 8, 2010, www.ft.com/csm/s/0442e42c-2a52-11df-b940-00144feabdc0.html?ft_site=falcon&desktop=true#axxzz4ddV1efzDml

572 Although different States are at liberty to develop rule on the question of negotiable, this demarcation is without much success. (For example in the UK, the FSMA RAO attempts to clarify this demarcation.
573 Sections 540 to 542 of UK Companies Act 2006, Part 17
574 Section 541 of the Companies Act 2006 UK
575 Under German law, a share is known as Aktiengesellschaft. Aktien means shares while Gesellschaft means corporation. The interpretation of these terms generally creates some philosophical similarity with the English definition. But what is unclear however is whether there is also similarities in the nature of interests created and transferred by shares themselves.
between the US model and EU civil law as they remain indecisive. This also relates to how a share is seen divergently in Latin America. Mexico for instance considers shares as a type of contract while Argentina and Brazil look to shares as a form of property. Even though Singapore, Hong Kong, India, South Africa looks to share distinctly in the same way they are seen in the UK, their application in practice differs. The same applies to debt instrument. Secondly, and apart from the conceptual incoherence as above, the difficulties created from the application in practice is another source of great concern. This is aptly demonstrated in the area of cross-listing or multi-listing. There are clear fungibility issues which continuously throw up issues around re-registration, convertibility, differences in operating conditions due to market (foreign exchange volatility), regulatory fragmentation and settlement problems.

On the question of fungibility, it may be difficult currently to purchase a share in US Company issued in New York Stock Exchange (NYSE) and sold on the same day in London Stock Exchange (LSE) even where the US Company is cross-listed in both markets. The need for re-registration becomes necessary to accommodate the structural defects in both markets inability to agree on conditions that guarantee equivalence status. The desire to maintain local sovereignty and uniqueness seems to take precedence over increased transactional cost for market participants. One particular feature that present a problem with this approach is that, even though a share that was purchased at New York Stock Exchange of a particular US Company is exactly the same as one bought of the same US Company in London Stock Exchange, the respective clearing and settlement systems of both countries will be responsible for the respective purchases within their local jurisdiction. This is the same with shares listed in Frankfurt.

There is also a practical question on the impact of these changes to technical nomenclature and terminologies that regulate securities in the market. For example the question of whether shares ‘admitted for trading’ are treated similarly with ‘listed’ shares remains controversial. While the host market regulator, clearing and settlement systems have not much to say, shares that are admitted for trading this is not the case with listed shares. The differences in these regulatory approaches are not only borne out of desire to maintain unique identities, but also as a result of differences in regulatory regimes and conceptualisation. For example, the concept and nature of interests warehoused within specific instruments are essentially different in jurisdictions. One key feature is the differences in the understanding of fungibility and proprietorship. These variations and the associated transaction costs have more often eroded some of the benefits of cross-listing which includes market access for economies of scale, increased liquidity to guarantee reduced cost of capital, increased transparency due to better disclosure, investor protection by leveraging bonding

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577 Under Italian corporate law, shares are known as ‘Societal Anomma’. The definition of shares under this circumstance is conflicted between the US model and the Civil law model.

578 A situation where the same issue is traded in multiple markets.


580 The insistence on local settlement rules and operations over the same instrument by the same parties along the chain has cost implications. It is sometimes called the fragmentation of a single transaction into several transactions for the purpose of market protection. This increases the complexities and costs of transitions. It also changes the underlying nature of particular securities as it travels along the chain and contributes to the uncertainties in their understanding.
mechanism with low regulatory environment and increased visibility. Others include search for better opportunities and diversification into more productive offerings.

One major difference is the question of fungibility. The idea of fungibility between both markets radically changes the nature and colouration of tradable risks.\textsuperscript{581} This goes to the very question of the nature of the instruments themselves. Four distinct models seem to evolve from the study of how tradable risks are captured from the point of view of financial instruments.\textsuperscript{582} These models are

1. UK, Germany, France and Portugal models in Europe and they relate to Mexico and other Latin American countries
2. The US as it relates to the North American model and South Africa’s model in relation to African countries
3. The Singapore/Hong Kong model as they relate to Asia

The practical consequences of these disagreements played out when golden shares issued by some countries in Europe were struck down by the European Court as illegal and inconsistent with European Union Law.\textsuperscript{583} Attempts by MiFID and IOSCO to resolve this dilemma has yielded no significant fruits. These have implications for cross-border engagements:

a. It inhibits the free flow of co-ordination
b. It affects the opportunity to clearly define the financial instruments with certainty both domestically and internationally.
c. The absence of clarity and understanding of these instruments inhibits the possibility of product development and diversity within the market.

While acknowledging that the court centred functionalist approach in the United States is not full proof in terms of the non-uniformity in the application of certain test within the prong, this research demonstrates that these defects do not affect the core utility of the model and its capacity to facilitate a flexible liquid market. However, the lack of uniformity in its application has created gaps in knowledge and incoherencies in the definition of what constitute investment. As a result, it has become difficult to differentiate an investor from an employer.\textsuperscript{584} For instance, the element of profit created a heated dispute in the determination of their scope and limits. There are issues as to whether it arises from income streams or savings from profit.\textsuperscript{585} This also raises question whether

\textsuperscript{581} This goes to the very question of how the interests conveyed by respective instruments are represented, transferred and distributed

\textsuperscript{582} The lack of coherence with respect to tradable risk which in this case the tradable value represent a major problem for financial markets and regulators; the conceptualisation of this risk also remains a vital source of confusion.

\textsuperscript{583} In 2003, British government’s golden shares in BAA was struck down as illegal by the European courts as contradictory to the principles of free movement of capital within the European Union – Business/BAA ‘golden share’ ruled illegal 2003-05-13, retrieved 2016-05-13. The European Court of Justice also held that Portugal’s holding of golden shares in Energias de Portugal was illegal for the same reason as above –Curia.europa.eu - retrieved 2016-04-02. Same was in the case in Spanish government’s stake in Telefonica, Repsol YPF, Endesa, Argentaria and Tabacalera. This consistent story also played out in the German government golden shares in Volkswagen AG and German Land (Federal Stat) of Niedersachsen (lower saxony) – Zumbansen; Daniel Saam; The ECJ, Volkswagen and European Corporate Law: Reshaping the European Varieties of Capital, CLPE Research Paper 30/2007; also 7 German Journal 1027 (2007)

\textsuperscript{584} International Brotherhood of Teamsters v Daniel 439 U.S. 551 (1979), 569-570

\textsuperscript{585} International Brotherhood of Teamsters v Daniel 439 U.S. 551 (1979), 558-562
such profit must emanate from pre-sale activities or profit arising from post-sale activities. The differences in interpretation reflect the court understanding of the variations in contexts and their impact on the appreciation of legal texts. For instance, the ideological conflict between the lower courts or Circuits on the understanding of vertical and horizontal commonalities is further perpetuated by the palpable silence of the US Supreme Court on the issue. In concluding, the chapter highlights the conflicts between formalist and functionalist approaches. It exposes how the tensions impact the understanding of securities. The limitation in the scope of statutory language presents constraints to its adaptability to meet dynamic investment preferences. The demand on national governments to justify economic priorities are no longer on the basis of historical connection, but predicated on the implementation of systems that guarantee national prosperity, self-preservation and national identity. This makes a strong case for a functional, flexible court centred context sensitive approach in legal design. That framework should be about adopting a uniform jurisprudence to accommodate uniform meaning. The chapter concludes that it is no longer attractive to appreciate these global fractures in the conceptualisation of negotiability and transferability as essential components within securities.

Chapter 3 and 4 takes the above conclusions and demonstrates through empirical evidence the impact of gaps created by the formalist design. The ideas explored include why market participants are unable to leverage statutory language to create products in the market. This is achieved by exploring the multiple causalities and how they impact the language and structure of legal text. The research also demonstrates a link between the definitional incoherence of securities and poor product development in the market. The data points from empirical research reveals poor understanding of the nature of proprietary interests warehoused within shares, bonds, debentures, notes and other financial instruments. The chapter discloses the following:

a. Absence of coherent and consistent operating language in the definition of securities borne out of clashes between the two competing forces of legal and non-legal themes
b. Confusion and lack of clarity with regards the nature of these instruments and their applicable laws. The challenge as the whether they should be regulated by property law or contract law remains potent.
c. Lack of clarity with regards the nature of proprietary interests and rights that are conveyed
d. Issues around identification or specificity of securities for the purpose of establishing proprietary interest
e. The blurring nature of respective instruments. For example the differences between respective asset types, classes and categories are not express within legal frameworks.
f. Lack of clarity and understanding of the role of custodian in relation to issuers and the nature of their legal relationship
g. Confusion with regards the place of these assets within their respective legal relationship.

This study identifies the tensions that exist and demonstrates how these tensions impact language structure, their interpretation, institutional structures and legal compliance. The effect of data outcomes shows up in the lack of clarity and demarcation between excluded securities and registrable securities, uncertainties with regards to the differences between excluded transactions and excluded securities, lack of clarity between excluded securities and included transactions, lack of

586 National priorities and technologies disruption is also considered
certainty between included and excluded transactions and lastly, the incoherence in the characterisation of the distinct financial instruments themselves. The chapter concludes that these conflicts and their effects are created partly by

a. Lack of coherent jurisprudence on the conceptualisation of securities. This is because of lack of clarity and unanimity with respect to the definition of the underlying components
b. Inconsistencies in the operating words, their meaning and application within a definition
c. The conflict between the legal and non-legal themes and their impact on market understanding of securities

The research therefore concludes that the absence of strategic fit between the legal and non-legal themes, contributes to definitional incoherence of securities.

Chapter 5 argues that the formalistic legal design accentuates the problem of strategic fit between legal and non-legal themes. This is aptly demonstrated by inability of formalistic language to accommodate diverse contexts which securities represent. The inherent incapacities in the formalist design to capture the networks and dimensions that constitute the securities significantly limit its understanding. This in turn affects its application and regulation. To resolve these dilemmas, this research practically demonstrates that the functionalist court-centred context-sensitive approach has the capacity to elucidate and weave together all those components and underlying dimensions of securities in a flexible manner as to create and facilitate the development of investment products. This system has been found useful in the US and Singapore. The research identifies the absence of the above as responsible for poor product development in formalist market. It further discloses that formalism is one of the challenges with the UK’s model despite its attempt at adopting a measure of flexibility. It therefore submits that the United Kingdom’s model has developed a lot more than Nigeria’s because of its evolution into greater flexibility in legislative language. This is in furtherance of its attempt to achieve strategic fit between legal and non-legal themes.

The research concludes that the context sensitive functionalist approach remains the only viable option that is necessary to weave together all the contexts of securities into a coherent whole. In the case of Nigeria, the research concludes that the functionalist context sensitive approach is the solution to the definitional incoherence of securities and poor product development in the Nigerian market. To achieve this, the research proposes the following changes to the Investment and Securities Act 2007 to include:

1. Changes to the statutory definition of securities under the Section 315 of the Investment and Securities Act 2007. This includes reverting to the use of the phrase “unless the context otherwise admits, securities means …” this should be followed by clarity in the Act as to which bodies are vested with powers to determine the context. It is highly recommended that a mix of court and regulatory bodies should be vested with the power to determine context.

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587 This research however isolates the downsides of the US variant of this model and prescribes a solution. It advocates increased focus on identifying applied research and statistical tools to properly capture context in a multidisciplinary fashion. This is referenced in the concluding part of chapter 5.
2. There is the need for flexible rules on Transfer of Proprietary Intangibles to be enacted and made to apply side by side with the ISA 2007, SEC Rules and Guidelines. This rule should clarify the meaning, status, scope and nature of negotiability an transferability.

3. There is the need to cross-reference Section 315 ISA 2007 definition of securities with Part 2 Section 304 ISA 2007 which identifies financial instruments.  

4. An extension of Section 315 ISA definitional function is proposed to include a definition of the following: ‘Issue,’ ‘incorporated,’ ‘unincorporated,’ ‘listing,’ and ‘negotiable’, and ‘transferable’.

5. The use of the word ‘or’ should be read into the definition conjunctively where the context admits. This means making Section 18(3) of the Interpretation Act inapplicable or subject to the provision of the ISA 2007.

On the basis of the above recommendations, this research proposes a court centred, context sensitive and functionalist legal framework and definition for the conceptualisation of equity, debt and derivatives in the Nigerian Capital Market.

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588 This definition should have exceptions for purpose of clarity
Chapter 7 Conclusion

7.1 Introduction

This thesis unearths the fundamental causes of definitional incoherence of securities and shows how this has led to poor understanding and development of these instruments in the Nigerian Capital Market. It demonstrates that formalist conceptualisation of securities limits the capacity of language to optimise the concepts and liberate their character for development. Based on these discoveries, it is now clear that changing contexts in markets can only be captured when the language of law encourages flexibility especially at a time where the market seeks cross-border linkages. Below is a brief summary of findings.

7.2 Findings of this research

Firstly, the research demonstrates that a court centred context sensitive functionalist approach to the conceptualisation of securities is the only way to achieve improved product understanding and development in the Nigerian capital market. It further posits that this context sensitive model has the capacity to integrate national framework into regional and global contexts for improved cross-border activities. The level of symbiosis between the national and regional and global model is effective at strengthening cross-border exchanges and providing the boost to investors’ confidence. Apart from low cost of transaction flowing from increased liquidity, market practitioners are bound to enjoy the ease of access that strengthens confidence. The capacity to integrate philosophical viewpoints is one of the key strengths of this model. This includes bringing together both structural and linguistic positions within the context of conceptual and philosophical environment. The mutual exchanges between these themes help in the identification of agreements and frictions within the concepts. The recommended model\(^{589}\) has the capacity to clarify the underlying assumptions that have hitherto regulated the understanding of securities and transform empirical data obtained through court process into usable investment strategies. This is the by-product of its ability to harvest and transform contractual intentions of parties into tradable rights. A court centred context sensitive model provides the ability to monetise parties’ rights while providing liquidity in the market. These rights may include express or implied intentions that are conceptually captured within the context of parties’ intentions. The model is also capable of leveraging language and its limitation to create usable investment propositions. This is possible through the recognition of the power of language in the design of party autonomy.

Secondly, and after the examination of data, the research made the following additional findings:

a. That the nature of rights and duties and how they are conceived in a market affects their functioning

b. The formalist or strict allocation of duties to transferor without necessary contextual safeguards will restrict the rights of transferee and third party. This in turn will limit the negotiability component and characteristics of circularity.

\(^{589}\) The recommended model in this case is the Conceptual Onion
c. Where transferor is made to owe a separate duty to transferee, the weight of duties will create a unidirectional flow of duties and a multi-dimensional rule of liability. This creates a Privilege - No Right relations which inadvertently reduce the rules of liability.

d. The Power – Liability relations guaranteed by rule of law will make the transferor owe two separate duties to transferee and third party, but cannot owe the same duty to both. This creates Privilege – No Right relations which provide the disruption of seamless circularity.

e. The interference of the right to non-interferability promotes circularity but disrupts transferee’s duty of vigilance. This affects negotiability and circularity.

From the above findings and more, it is therefore clear that the manner of construction of legal instrument is important in product development and optimisation. This means that the United States for instance has effectively created a system that leverages on the capacity of language to capture varied contexts and epochs. The framework in Figure 4 successfully resolves the conflicts between the formalist and functionalist philosophies by integrating both paradigms in the exploitative determination of context.\textsuperscript{590} The framework in comparison with other models around the world has been uniquely successful at weaving together all the legal and non-legal themes to arrive at a coherent standard across the United States.

Thirdly, this thesis illustrates the point that the variations in the conception of rights and duties constitute the main disagreement in the proper construction of investment products. It identifies differences in language and structure of definitions as partly responsible for this divide. As a result, the research further finds that the formalist structure and language are ill-equipped to accommodate the diverse contexts that constitute those variations in the concepts; variations which are brought about by the philosophical dispute between form and function coupled by technological disruptions of Digital Ledger Technologies and Crypto-Instruments. Therefore excessive reliance on formalist structure and language in the conceptualisation of securities leads to definitional incoherence. It also establishes the role of non-legal themes in shaping the content and structure of securities contexts and regulation.

Fourthly, this thesis furthers the on-going policy debate which is on how best to influence national policy towards a flexible regulatory approach in investment conceptualisation, regulation and application to guarantee seamless trade and movement of capital across border at greater pace and lesser cost. This dialogue in important given the myriad of institutional disagreements that have heralded the concept and its application in the market\textsuperscript{591} especially as it relates to quest for a model to enhance seamless global coordination, mutual recognition and enforcements of these instruments. The conflict or dilemma in the choice between the European formalism or conceptual purity and the United States functionalism or market focused approaches remains unresolved. Apart from the ideological impact of this dispute, the obstructive erosion of the underlying dimensions of securities, stand in the way of its contextual examination on a case by case basis. This is despite the desire of flexibility in the face of attempts by statutes to regulate party autonomy. The choice of

\textsuperscript{590} This Figure 7 Model of capturing context for the understanding of securities is potent given the multifaceted nature of securities as disclosed in its cellular structure as captured in Figure 1

\textsuperscript{591} The clashes that results from these institutional disagreements on the nature and interpretation of the components that constitute securities continuously erodes party autonomy despite its success at creating unique regulatory structures in countries across the globe. For example the global shares argument captured in this chapter.
technique is predicated on the society’s design of the law, its purposes and its operational contexts. Therefore, given the multidimensional nature of securities, its purpose and regulation can only exist within the realms of context. This means that appreciating these contexts can only be achieved through effective and flexible regulatory structure.

Fifthly, through the analysis of data, this thesis discloses the following as a justification for its definitional incoherence and the incapacity of the laws to galvanise product development and optimise the potentials of products in the Nigerian Capital Market:

a. This research submits that the design of ISA 2007 on the definition of securities is formalistic. This conclusion is informed by the presence of the following statutory features:
   1. The word ‘means’ which points to certainty does not take into account the multidimensional nature of securities as indicated in Figure 1 of this thesis.
   2. The lack of definition and consistency in the operational words within the definition in Section 315 of the ISA 2007.
   3. Lack of definition of key instruments mentioned in the definition itself
   4. The sum total of the Investment and Securities Act 2007 as a whole and the rigid underlying linkages with other statutes
b. Absence of framework to consider other internal and external contexts.

The Section 315 of ISA 2007 definition has not taken into account the nature of security as an amalgam of legal and non-legal themes. Even its similarities with the United Kingdom’s design on the basis of historical connection are insufficient to guarantee similarities in legal outcomes within the market. It further finds that the effectiveness of a design is not so much about its uniqueness, but on where the model sits within the context of regional, continental and global frameworks. Therefore a framework is needed to weave together all the contexts so as to achieve strategic fit between the legal and non-legal themes. As part of devising a conceptualisation framework for the Nigerian market, this thesis finds as follows:

a. That there should be incorporation and actualisation of strategic fit between legal and non-legal themes in the conceptualisation of securities. This includes driving a consensus between traditional (indigenous) approaches and new technological (received) approaches.
b. Ensuring political economy, socio-cultural, technological, historical, psychological and philosophical contexts are factored into the conceptualisation of securities.
c. That a definition of securities as replacement for the current Section 315 ISA 2007 definition is necessary to provide the basis for its contextual understanding. There is a need to make significant adjustments to the language and operating words in the definition.
d. That a court centred context sensitive functionalist model is necessary to facilitate and guide the courts in reaching judgements in order to fashion a comprehensive and coherent jurisprudence for securities in Nigeria.
7.3 Original Contributions to Literature

Significant opportunities are often wrapped within tensions and disagreements. The very nature of conflicts between formalism and functionalism throws up significant opportunities and challenges. Apart from the symbolism of idealistic positioning by the distinct schools of thought, this research captures the challenges and opportunities as its core contributions to knowledge. These are clearly laid out in paragraphs below:

1. Identification of gaps, contradictions and tensions in pre-existing literatures and their impact on the understanding of securities. The problems identified in current literature on the conceptualisation of securities are:
   a. Conflicting philosophies on securities which increasingly contributes to its conceptual gaps and contradictions
   b. Understanding the nature of these instruments leading to its definitional incoherence.
   c. Lack of identification of pre-existing conflicts in relation to new and emerging conflicts.  
   d. The impact of these conflicts on philosophical understanding and conceptual certainty of securities
   e. How paragraphs (a) to (c) above impact the underlying components and dimensions of securities; and how these continuously unsettles its framework and structure
   f. How the unsettling of the gradual evolution of securities is further disrupted by new emerging forces and the impact of such disruption on the framework and understanding of securities
   g. The need to develop a framework that recognises these divergence and how the capacity to integrate them help in the understanding of securities
   h. The importance of understanding securities to promote its development in the market and its impact on market development and economic growth
   i. How the flexibility built into this framework helps to capture market dynamism, contexts and weave together and possibly reverse engineer the philosophical conflicts and divergent contexts towards economic growth and development.

2. Identification of the tensions between pre-existing and new traditions resulting from:
   a. Changes in language and erosion of traditional interpretative approaches leading to significant alterations in the underlying dimensions of securities
   b. Disruptions in pre-existing relationships that were once predicated on historical nexus and the creation of new ones based on measures that align with contemporary national priorities other than history.
   c. The uncertainties created from heightened tensions emanating from differences in legal and non-legal themes.
   d. How these controversies are expanded and exploited by geopolitics, political economy and technology. The typical effect of these challenges on the market and underlying dimensions of securities.

This philosophical conflict now exacerbated by technological disruption of the space
3. Developing a framework to manage these tensions and contexts in Nigeria and by extension West Africa. This functionalist court centred context sensitive framework otherwise known as the Conceptualisation Onion meets the requirements for the resolution of the conflicts and inadequacies of the formalist model through the following inherent capacities, features and characteristics
   a. Identification of the key components of securities and ability to weave around them a coherent jurisprudence that is flexible and context sensitive. These components include unhedged risk, negotiability and transferability
This is a model that consists of intra/inters connected concentric rings that discloses the linkages between the various components that constitute securities as a concept. With each component standing alone, the absolute and relative effects are felt when explored against one another within varied contexts. The fact that financial instruments are mere descriptive labels as discussed in the body of this thesis strengthens the view regarding its unrepresentativeness with respect to the inherent content and economic effect they create. Therefore, the need for their examination using various tools becomes imperative. No attempt has been made so far to properly delineate each of
these instruments with specificity. The negotiability and transferability component still suffers from lack of clarity due to absence of definition. Even more disturbing is the lack of definiteness of the substance that is being negotiated or transferred. This model identifies case law induced context as an administrative process for clarifying the gaps and identifying the core substance or property that is being transferred and negotiated. From a synthesis of case law and empirical data, the model identifies unhedged risk as the core of investment securities. Unhedged risk is the substance and property that makes up financial instruments and constitutes the basis for negotiability and transferability within a regulated market. While exploring the context of other components, the assessment of the constituents and contexts of unhedged risk remains the most important determinant of the true nature of investment securities. Therefore all other components within the model must be explored by first looking at their individual contexts and then those contexts within the context of unhedged risk.

The interpretation and expansion of the term ‘unhedged risk’ as it relates to negotiability/transferability and financial instrument generally is extremely important. On the question of financial instruments Section 304 ISA Part II specifically identified instruments that are and should be known as financial instruments. While these instruments merely represent listing of intentions, there is clearly no unifying principle that brings them together and establishes their essence. With a context sensitive model, the very essence of their existence is brought alive where the concept of unhedged risk is identified as the ‘value’ or ‘property’ that present investment proposition to investors. The capacity of the model to weave together the entire legal and non-legal contexts into a tradable product or proposition that has the ingredient of proprietary risk (unhedged) is the unique feature. The incidence of unhedged risks explains the importance of risk-reward element in investment. As a useful tool, risk sits at the very core of investment because the capacity to measure, value, commoditise and trade it as a property speaks to the sophistication and functionality of a system. This is more so where the system allows for ownership of risks and their possible breakdown into varied slices for the purpose of circulating them in the market as negotiable investments. Therefore the definition of Financial Instruments within the meaning of Part 2 Section 304 of ISA 2007 which is recommended to be referenced in the new Section 315 ISA 2007 as proposed must have at its very core risks that are unhedged, negotiable in nature and freely transferable within the market. The conceptual nature of this risk property must be determined on case by case basis. In other words, the substance and economic effect of transactions between parties should dictate the contextual nature of the risk property. The determination of context is a role to be shared by the regulator and the court, but with the court having the upper hand because of the following characteristics:

1. The court have the benefit of legal expertise on both sides, the judicial panel, existing precedence and court procedures/rules with which to carefully sift empirical data from various sources towards the determination of real intent
2. The court have the benefit of understanding real time the new thinking of society on the subject and how that is reflected in parties decisions and likely legal/commercial effect it

593 As discussed in Chapter 2 of this thesis
594 The risk must be free and unhedged to qualify as security. This is because a hedged risk is conceptually a contract for payment for good delivered or to be delivered and/or services rendered. The unhedged nature also makes the risk freely transferable without encumbrances that are usually tied to contracts for payment.
elicits. This justifies how the courts are able to achieve strategic fit by weave legal and non-legal themes into a coherent jurisprudence on the subject.

This is the concluding chapter. It simple rests views on the conclusions reached in previous chapters and highlights the likely benefits of the model below to the Nigerian market by proposing the following definition for securities in the Investment and Securities Act (Nigeria).

Unless the context otherwise admits, securities means

1. Those financial instruments herein listed in Section 304 Part II of the Investment and Securities Act 2007 whether in physical or dematerialised form.
2. In so far as they are issued by incorporated, unincorporated entities, whether by domestic or foreign bodies.
3. and provided they are made negotiable and transferable either physically or through electronic means within the market either through issuance and/or listing or any other means to be determined by law.
4. This does not include financial instruments that are:
   b. Specifically listed in Rule 8 and any other provision within the SEC Rules that so designate any instrument(s) as excluded.

7.3.1 Conceptualisation Onion: Implications and Recommendations for Research, Policy and Practice

This research reviews and synthesises the dichotomies and advances so far made in securities regulation across the globe. The uniqueness in these achievements is most felt by systems that have recognised the intersection of multiple disciplines in the field of capital market investment and risk management. Prompted by multiple calls for a multidisciplinary approach to investment regulation, market practitioners and policy makers are increasingly seeing the importance of exploring knowledge intersection a lot more deeply to better appreciate securities as a tool for human interaction.

Several centuries of dealing in securities have failed to capture this unique feature in the understanding of the substructures that constitute securities. The basis upon which these instruments were understood took account solely of associated performance of market practitioners and investors’ contractual preferences. Little attention was paid to the very contexts that shaped individual actions of investors and market practitioners. Also the effect of these actions on rules and market conduct were not so visible in most analyses. This led to frequent market failures due to gaps between notions of investment and the contexts that drive market activities. Chapter 2 of this thesis chronicles these gaps and contradictions as a way of further exposing the inefficiencies in the fragmented regulatory structures of securities across the globe.

Apart from perceived tensions borne out of fragmented regulatory structure, specific failures in clarifying the measurement criteria for each of the components and dimensions that constitute securities became evident. As presented in both chapters 2, 4 and 5, data available identify the constraints placed by differences in interpretative standards on the uniform understanding of these
components across the globe. Therefore the impact and changes witnessed in language structures continue to impact the nature and understanding of securities. Chapter 4 clearly identifies some of the themes that have shaped language construction and appreciation across various contexts. Aside historical context, socio-political contexts and economic situations have imperilled any potential for integrated structures. It however provides examples of how systems have adopted functional and flexible approach to integrate context with a view to creating useful products in the market that meet diverse investment objectives.

The thesis recommended the functional approach for the conceptualisation of securities in Nigeria while providing a working definition and various changes to the Investment and Securities Act 2007 (Nigeria). In view of this introduction and previous sections, this part of the final chapter looks to examine the implication of these findings on policy and practice in the area of securities regulation in Nigeria, West Africa and by extension across the globe. This is to enable the development of new approaches to the understanding, conceptualisation, application and enforcement of securities.

7.3.2 A glimpse into the future of securities regulation in Nigeria with the Conceptual Onion (The Epistemology of the Contributions)

Securities is to be viewed as a means of communication across contextual divide and a cultural tool that represent an amalgam of various legal and non-legal contexts. The basis for the determination of harmonisation criteria will no longer be based on solely mathematical models but on constituencies in the social variables. Therefore the content of every instrument will be explored to understand the parties’ intention, economic and social equivalence. Parties will provide evidence of their contractual intentions as it relates to respective contexts of their market. This information will help in testing the equivalence criteria against other contexts. With this fully entrenched, a picture of the jurisprudence that shapes the concept of securities will start building up that body of principles that reflect specific contexts of a market in relation to regional, continental and global context. Therefore, its approach hopes to assess its proficiency on the basis of how well it strategically fits to its internal and external contexts. The criteria will include how flexible the capital market system is at accommodating dual listing, cross listing, multiple listing, and free movement of securities within and outside the market as ownership of instruments change without inhibitions. The capacity of instruments to store and retain value and certainty with regards the measurement of value in the determination of price. Clarity in the pricing of risk for the purpose of determining value and their clarity and capacity to cut these risk properties into slices representing determined value for their easy movements within the market is important. How these slices are representative of varied investment preferences of investors becomes a question. This conceptualisation is represented in a six staged process:

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595 This uninhibited movements is effected despite changes in ownership of these instruments
Stage 1 – identify and determine the equivalence in macroeconomic variables\textsuperscript{596} to distil equivalence criteria\textsuperscript{597}

Stage 2 – test recognition or equivalence criteria against parties’ contractual intentions

Stage 3 – by doing stage 1 and 2, a picture of the jurisprudence that shapes the concept of securities will emerge to reflect specific market context.\textsuperscript{598}

Stage 4 – assess the proficiency of the output from stage 3 on how well it strategically fits to market’s internal and external contexts

Stage 5 – also assess how the equivalence criteria integrates the flexibility of the capital market system in accommodating dual listing, cross listing and multiple listings within markets, clarity in risk pricing/valuation, capacity to fractionalise and circulate risks in the market.

Stage 6 – integrate the findings from applied research and market practice into knowledge base to create a symbiosis between researchers, practitioners and the knowledge base. Create linkages between the knowledge base and the people to capture their context by applying various media sources.

Within the market, policy makers, regulators, market operators, practitioners will now operate from the position of knowledge that securities is not merely a contract between parties, but a socio-political and economic tool of communication that warehouse various contexts. This view is clearly a departure from that which is known and appreciated over the years. The full realisation of this reality is the sum total of research findings captured in chapters 2, 3, 4, 5 and 6 of this thesis. Therefore, the broader vision is to condense these findings into the Conceptualisation Onion from where policies and practices can emanate by taking advantage of diverse contexts. The functionality of the Conceptualisation Onion will be judged on its capacity to weave together diverse internal context and external contexts/themes. One of the main challenges of the regulators and market participants is in their inability to bridge research and practice. The lack of interaction between practice and research within the market remains a problem that has impacted productivity and efficiency. It is likely that the Conceptualisation Onion will help to bridge this gap by interpreting current knowledge with new knowledge.

The criteria of measurement provided for effectiveness can provide a major source of integration of these paradigms. Therefore research and practice can be integrated through the development of a cumulative knowledge base that serves both interests interchangeably. The mutual exchanges between the knowledge base and pre-existing theories could lead to the development of new theories. With principled research and practices feeding into the knowledge base, the level of interpreting between the knowledge base and theories which improves the quality of knowledge base will then help to shape future practices and research. Figure 8 (the Contextual Web) below

\textsuperscript{596} The macroeconomic variables include economic, socio-cultural, political, technological, environmental and legal elements

\textsuperscript{597} To determine the equivalence in macroeconomic variables, a critical study of their interconnections and intersections is carried out to identify commonalities

\textsuperscript{598} This discloses the economic and commercial effect of the transaction
which is also known as the Context Web represents this diagrammatically and goes to reinforce the inter-connectedness of these elements.

Figure 31 - The Context Web
A thorough examination of this diagram explains the network of relationships between the Markets’ Knowledge Base and the Conceptual Onion in their quest to implement context sensitivity. The Conceptual Onion primarily achieves a dual purpose of determining context and linking research to market practice.\(^5^{99}\) It also takes advantage of the interactions taking place within the Knowledge Base itself which includes the meeting of research, practice, theories and public through the media. Apart from this function, what remains critical in the implementation of the Conceptualisation Onion is on how it can be used as a tool to broaden the knowledge base of the market and increase their conceptual understanding of securities and their potentials. It is also helps to delineate the elements that provide the jurisprudential measurement of the instruments for the purpose of recharacterisation. In achieving these, the thesis proposes the following guidelines. First, the thesis recommends the functional characterisation of securities from a multi-disciplinary standpoint within the market. This research finds that multi-disciplinary approach to the conceptualisation and characterisation of securities would provide a conceptual bases to identify all the thematic strands and contexts which securities represent. The method hopes to elucidate the commonalities within the concept for the purpose of identifying the governing variables that should shape and be shaped by regulation. Second, the research draws attention to legal language construction methods adopted as critical to the extensiveness and selectiveness of policy and regulation of securities. Therefore, the language must be expansive and context-sensitive in sufficient measure to capture all the legal and non-legal themes that constitute securities.

Before looking at what these broad measures means specifically for research and practice in the world of securities, it may be important to clarify that adoption of a functionalist approach to securities conceptualisation must not be confused with a presumption for one universal model of conceptualisation. The measure is aimed at achieving unity in diversity by situating, delineating and clarifying a coherent jurisprudential framework for the conceptualisation of securities where national model can easily find its place within the context of regional, continental and global models. The opportunity to emphasise this point is indeed crucial for social; and political reasons. It is imperative to interpret multi-disciplines within a functional language regime. So much can be achieved through these measures shaping the quality of research around the field of investment securities and securities regulation within the field of research and research practices.

### 7.3.3 Implications and Further Recommendations

This research places emphasis on the need to have future examination of the concept of securities on that point of intersection between multiple disciplines so as to understand its place and nature of interaction. The reason for this is to research three cardinal areas:

a. The place of current knowledge and literature on securities, its antagonising and supporting features.

\(^5^{99}\) The Conceptual Onion achieves this principally by drawing on statistical and applied research tools to combine data analytics with behavioural science. It can democratis the process by limiting the pre-conceived biases of a single data originator or likelihood of wrong/false data. The statistical and measurement tools include various data collection and analytical tools/models that are now enabled by advanced software, algorithms (artificial intelligence, machine learning technologies). Secondly, the suggested applied research tool for the purpose of the Conceptual Onion is the Contextualisation Triangle or the Context Engine.
b. The likely impact of research features on knowledge base through the interaction of research and practice

c. Research into modalities for reinforcing existing knowledge base and building upon new evolving/emerging knowledge bases.

The entire gamut of this research advocates for a departure from traditional approaches to securities conceptualisation that are essentially formalistic and linear to a functional multidisciplinary approach that accommodates diverse contexts. With this approach, new forms of knowledge are bound to emerge that caters for varied subject areas and their perspectives at understanding securities as a concept. This is likely to enrich design of legislative framework, legislation, regulation and enforcement. It is also likely to accommodate views from non-lawyers in a collaborative manner in the framing, delivery and enforcement of securities legislation. Therefore, this thesis submits that the design parameters, interpretative techniques, language content and enforcement of securities laws and regulation are likely to be impacted by the Conceptual Onion model of conceptualising securities. The research further takes the view that additional studies is required to deeply explore the point of intersection of disciplines, their nature, dynamics and impact on the concept of securities.

It is however unclear how much can be achieved through microscopic studies of intersection of disciplines for the purpose of capturing the intricate but dynamic underlying dimensions of securities. This is because of fluidity of applied research to the dynamic substructures of securities that are in constant evolution. It is not that applied research cannot be useful where the baseline problem areas are identified and addressed with practical solutions from research, the academic arguments for and against the effectiveness of applied research and their contribution to fundamental knowledge, remains potent. While the importance of basic research remains sanguine, applied research conveys significant transformative effect on knowledge base. The usefulness of the applied research is subject to the following tests:

a. Whether applied research captures the dynamics of complex systems and their interventions
b. Whether the research galvanises collaborative research enterprise between researchers and practitioners to achieve distinct but complementary research solutions
c. Whether the research guarantees continuous refinement and development of research products
d. Whether the research creates the capacity to explore theories and practice in uniquely diverse ways

If answered affirmatively, the applied research will lead to the development of prototypes that captures diverse contexts. Such development has the potentials of increasing wider adoption of research principles and further increases the need for research intensity and relevance. A research output achieved with rigour cannot be easily replicated by competitors. This could provide an edge for the initiating bodies to take the lead in the application and understanding of design and measurement criteria. While placing significant emphasis on research and product of research, funding is essential and should emanate from funds created by market participants and regulators.
7.4 Conclusion

This research set out to identify the gaps, contradictions and inconsistencies in the market that have contributed to the definitional incoherence of securities. The language of statute and the interpretative philosophies were identified. These were measured against the need for parties’ contractual intentions so as to discourage disenfranchisement. Formalism in language as a philosophical position was identified as placing constraints on language and party autonomy. The determination of what amounts to the right context and how context should be allocated became a problem. Firstly, the research agrees through the Conceptualisation Onion that context must drive the meaning of the various components within the Onion. It also agrees that context remains the only productive way to harmonise the disagreements amongst the components.

Therefore by the above submission, it became critical to understand the true situation of context itself. A multi-disciplinary approach is agreed because of its capacity to capture legal and non-legal themes. The determination of these themes and their points of intersection was critical in addressing their impact on the components of the Conceptual Onion. The usefulness of utilising contextual synthesis in product development was eloquently demonstrated in the examination of functionalism in chapter 4. The lingering question was on the determination and proper allocation of the elements within context itself to ensure its appropriate deployment within defined parameters. This will help in the reliability and validity of research outcomes generated from contextual exploration.

One other area that militates against proper contextual synthesis is the prevalence or insistence on disciplinary boundaries. The need to expand the criteria and research tools for the synthesis of contexts remains valid. Therefore, the need to actively encourage and promote multi-disciplinary collaboration in contextual synthesis is likely to impact the knowledge base, influence theoretical changes in the field, impact policy by changing the nature of prevailing social structures and quality of interactions therefrom. This is more likely to impact the research tools, the media engagement methodology, quality of practitioners, regulators and laws/rules and regulations on securities as a concept. The public and investors’ awareness is likely to be improved as every individual sees their field of specialty or enterprise squarely represented in investment instruments. This is more likely to improve speedy adoption and engagement by all and sundry as they see securities not just as instrument of contract between contracting parties, but a communication tool that constitute an amalgam of diverse interests, themes and contexts.
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230


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Appendix

Focused Group Structured Interview Questions (Questionnaire enclosed)

1. Do you agree that the No Look Through provisions affect transferability and circularity? In view of your answer, is it safe to ascribe securities to contract law or property law?
2. Given the multi-layered intermediation of these instruments, can you still safely say that the No Look Through provisions have any effect? Why?
3. Do you agree that your ability to move securities around in the market is constrained by the formalistic nature of securities definition? To what extent do you agree? Why?
4. Do you think the structure and language of the definition of securities constrain conceptualisation? Why?
5. Can judicial context sensitive approach resolve this definitional incoherence?

Unstructured questions were built around the following:

1. Specificity of instruments in the face of multi-layered intermediation and its legal effect on transferability and circularity - (The No Look Through controversy)
2. The legal effect of capacity within the purview of Agency and/or Trust relationships in the quest to ensure clean break, transferability and circularity. The legal effect of Agency Contract and Trust Deed in the market.
3. The legal effect of holder in due course within the context of transfer and circularity.
4. Identification of borderline instruments and how their respective legal treatment constrains transferability and circularity.

<table>
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<th>Data capture processes</th>
<th>The occasion</th>
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<tr>
<td>Focused Group interaction</td>
<td>Meeting with lawyers in common room, court premises in Lagos</td>
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<td>Questions to business journalists on Channels Television, Nigeria</td>
<td>Every week questions were put to regulators and market participants on live programmes through the journalists using my Twitter handle @ikpems</td>
</tr>
<tr>
<td>Interaction with staff of NSE</td>
<td>Informal interaction with a member staff and lawyer with the NSE</td>
</tr>
<tr>
<td>Staff of SBL, Nigeria Bar Association</td>
<td>Questions embedded into agenda and discussions</td>
</tr>
<tr>
<td>Disguised-non-participant observation</td>
<td>Visit to some law firms and broker dealers operating in the market</td>
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** Names included in this research are as provided by respondents **
## Mode of Data Capture

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<td>Researcher</td>
<td>Legal Practitioners for market participants and regulators</td>
<td>Planned interactions</td>
<td>11/03/2014, 10/03/2015, 17/10/2016</td>
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<td>Unstructured</td>
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<td>About the NSE and SEC legal operations</td>
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<td>Legal Practitioners</td>
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<td>22/6/2016, 18/6/2017</td>
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<td>Unstructured</td>
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<td>Mkt Participants, NSE, NASD-OTC, FMDQ-OTC, SEC, CSCS</td>
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<td>Every week from the 25/11/2015 to 31/01/2018</td>
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<td>Observation</td>
<td>Mr A. Inyang</td>
<td>Market participants and lawyers</td>
<td>Informal interactions with lawyers and market participants in Nigeria during my visits</td>
<td>26/03/2015, 12/10/2016, 27/01/2017, 18/10/2017, 09/03/2018</td>
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</table>

**Names included in this research are as provided by respondents**
Securities Conceptualisation Questionnaire

No Look-Through Provision

1. Do you agree that the No-Look Through provisions affect transferability and circularity? In view of your answer, is it safe to ascribe securities to contract law or property law?

2. Given the multi-layered intermediation of these instruments, can you still safely say that the No-Look Through has any effect? Why?

Formalism

1. To what extent do you agree that your ability to move securities around in the market is constrained by the formalistic nature of securities definition –
   (a) Agree       (b) Disagree

   Why?

Structure of definition

1. What role do you think the language of legislation play in constraining?

Judicial Context-Sensitive Functionalist Approach

1. Can judicial context-sensitive functionalist approach resolve the above?