

## THE OBLIGATION TO PROVIDE OFFEREEES OF CORPORATE SECURITIES WITH FORMAL DISCLOSURE DOCUMENTS

It is axiomatic that sound investment decisions can only be made if an investor has access to all material information relating to the investment. It is also axiomatic that many investors do not have the expertise to recognise that there may be insufficient information available upon which to make an informed judgment. Similarly, many investors do not have the ability and motivation to seek out information for themselves. Those investors who lack the expertise to recognise the inadequacy of information or who are unable to ascertain all material information for themselves are, therefore, at a disadvantage in the investment world. The legislatures of many countries have tried to overcome this disadvantage by compelling the disclosure of certain material investment information to the market in general and, under some circumstances, by ensuring that persons who are asked to take up particular securities not only have access to material information but are actually given possession of that information. This article will concentrate on the circumstances in which Australian investors are entitled to possession of information prior to the making of an investment decision<sup>1</sup>. It is not proposed to examine the adequacy of the particular information required to be disclosed or to debate the arguments for and against the disclosure—orientated philosophy of the existing legislation.

Professor Gower has written of the prospectus provisions of the U.K. Companies Act 1948-1967: "These are extremely confusing, largely because they have grown up haphazardly as new safeguards have been added to meet dangers revealed by experience. But the general aim is clear, namely, to ensure that the company gives to the public the essential minimum of information about its position when it is launched into the world, and that whenever it offers its securities to the public it fully and fairly discloses the relevant facts so that the risk of the investment can be assessed"<sup>2</sup>. The following analysis will show that, although the provisions of the Australian Companies Acts<sup>3</sup> do materially diverge from their United Kingdom counterparts, Professor Gower's comments also hold true for them. Not only are the Australian provisions confusing but, read literally, they require urgent revamping on two other counts. Firstly, the existing provisions inadequately achieve their general aim as stated above by Professor Gower. Secondly, they impose burdens and restraints on persons seeking to dispose of securities which appear to have little if anything to do with the achievement of that general aim. As new Australian Government legislation

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1. The distinction drawn between "possession" of information and "access" to information precludes a discussion, *inter alia*, of statements in lieu of prospectus which must be filed with the appropriate agency at least three days before a public company first allots securities: Uniform Companies Act, s.50. See n.3 *infra*.

2. L. C. G. Gower, *Modern Company Law* (Stevens, 3rd ed., 1969), 295.

3. N.S.W., Companies Act 1961-1974; Vic., Companies Act 1961-1971; Qld., Companies Act 1961-1971; W.A., Companies Act 1961-1971; S.A., Companies Act 1962-1972; Tas., Companies Act 1962; A.C.T., Companies Ordinance 1962-1971; N.T., Companies Ordinance 1963-1968. The sections of the Acts discussed in this article are, with one exception, uniform throughout the States and Territories. The Acts will, therefore, be referred to as the Uniform Companies Act or the U.C.A. S.40 is uniform in all jurisdictions except New South Wales.

is proposed in this area of securities regulation this is an opportune time to highlight some of the deficiencies in the existing regulatory structure and to comment on alternative regulatory systems of other jurisdictions.

### **The Prospectus Provisions of the Uniform Companies Act**

Section 42(1) of the Uniform Companies Act provides that a prospectus shall not be issued, circulated or distributed by any person unless a copy thereof has first been registered by the Registrar<sup>4</sup>. The Registrar, under s.42(2), shall not register a copy of any prospectus unless, *inter alia*, it appears to comply with the requirements of the Act. Section 39 prescribes what is necessary by way of form and content for a prospectus to comply with the Act. The Act, therefore, prohibits any person issuing or circulating any prospectus if that prospectus is not in the prescribed form and is not registered by the Registrar.

The Act imposes criminal penalties on persons who fail to comply with the prospectus provisions<sup>5</sup> and civil liability may be incurred for "untrue statements" or "wilful nondisclosures" in a prospectus which cause loss or damage to persons who subscribe for or purchase securities on the faith of a prospectus<sup>6</sup>.

"Prospectus" is defined by s.5(1) as "a prospectus, notice, circular, advertisement or invitation inviting applications or offers from the public to subscribe for or purchase or offering to the public for subscription or purchase any shares in or debentures of or any units of shares in or units of debentures of a corporation or proposed corporation."

Whether or not the prospectus provisions of the U.C.A. are applicable, therefore, turns upon (a) *to whom* the offer or invitation is addressed (b) *what* is offered or invited, and (c) *how* the offer or invitation is made.

#### **(A) TO WHOM THE OFFER OR INVITATION IS ADDRESSED**

The definition of "prospectus" in s.5(1) only embraces offers or invitations to the public. The entire system of prospectus regulation hinges upon whether or not the public is offered, or invited to apply for, securities<sup>7</sup>.

The "public" is defined in both positive and negative terms by s.5(6). On the positive side, s.5(6) states that a reference in the Act to an offer to the public shall, unless the contrary intention appears, include an offer to any section of the public, whether selected as clients of the person issuing the prospectus<sup>8</sup> or in any other manner<sup>9</sup>. On the negative side, the sub-section

4. In New South Wales, the Corporate Affairs Commission; in Queensland, the Commissioner for Corporate Affairs.

5. U.C.A. ss.37(1), 39(4), 40(4), 42(3).

6. U.C.A. s.46.

7. The generic term "securities" is used throughout the text to describe shares and debentures. The term does not cover interests other than shares or debentures. The offering of "interests" is regulated by Part IV, Div. V of the U.C.A. As is the case with shares and debentures, an offering of interests will only require a prospectus if the offer is made to the public. See: U.C.A. ss.81-83.

8. The reference to "prospectus" produces a curiously circular affect. The definition of "offer to the public" is important because the prospectus provisions are contingent on there being a public offer yet part of the definition of "offer to the public" assumes the existence of a prospectus. The problem could be overcome by inserting the words "making the offer or invitation" in lieu of "issuing the prospectus". This has been done in the definition of "offer to the public" in cl.12 of the Australian Government's Corporations and Securities Industry Bill.

9. What is meant by "section of the public"? The reference in s.5(6) to "clients" of the person issuing the prospectus suggests that if a stockbroker offered securities

specifically deems four types of offers or invitations not to be offers to the public. The exemptions are: offers to enter into underwriting agreements; offers to persons whose ordinary business it is to buy or sell shares or debentures as principal or agent<sup>10</sup>; offers to existing members or debenture-holders of a corporation of shares or debentures of that corporation<sup>11</sup>; and offers of shares by a corporation to another corporation on the latter corporation winding up or disposing of some or all of its property to the offeror corporation in consideration, *inter alia*, of the sale of the property<sup>12</sup>.

The exemptions all appear to relate to offers to persons whom the legislature did not regard as needing the protection offered by a compulsory prospectus. Underwriters, and other persons whose ordinary business entails buying and selling securities, are thought to be sufficiently well informed of investment practices to be able to fend for themselves without the paternalistic assistance of statutorily demanded disclosure. A little surprisingly, perhaps, the same view is taken of offers to existing shareholders or debenture-holders of the corporation. The legislators no doubt thought that existing

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to all (some ?) of his clients then that might be an offer to a section of the public. Would an offer to a company's employees be an offer to a section of the public? Would the answer depend upon the number of employees involved? The resolution of the question is extremely important given the increasing tendency of companies to offer securities to employees. Proprietary companies are permitted to have an unlimited number of employee-members (U.C.A.: s.15(1)(b)) yet proprietary companies must not offer securities to the public (U.C.A.: s.15(1)(c)). Thus a proprietary company may be acting improperly if it offers its securities to its employees as a class. It has been suggested that the specific exemption, in s.5(6), granted to offers to existing security holders of the offeror corporation would not have been necessary if an offer to such a limited class of persons had not *prima facie* been an offer to the public or a section of the public: *Nash v. Lynde* [1929] A.C. 158, at 171 per Lord Buckmaster. Conceptually, there appears little distinction between a company's employees and a company's existing security holders; if a company's security holders would be "a section of the public" then it is possible that a company's employees would also be "a section of the public".

10. Are offers to institutional investors, such as life assurance companies, exempted from the prospectus requirements by this section? Professor Ford has taken the view that they are not exempt: H. A. J. Ford, *Principles of Company Law* (Butterworths, 1974), 266. It is submitted that life assurance companies and other institutional investors do buy and sell securities in the ordinary course of their business and are within the exemption. Even if this is not correct, offers to such investors ought not to require a prospectus because they do not need the protection afforded by a prospectus. As to this, see *infra* pp.140-143.
11. This exemption clearly does not cover offers of securities in company X to the members of company Y. The question arises whether, if company X offers its shares to the shareholders of company Y as part of a take-over offer, company X would have to prepare, register and deliver a copy of a prospectus. Some take-over offers are regulated by non-prospectus provisions of the U.C.A. and these provisions require Company X to register and deliver a disclosure document in the form of a Part A Statement. Might company X also have to register and deliver a prospectus? The members of company Y might well be considered to be the public or, at least, a section of the public. But see *Government Stock and Other Securities Investment Co. Ltd. v. Christopher* [1956] 1 All E.R. 490 where Wynn-Parry J. thought that such an offer of shares in a take-over scheme was not an offer to the public because the offer was only capable of being accepted by the shareholders of the offeree or target company. In these circumstances the offer fell within s.55(2) of the U.K. Companies Act, 1948, which, in rather ambiguous terms, exempts certain offers from the prospectus provisions if the offer is not "calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer". The U.C.A. does not contain a similar section yet Wynn-Parry J.'s decision may nevertheless be followed in Australia. See: *Colortone Holdings Ltd. v. Calsil Ltd.* [1965] V.R. 129, at 134 per Gillard J. Take-over offers and invitations are specifically excluded from the definition of "prospectus" in the Australian Government's Corporations and Securities Industry Bill, cl.3.
12. Such an offer was held not to be an offer to the public of shares for subscription even before the specific statutory exemption was enacted. See: *Booth v. New Afrikaner Gold Mining Company Ltd.* [1903] 1 Ch. 255 (C.A.).

holders of securities in a corporation could be assumed to have sufficient knowledge of the corporation's affairs to be able to evaluate the wisdom of making a further investment in it. This assumption has been questioned on the basis that existing securities holders can only properly decide whether to supply further capital if they are aware of the corporation's precise financial position and plans at the time the additional capital is sought. The Eggleston Committee recommended that some disclosure, short of full prospectus disclosure, should be required where securities were offered to existing members. The idea was to legislate to make compulsory what the Committee regarded as "the normal practice of companies . . . to send details of the offer to shareholders in a circular which sets out the terms of the issue, and usually gives some information as to the progress of the company, plans for future expansion, and the like"<sup>13</sup>.

Apart from offers which are clearly deemed not to constitute offers to the public under s.5(6), all other offers of securities in corporations have to be carefully scrutinized to determine whether a registered prospectus is required because of the "public" nature of the offer. Unfortunately, little guidance is afforded by the Act or by decided cases as to precisely when an offer is a public one. The failure of the courts to clearly define the elements of a public offer has been much discussed elsewhere and little point is served by exhaustively reviewing the authorities here<sup>14</sup>. What is interesting about the

13. Fifth Interim Report of the Company Law Advisory Committee to the Standing Committee of State and Commonwealth Attorneys-General (1970), paras. 8-12. The Australian Government's Corporations and Securities Industry Bill, cl.12, has deleted this exemption and has specifically brought such offers within the "public" umbrella: see *infra* p.158.

14. See, for example, P. C. Heerey, "Directors and Public Issues" (1967) 5 M.U.L.R. 429, particularly at pp. 441-445. The following extracts from the two leading cases on the meaning of the term should indicate the current state of confusion.

"The public' . . . is of course a general word. No particular numbers are prescribed. Anything from two to infinity may serve: perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole. The point is that the offer is such as to be open to any one who brings his money and applies in due form, whether the prospectus was addressed to him on behalf of the company or not." *Nash v. Lynde* [1929] A.C. 158, at 169 per Lord Sumner. This passage was cited with approval by the United States Supreme Court in *S.E.C. v. Ralston Purina Co.* 346 U.S. 119 (1953).

"It may be conceded that it may be possible to establish an invitation to the public by proving a series of particular invitations to individuals over so wide a field and in such circumstances or terms as to lead to the inference that an invitation to the public is being made. . . . In my opinion, *Nash v. Lynde* lends no support to the proposition that an invitation to a single member of the public . . . is an invitation to the public. . . ." *Lee v. Evans* [1965] A.L.R. 614, at 617 per Barwick C.J.

"I am not intending to hold . . . that the size of the immediate audience is necessarily conclusive of the question whether the invitation is an invitation to the public. . . . [I]n considering the answer the distinction must not be overlooked between the case of an invitation which is itself open to acceptance by any member of the public who may be interested and the case of an invitation which itself is open to acceptance by a specific individual only but, if declined by him, is likely to be followed by similar invitations to other specific individuals in succession until an acceptor is found. The first of these is a case of an invitation to the public; the second, in my opinion, is not. . . ." *Lee v. Evans*, *supra*, at 621 per Kitto J.

"An invitation can be conveyed or communicated to the public in many ways: in writing, by a notice in the press or posted in a public place conveying an invitation to any readers orally by an address to a public meeting or an announcement in a public place: by handing leaflets to passersby in a public street: by circulars sent through the post: by going indiscriminately from house to house repeating the invitation. The essence of an invitation to the public is not in the manner of its communication or in the number of the persons to whom it is communicated. The criteria are rather, are the recipients of the invitation

offer to the public cases is that the courts have never avowedly approached particular fact situations in terms of whether the recipients of the offers in question were deserving of the protection of the prospectus provisions. The prospectus provisions were intended to safeguard investors who needed to know certain information in order to be able to evaluate an investment. The exemptions from the definition of "public" in s.5(6) all relate to situations where the investors' need to know material information can usually be satisfied by means other than a formal prospectus. It is submitted that the courts should adopt, as the basic criterion for determining whether an offer is a public one or not, the need of the offerees or invitees in question for prospectus type disclosure<sup>15</sup>.

The offeree's "need to know" has become the single most important determinant of "a public offering" by United States courts. Pursuant to the Securities Act 1933, s.4(2), an issuing corporation may escape from the registration and prospectus provisions of the Act by demonstrating, *inter alia*, that the issue involved no "public offering". In *S.E.C. v. Ralston Purina Co.*<sup>16</sup> the United States Supreme Court held that to ascertain the meaning of "public" the policy of the Act had to be determined and that meaning of "public" chosen which would advance that policy. The Court had no difficulty in finding that the Securities Act 1933 was intended to protect investors by ensuring that they had access to all relevant information. The "no public offering" exemption, therefore, was designed for offers to those who could fend for themselves and who did not need the protection of the Act. An offeree could fend for himself, *inter alia*, if he knew or had access to prospectus quality information.

Recently the United States Securities and Exchange Commission formulated guidelines designed to assist corporations in determining their eligibility for s.4(2) exemption. In the S.E.C.'s view, exemption from s.4(2) requires compliance with *all* of the conditions laid down in Rule 146<sup>17</sup>. Among the most important of those conditions are:—

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chosen at random, members that is of the general public, the public at large, all and sundry; or are they a select group to whom and to whom alone the invitation is addressed, so that if an outsider sought to respond to it he would be told that he was not one of those invited to come in. . . .

" . . . Whether or not the proposal be an offer or invitation, it cannot be an offer or invitation to the public if it be addressed to a particular person. . . ."

*Lee v. Evans, supra*, at 624-625, per Windeyer J.

See also: *Sherwell v. Combined Incandescent Mantles Syndicate Ltd.* (1907) 23 T.L.R. 482; *In re South of England Natural Gas and Petroleum Co.* [1911] 1 Ch. 573; *Ex parte Lovell*; *Re Buckley* (1938) 38 S.R. (N.S.W.) 53; *R. v. Empire Dock Ltd.* (1940) 55 B.C.R. 34; *R. v. Piegras* (1959) 23 D.L.R. (2d.) 220.

15. Several recent decisions of Australian courts suggest a willingness to broadly interpret some of the prospectus provisions of the U.C.A. so as to achieve what the courts considered were the objectives of the legislation. See: *Mutual Home Loans Fund of Australia Ltd. v. Attorney-General* (N.S.W.) [1971] 2 N.S.W.L.R. 162; (1973) 47 A.L.J.R. 749 (H.C.); *Attorney-General (N.S.W.) v. Australian Fixed Trusts Ltd.* [1974] 1 N.S.W.L.R. 110.
16. 346 U.S. 119 (1953).
17. S.E.C. Securities Act Release No. 5487 (Apr. 23, 1974). For a discussion of the case law on the "no public offering" exemption and Rule 146 see: G. C. Spencer, "Private Placement of Securities in Oregon: The Legal Framework" 53 *Oreg. L.R.* 131 (1974); Borton and Rifkind, "Private Placement and Proposed Rule 146" 25 *Hast. L.J.* 287 (1974); Note, "S.E.C. Rules 144 and 146: Private Placements for the Few" 59 *Virg. L.R.* 886 (1973); T. A. Alberg and M. E. Lybecker, "New S.E.C. Rules 146 and 147: The Non-Public and Intrastate Offering Exemptions" 74 *Columbia L.R.* 622 (1974); E. T. McDermott, "The Private Offering Exemption" 59 *Iowa L.R.* 525 (1974). Compliance with Rule 146 creates a presumption that the issuer is entitled to rely upon the "non-public

- (1) During the course of direct communication between the issuer and the offeree or his representative, where questions may be posed, the offeree or his representative must have access to the type of information required to be included in a full disclosure registration statement filed under the 1933 Act and whatever information is necessary and available to verify that information.
- (2) The issuer must have reasonable grounds to believe that (a) either the offeree or his investment representative has such knowledge and experience in financial and business matters that he is capable of utilizing the information to evaluate the risks of the prospective investment and of making an informed investment decision and (b) the offeree is able to bear the financial risks of the investment, where the offeree utilizes an investment representative.
- (3) The number of purchasers<sup>18</sup> must be limited to thirty-five persons<sup>19</sup> excluding any fully owned affiliate of the issuer, any director or executive officer of the issuer, any bank lending money to the issuer, various employees and those who purchase for cash in an amount of \$150,000 or more<sup>20</sup>.

The critical importance of the "need to know" criterion has also been recognized in Ontario. In February 1970 a committee of the Ontario Securities Commission recommended that the confusing concept of a "public offering" be largely eliminated from the Ontario Securities Act in favour of a mandatory prospectus requirement for all distributions of securities other than those specifically exempted by legislation<sup>21</sup>. Ontario Bill No. 75 of 1974, entitled The Securities Act, 1974, which is likely to provide the basis for a

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offering exemption". Compliance with Rule 146 is not the only way to come within the exemption. Issuers may rely on s.4(2) by complying with administrative and judicial interpretations in effect at the time.

18. Note that Rule 146 imposes no restriction on the number of persons who are approached so long as they are approached by direct communications and not by means of advertisements etc.
19. The Eggleston Committee, in its Fifth Interim Report released in 1970, noted some of the unresolved difficulties inherent in the phrase "offer to the public". On the assumption that the legislature intended to free companies making "relatively small offerings" from the considerable expense involved in complying with the prospectus provisions, the Committee recommended the enactment of a section to specifically exempt from the prospectus provisions any issue of securities not involving the issuing company in making more than fifty *offers or invitations* within any three month period. The Committee's recommendation, which is based, it is submitted, on a dubious assumption, would, unlike Rule 146, do nothing to ensure that the offerees actually approached were able to fend for themselves.
20. Rule 146 is to be contrasted with s.227(b) of the First Tentative Draft of the American Law Institute's proposed Federal Securities Code (1972). It would exempt any "limited offering" where the number of purchasers, not counting institutional investors, does not exceed 35. Unlike Rule 146, nothing would turn on the purchaser's access to information, investment sophistication or ability to bear the risk. See L. Loss: "Proposals for Australian Companies and Securities Legislation: Comments from the American Experience" (Australian Attorney-General's Dept. 1973), pp.28-29. Loss prefers the Law Institute's approach to that recommended by the Eggleston Committee. He believes that the numerical limitation should be framed in terms of buyers rather than offerees for two main reasons. Firstly, because it is difficult to see how an offeree who does not buy can be hurt and, secondly, the test should be as definite as possible in implementation and enforcement and it is much easier to count buyers than it is to count offerees. The proposal in the Ontario Bill 75 of 1974, noted *infra* p.142, adopts, as criteria for exemption from the prospectus provisions, both the number of offerees and the number of purchasers.
21. Report of the Committee of the Ontario Securities Commission on the Problems of Disclosure Raised for Investors By Business Combinations and Private Placements (Feb. 1970), pp. 41-45. The report has become known as the Merger Report.

uniform approach to securities regulation throughout the Canadian provinces<sup>22</sup>, embodies these recommendations. Basically, Bill 75 requires a prospectus to be issued in respect of previously unissued securities or in respect of sales of issued securities by a shareholder who holds "a sufficient number of any securities . . . [of a corporation] . . . to affect materially the control of that [corporation]"<sup>23</sup>. Many exemptions from the prospectus requirement are stated<sup>24</sup>. They relate, *inter alia*, to sales made to banks, loan corporations, insurance companies, registered securities dealers, underwriters and to persons who purchase, as principal, securities for a consideration of not less than \$97,000 cash or \$100,000 if the purchaser pays with assets. Bonus share issues are exempt, as are rights issues, although the Securities Commission may object to the latter. Shares sold to employees are exempt so long as the employees are not induced to take up shares by expectation of employment or continued employment. Perhaps, for present purposes, the most interesting exemption is contained in clause 70(1)(k). It exempts sales made between an issuer and not more than fifteen purchasers if each of the following requirements is satisfied:

- (i) each purchaser purchases as principal;
- (ii) each purchaser,
  - (a) is an experienced investor who, by virtue of his nett worth and investment experience or by virtue of consultation with or advice from a registered adviser, is able to evaluate the prospective investment on the basis of information respecting the investment presented to him by the issuer and who has access to substantially the same information concerning the issuer that a prospectus accepted for filing under the legislation would provide, or
  - (b) is a senior officer or director of the issuer or his spouse, parent, brother, sister or child;
- (iii) the offer and sale of securities are not accompanied by an advertisement and no selling or promotional expenses have been incurred or paid in connection therewith; and
- (iv) the solicitation in respect of securities is made to no more than twenty-five prospective purchasers.

Rule 146 and Bill 75 represent noteworthy attempts to achieve the aims of disclosure—orientated legislation and, at the same time, to bring more certainty into this important area of business regulation. The policy espoused is one

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22. Introducing Bill 75 of 1974 (The Securities Act 1974) to the Ontario legislature on June 7, 1974, the Minister of Consumer and Commercial Relations said that the legislation had "been discussed in detail with the representatives from other Provinces and we anticipate that it will find acceptance as a Uniform Provincial Securities Act". (Bulletin of Ontario Securities Commission for June, 1974, p.105). Bill 75 was not passed in the session in which it was introduced.

23. Clauses 52(1) and 1(12). A person or company holding more than 20 per cent. of the outstanding voting securities of an issuer is, in the absence of evidence to the contrary, deemed to affect materially the control of that issuer: cl.1(12)(iii). Sales of issued shares by controlling shareholders are not subject to any special disclosure regulation in Australia, although, if the company is a listed public company, details of changes in share ownership will have to be recorded in the company's register of substantial shareholders: U.C.A. ss.69a-69n. The arguments in favour of requiring special disclosure by controlling shareholders are stated in the *Merger Report* at pp.52-53. For a discussion of the regulation of sales by controlling shareholders by the U.S. 1933 Securities Act, see: H. Frank "Sales of Securities by 'Controlling Persons' under the Federal Securities Act" 14 *Hastings L.J.* 137 (1962); Note: "Rule 144: S.E.C. Regulation of Dispositions by Controlling Shareholders and Private Places", 25 *Vand. L.R.* 845 (1972).

24. See cl.70.

geared to ensuring that each individual person who is offered securities at least has the opportunity to appraise prospectus quality information before making an investment. The current Australian prospectus provisions, given the way they, and similar United Kingdom provisions, have been interpreted by the courts, do not ensure that all investors have access to prospectus quality information when asked to take up securities. In their vague conceptual meanderings the Anglo-Australian courts have not seized upon an offeree's "need to know" when determining whether a public offer is involved but they have instead concentrated on such matters as the number of persons approached and whether or not the offer may be accepted by anyone who may choose to take advantage of it. These considerations ought to be extraneous to the disclosure objectives of the legislation.

Any modification of the "offer to the public" aspect of the prospectus provisions of the Uniform Companies Act may have an impact on proprietary companies which must, by their articles or memorandum, be prohibited from offering securities to the public<sup>25</sup>. Sole reliance on the criterion of the offeree's "need to know" prospectus quality information might mean that many offers of securities in proprietary companies are considered to be public offerings. It is by no means clear to the writer that persons who are offered securities in proprietary companies ought to be in any worse position than persons who are offered securities in public companies as regards the information they are entitled to prior to the making of an investment decision. If it is considered that proprietary companies ought to be freed from an obligation to comply with the prospectus provisions because the trouble and expense involved might unduly hinder the financing of small businesses then several solutions are possible. One is to adopt the U.S. Securities Act exemption for small issues of securities to the public. The Securities and Exchange Commission, under s.3(b) of the Act, has the power to grant an exemption from the registration and prospectus provisions if it finds that they are "not necessary in the public interest and for the protection of investors by reason of the small amount involved or the limited character of the public offering". The S.E.C.'s power to exempt was originally limited to issues to the public involving an aggregate amount of U.S. \$100,000 or less. The limit was raised to U.S. \$300,000 in 1945<sup>26</sup> and, after repeated attempts by legislators, to U.S. \$500,000 in 1973<sup>27</sup>.

A greater discretion would be given to the Ontario Securities Commission by clause 72 of Bill 75 of 1974<sup>28</sup>. It would permit the Commission, on application of an interested person or company, to rule that the registration and prospectus provisions ought not to apply if it is satisfied that to do so would not be prejudicial to the public interest. The Commission may impose such terms and conditions as it thinks necessary in granting the exemption. The necessity to seek such exemptions would, of course, only arise if no other specific statutory exemption was available.

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25. U.C.A. s.15(1)(c).

26. See L. Loss, *I Securities Regulation* (Little, Brown & Co. 2nd ed. 1961, Supp. 1969), at 606-607.

27. Alberg and Lybecker, *supra* n.17, 622 n.3. The S.E.C. has recently proposed Rule 240 which it is hoped will guide issuers in interpreting s.3(b) of the Securities Act (S.E.C. Securities Act Release No. 5499, June 3, 1974). Rule 240 would exempt transactions where the issuer sold less than U.S.\$100,000 of securities during any consecutive twelve-month period to 25 or fewer purchasers provided, *inter alia*, there was no general advertising or sales solicitation. Immediately before and after any sale pursuant to the proposed rule, there could be no more than 50 beneficial owners of the issuer's securities. *Id.*

28. Cl.72 is in similar terms to s.14 of the 1971 Ontario Securities Act.



**(B) THE SUBJECT MATTER OF THE OFFER OR INVITATION**

The offer on invitation must be of securities for subscription or purchase. The word "subscription" is used in contradistinction to the word "purchase" throughout the Uniform Companies Act. "Subscription"<sup>29</sup> refers to the acquisition by issue and allotment of unissued securities in a corporation whereas "purchase" signifies the acquisition of issued securities in a corporation. As Lord Greene, M.R., in *Re V.G.M. Holdings Ltd.* stated:

"Quite apart from those considerations relating merely to the language of the Act, it seems to me that the word "purchase" cannot, with propriety, be applied to the legal transaction under which a person, by the machinery of application and allotment, becomes a shareholder in the company; he does not purchase anything when he does that. Counsel for the respondent endeavoured heroically to establish the proposition that a share before issue was an existing article of property, that it was an existing bundle of rights which a shareholder could properly be said to be purchasing when he acquired it by subscription in the usual way. I am quite unable to accept that view. A share is a chose in action. A chose in action implies the existence of some person entitled to the rights, which are rights in action as distinct from rights in possession, and, until the share is issued, no such person exists. Putting it in a nutshell, the difference between the issue of a share to a subscriber and the purchase of a share from an existing shareholder is the difference between the creation and the transfer of a chose in action. The two legal transactions of the creation of a chose in action and the purchase of a chose in action are quite different in conception and in result"<sup>30</sup>.

*(1) Offers or Invitations of Securities for Subscription*

An offer or invitation relating to unissued and unallotted securities of a corporation will be made whenever a corporation wishes to raise share or loan capital. Capital will of necessity be raised when the corporation is first formed but it may also be raised subsequently. Whenever a person is asked or invited to supply capital to a corporation that person, in order to make a wise investment decision, must know certain facts about the corporation—facts enabling the person to assess, on the one hand, the degree of risk to which the capital may or will be subjected and, on the other hand, the relative profit earning potential of that capital in that corporation. A prospectus which complies with the Uniform Companies Act will go some way towards providing an investor with at least the minimum amount of information, relating to the corporation and the planned use of the capital it is seeking to raise, necessary to formulate a sound business judgment. It is the corporation that is seeking to place new capital at risk and it is the corporation which can and should disclose information pertaining to that risk.

29. In *Government Stock and Other Securities Investment Co. Ltd. v. Christopher* [1956] 1 All E.R. 490, at 492, Wynn-Parry J. thought that "subscribing for shares" meant taking or agreeing to take shares for cash. In *A-G (N.S.W.) v. Mutual Home Loans Fund* [1971] 2 N.S.W.L.R. 162, at 169, Asprey and Mason J.J.A. declined to decide whether the meaning of "subscription" in s.40(I) N.S.W. Companies Act was so limited. Note that for the purposes of s.374 of the Uniform Companies Act an offer of securities for subscription or purchase is to be construed as including an offer of shares by way of barter or exchange: s.374(12). Does this infer that a similar construction ought not to apply in other sections of the Act?

30. [1942] 1 All E.R. 224, at 226.

The Uniform Companies Act departs in one instance from the premise that one who takes up an offer or invitation relating to issued or allotted securities cannot be a subscriber for those securities. The exception is contained in s.43. Under that section a person who takes up previously issued or allotted securities may be deemed to have subscribed for those securities from the corporation.

Section 43(1) provides that where a corporation allots or agrees to allot any securities with a view to<sup>31</sup> all or any of them being offered for sale to the public, any document by which the offer for sale to the public is made shall for all purposes be deemed to be a prospectus issued by the corporation and the person accepting the offer shall be regarded as a subscriber for the securities from the corporation. The liability, if any, of the person actually making the offer for mis-statements or non-disclosure in the document or otherwise is preserved and exists alongside the liability, if any, of the corporation in respect of the prospectus. The section plays a curious role in the U.C.A. and, as its importance has been misunderstood in the past, it warrants a full examination.

Section 43 had its genesis in the 1926 United Kingdom Greene Committee Report<sup>32</sup>. The Committee found that it had become common practice for corporations to avoid the prospectus provisions of the U.K. Companies (Consolidation) Act of 1908 by offering securities indirectly to the public. The corporation would first allot or agree to allot its securities to brokers or others engaged in finance or investment. No prospectus was required for the allotment because no public offering was involved. The allottees of the securities would then offer the securities to the public. Although the definition of "prospectus"<sup>33</sup> in the 1908 Act embraced both offers of securities for subscription and purchase, the legislation only specifically regulated prospectuses issued by or on behalf of a corporation. Thus the legislation only prescribed the form and content of prospectuses offering shares for subscription and the filing requirements and statutory liability for statements in prospectuses only extended to prospectuses offering shares for subscription<sup>34</sup>. An offer of securities to the public for sale or purchase by an allottee was, therefore, totally unregulated. The Greene Committee said: "There is no doubt that this method of placing shares with the public has in many cases been adopted for the purpose of avoiding the strict requirements of the law with regard to prospectuses, with the result that the public has been deprived of the protection which the legislature intended it to have"<sup>35</sup>.

The view that the subsequent resale of the securities to the public by the allottee did not require the registration of a prospectus which complied with the Act was, perhaps, a little too sweeping. In many cases, where a corporation

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31. Does the phrase "with a view to" mean that it must be shown either that the allotting corporation actually intended the securities to be offered to the public or that the allotment would not have been made but for the knowledge that there would be a subsequent offer of the securities to the public? Would it be enough to show that the corporation should have realised that the securities would be offered to the public? Does it matter whether or not the securities were allotted by the corporation to X with a view to X selling them to Y so that Y could offer them to the public? So far there is no case law on s.43 or its United Kingdom equivalent (s.45 of the U.K. Companies Act 1948).
  32. *Company Law Amendment Committee Report* 1926, Cmd. 2657 (hereafter referred to as the *Greene Committee Report*).
  33. U.K. Companies (Consolidation) Act 1908, s.285.
  34. *Id.*, ss.80 and 84.
  35. *Greene Committee Report*, *supra* n.32, §40.

specifically set out to avoid the prospectus provisions by going through the formality of allotting securities to a person on the understanding that that person would in turn offer them to the public, the company—allottee relationship could be properly described as that of principal-agent<sup>36</sup>. If an agency relationship did exist with regard to the offer to the public then the offer would have been made by or on behalf of the principal corporation and the prospectus provisions may have applied. The Greene Committee seems to have recognised this for its recommendations were aimed at those relationships between company and allottee falling short of that between principal and agent. "(I)t cannot be right", the Committee stated, "that where the offerors are morally, although not in law, the agents of the company to place the shares with the public, the company or its directors should be able to avoid their responsibilities as they can at present"<sup>37</sup>.

Section 43(2) of the Uniform Companies Act provides that it shall be evidence, unless the contrary be proved, that an allotment or agreement to allot securities was made with a view to the securities being offered to the public if it is shown that the offer for sale to the public was made within six months after the allotment or agreement to allot, or, that at the date the offer to the public was made, the whole consideration to be received by the corporation in respect of the securities had not been so received. The subsection is ambiguous because it is not clear whether unrebutted or unexplained evidence of the type suggested will be automatically enough to establish that the corporation had the necessary intention<sup>38</sup>. The Greene Committee had recommended that the section would automatically apply if either of the two evidentiary factors was present. There would have been an irrebuttable presumption that the corporation had the necessary intention. This recommendation was apparently not adopted because it would have meant that the section would catch all resales of securities within, for example, six months of an allotment or agreement to allot, irrespective of the corporation's intention, and irrespective of the offeror being totally independent of the corporation<sup>39</sup>.

Offers to the public by private placees have also been the subject of special regulation in the United States and in the Canadian provinces. Generally, in these jurisdictions much more onerous restrictions have been placed upon the private placee's right to resell securities free of the prospectus requirements than is the case under s.43. Under s.43, for example, it may be very difficult to establish the necessary intention on the part of the corporation in respect of offers to the public made more than six months after the allotment or agreement to allot. In the United States, s.5 of the 1933 Securities Act makes

36. See, for example, *Clark v. Urquart and Stracey* [1930] A.C. 28.

37. *Greene Committee Report*, *supra* n.32, §40.

38. Most writers are of the opinion that there is a rebuttable presumption that an allotment was made with a view to the securities being offered for sale to the public if either of the two "evidentiary" factors is established. See, for example, Ford, *supra* n.10, 268; R. R. Pennington, *Company Law* (Butterworths, 3rd ed.), 217.

39. The second reading speech of Sir P. Cunliffe-Lister in the House of Commons on the bill containing the U.K. equivalent of s.43, supports this view. He said of the relevant clause: "It will not touch cases where there is no privity between the company and the vendors who offer the shares for sale. An independent person wishing to dispose of a large block of shares will be perfectly free to do so. This only deals with the case where an offer is being made on behalf of a company." *U.K. Parliamentary Debates (Commons)* (1928), Vol. 213, at 1445. These remarks suggest that something in the nature of an agency relationship must exist between company and offeror, yet s.43 would have been unnecessary if only agency relationships were caught.

it unlawful for any person to sell any securities through the use of any means or instruments of transportation or communication in interstate commerce or of the mails unless a registration statement relating to those securities is in effect and unless a subscriber or purchaser of those securities receives a copy of a prospectus. Section 4 exempts from these requirements, *inter alia*, transactions by any person other than an issuer, underwriter or dealer and transactions not involving a public offering. Section 2(11) defines an "underwriter" as one who purchases from an issuer with a view to the "distribution" of the securities to the public or one who offers or sells for an issuer in connection with such "distribution" or one who directly or indirectly participates in such "distribution".

The problem with the "view to distribution" test is that it depends primarily on the subjective state of mind of the private placee at the time of the allotment from the issuing company<sup>40</sup>. Because of the uncertainty implicit in a subjective test of this nature, an uncertainty which is undesirable in the commercial world, the United States Securities and Exchange Commission has recently promulgated Rule 144<sup>41</sup> which lays down objective guidelines for private placees who wish to avoid classification as an underwriter. There are six necessary pre-requisites under Rule 144 all of which must be present to avoid "underwriter" classification. For present purposes, the most important are:—

- (i) the securities must have been held as fully paid up securities by the seller for at least two years<sup>42</sup>;
- (ii) there must be adequate current public information about the issuing company; and
- (iii) the sales must be made through selling brokers who must not solicit offers and the sales must not be of such a magnitude that the market in the securities is disrupted.

The aim of Rule 144 is to ensure that the adequacy of information about securities offered to the public is not made to depend upon the subjective

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40. Issuing companies have often sought to protect themselves by requiring private placees to sign a letter stating that they intend to hold the securities for the purposes of investment rather than for the purpose of distributing them to the public. These self-serving letters of investment intent do afford evidence of the placee's intention but they are by no means conclusive. If, having acquired the securities, the private placee acts in a manner inconsistent with holding the securities for investment purposes and the conduct cannot be satisfactorily explained by demonstrating a change of intention after the time of the purchase necessitated by a change of circumstances, then the placee may be found to have acquired the securities with a view to their distribution to the public. See, generally, Note, "Rule 144: S.E.C. Regulation of Disposition by Controlling Persons and Private Placees" 25 Vand. L.R. 845 (1972) partic. at 851-856, and the other articles referred to *infra* n.41.

41. Securities Act Release No. 5223, Jan. 11, 1972. The rule became effective on April 15, 1972. For a discussion of Rule 144, see H. S. Wander, "Rule 144 in Motion" 1 Sec. Reg. L. J. 50 (1973); Note, "Rule 144: S.E.C. Regulation of Dispositions by Controlling Persons and Private Placees" 25 Vand. L.R. 845 (1972); Note "S.E.C. Rules 144 and 146: Private Placements for the Few" 59 Virg. L.R. 886 (1973); Note, "Revising the Private Placement Exemption" 82 Yale L.J. 1512 (1973).

42. Interestingly, a bill was introduced in the United Kingdom House of Commons in 1924 seeking to extend the definition of "prospectus" in s.285 of the U.K. Companies (Consolidation) Act 1908 to "any advertisement, circular, letter, notice or other invitation to the public offering for sale any securities of any company . . . unless the company or person offering the securities for sale has had continuous possession of the securities for a period of not less than two years immediately preceding the date of the offer for sale". See Bill 256 of 1924 in [1924] *Public Bills* Vol. 1. The bill, which failed to pass, was aimed at the same problem that s.43 was subsequently enacted to combat.

intentions of those making the offer. Protection for the investor is more important than an incidental burden which may be placed upon a private placee. In this regard Rule 144 reflects a policy significantly different from that espoused in s.43. Section 43 is also out of step with the trend of legislation in the Canadian provinces. Ontario Bill No. 75 of 1974 makes the question of whether an offer of securities for sale by a private placee requires a prospectus, or like disclosure document, partly depend upon the length of time that the private placee has held the security and the adequacy of current public information about the securities offered. The length of time varies from two to eighteen months depending, partly, upon whether or not the securities are listed on a stock exchange<sup>43</sup>. The time period only begins to run once the corporation becomes a "reporting issuer" under the legislation and thus is subject to the wide ranging continuous public disclosure requirements contained in other clauses of the Bill<sup>44</sup>.

Ontario Bill 75 and S.E.C. Rule 144 attempt to strike an acceptable compromise between imposing such severe restrictions on the right of private placees to resell securities to the public that private placements would cease to be commercially viable and placing so few restrictions on their right to distribute the securities to the public that private placements became conduits for distributing securities to an inadequately informed public. If it were not for the fact that the current U.C.A. arguably over-regulates offers of securities for sale or purchase, by sections other than s.43, a strong argument could be made out for significant amendments to be made to that section. Apart from the difficulty in establishing the intention of the issuing corporation, s.43 is also deficient in that it is only capable of applying if the securities are subsequently offered to the public by means of a document. Consequently, oral offers and offers made on a stock exchange floor would not appear to be caught by the section.

## (2) *Offers or Invitations of Securities for Sale or Purchase*

### (a) The Prospectus Provisions

It is commonly thought in Australia that apart from offers of securities for sale falling within s.43 of the U.C.A., a prospectus is not required when previously issued securities are offered to the public for purchase<sup>45</sup>. This view, no doubt, partly stems from the fact that certain offers of shares for purchase are regulated by s.374(3)<sup>46</sup> of the U.C.A. which is not a prospectus provision. It is also true that prospectus type disclosure seems to be inappropriate once the securities in question have entered the public market place and the public has assumed the risk inherent in the corporation's capital raising. The content of prospectuses prescribed by s.39 seems to be appropriate for disclosure only when the public is being called upon to supply risk capital to a corporation. It is only at that time that it is useful to know, for example, what the minimum amount required to be raised by a securities issue is, what the opening date for subscriptions is and what the amount payable on application and allotment is. After the capital has been raised, and the risk assumed, the public's interest is not in *how* the capital is to be raised and utilised but is rather in the success or otherwise of that capital's utilisation. It is only by

43. See clauses 70(5), 70(6) and 70(8).

44. See Part XVI of the Bill, clauses 73-81.

45. See, for example, *Ford, supra* n.10. Paragraph 1305 of Professor Ford's book is headed "Prospectus required only where an offer or invitation of new securities is made to the public."

46. See the discussion of this section *infra* p.150.

having information about the profitability of a corporation that the market can place a value on the corporation's issued securities and that investors can choose to retain, buy or sell those securities. A prospectus seems to be totally inapt to perform this function.

Despite the undoubted reasonableness of the view that a prospectus ought not to be required in relation to offers of securities to the public for purchase, except in cases caught by sections like s.43, the law, whether by accident or design, does not support it.

The definition of "prospectus" in s.5(1) catches any notice, circular, advertisement or invitation inviting applications or offers from the public to subscribe for or purchase or offering to the public for subscription or purchase any securities. The definition draws no distinction between offers of issued and unissued securities. It follows that any offer of securities for purchase which is within the definition will be a prospectus and will have to comply with s.39 and be registered under s.42<sup>47</sup>.

If an offer of securities for purchase is a prospectus then all of the prospectus provisions of the Uniform Companies Act will be applicable even if the securities in question have previously been offered to the public, whether for subscription or purchase, and whether by means of a prospectus or otherwise. Although wisdom would suggest that a prospectus ought only be required to conform with the Act when securities are first distributed to the public the U.C.A. does not contain any such limitation. It is mind boggling to comprehend the fact that a person may, theoretically, be required to draw up, issue and register a prospectus complying with s.39 in order to sell securities which may have been initially allotted pursuant to a prospectus offering and which may have been previously resold countless times in the market over a period of many years. One has only to glance at the form and content of a prospectus, and at the sections imposing civil and criminal liability upon those responsible for a prospectus, to see that it is absurd to require a registered prospectus as defined. The problem could be easily overcome by confining the definition of "prospectus" to offers of securities for subscription or offers of securities which are deemed under s.43 to be offers of securities for subscription<sup>48</sup>.

The fact that the prospectus provisions of the U.C.A. do not distinguish between offers of shares for subscription and offers of securities for purchase makes s.43 virtually irrelevant. All private placees offering securities to the public for purchase by means of a document would have to comply with the prospectus provisions even without s.43. Further, both criminal and civil liability would result from a failure to conform with the Act. The *raison d'être* of s.43's equivalent in the United Kingdom simply does not exist in Australia. In the United Kingdom, apart from the equivalent of s.43,

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47. The Australian position is, therefore, in marked contrast to that pertaining in the United Kingdom where the only prospectuses which have to comply with the Act and be registered are prospectuses issued by or on behalf of a company or any person engaged in or interested in the formation of the company: U.K. Companies Act 1948, ss.38, 41. It is possible that a person who offers securities for purchase to the public by means of a procedure involving the issuing or circulating of a form of application may have to prepare and register a prospectus under s.38(3) of the 1948 Act which is in terms similar to s.37 of the Uniform Companies Act. See: Gower, *supra* n.2, 301.

48. The definition of "prospectus" in the Australian Government's Corporations and Securities Industry Bill is confined to offers of securities for subscription. See *infra* p.159.

the prospectus provisions only regulate offerings by or on behalf of an issuing corporation. The only significance of s.43 in Australia is that, if it operates to catch a particular offer, those who accept the offer will be deemed to be in privity with both the company and the offeror and will be entitled to remedies against both should the prospectus be faulty.

(b) Section 374 and the Prospectus Provisions

Section 374(3) prohibits a person from making an offer in writing<sup>49</sup> to any member of the public<sup>50</sup> (not being a person whose ordinary business it is to buy or sell securities<sup>51</sup> as principal or agent) of any securities for purchase unless the offer is accompanied by a statement in writing containing the particulars required by s.374(6). The required statement is, in effect, a mini-prospectus. The expression "any member of the public" is broader in meaning than the expressions "the public" and "a section of the public" used in s.5(6)<sup>52</sup>. It follows that an offer of securities in writing for purchase may require a s.374(3) statement in circumstances where no prospectus is required because the securities have not been offered to the public. It is incongruous that a formal disclosure document should accompany an offer of securities for purchase when, if the securities had been offered for subscription, no formal disclosure document at all might be required because they had not been offered to the public. It is also incongruous that a s.374(3) statement should accompany offers which may in themselves have to satisfy the prospectus provisions because the written offer has been made to the public or a section of the public, as well as being made to a member of the public. Section 374(4) partially meets this difficulty by exempting certain written offers from the section.

No statement is required if the securities offered are of a class of securities in which permission to deal has been granted by a prescribed stock exchange in the State and the offer so states and specifies the stock exchange. The assumption apparently underlying this exemption is that the offeree will have the choice of purchasing the securities on a stock exchange at a price established by, hopefully, an adequately informed market or purchasing from the offeror. Presumably, the offeree would not purchase from the offeror at a price above prevailing stock exchange prices.

If the securities offered for purchase are those of a corporation formed or incorporated outside the State where the offer is made, s.374(3) may be complied with if a prospectus accompanies the offer. Surprisingly, offers of securities in a local corporation are not granted the same exemption. Seemingly, a written offer of securities for purchase in a local corporation which is made to a member of the public and also to the public at large will have to comply with both the prospectus provisions and with s.374(3) unless the offer is within s.43 and is deemed to be an offer of securities for

49. S.374(12) provides, *inter alia*, that "offer in writing" includes an offer by means of broadcasting, television or cinematograph and goes on to indicate how the section may be complied with if the offer is made by these media.

50. S.374(13) provides that, for the purposes of the section, a person shall not in relation to a corporation be regarded as not being a member of the public by reason only that he is an existing securities holder in the corporation or a purchaser of goods from the corporation. Even though the prospectus provisions are implicitly not relevant to offers of securities in proprietary companies, s.374 seems to apply to securities in all companies.

51. The word "shares" and not "securities" is used throughout s.374. "Shares", however, is defined by s.374(11) to include debentures and units. To avoid confusion "securities" has been used in the text.

52. *Ex parte Lovell; Re Buckley* (1938) 38 S.R. (N.S.W.) 153, at 159 per Jordan C.J.

subscription. This seems to be the effect of s.374(4) (b) which exempts offers of securities which a corporation has allotted or agreed to allot with a view to their being offered for sale to the public if the offer is accompanied by a document that complies with all enactments and rules of law as to prospectuses.

The fact that s.374(4) does not grant a general exemption to written offers in the form of a registered prospectus means that some offers of securities for purchase might have to take the form of a registered prospectus and might also have to be accompanied by a s.374(3) statement. Such a dual requirement is nonsensical but its existence adds support to the view, already canvassed, that the definition of prospectus should be confined to offers of securities for subscription.

#### (C) THE FORM OF THE OFFER OR INVITATION

The definition of prospectus refers to a "notice, circular, advertisement or invitation" offering or inviting applications for securities. Any document offering or inviting applications for securities will be a prospectus. The reference to "advertisement" and to "invitation" does not make it clear whether or not the advertisement or invitation has to be in a documented form. An *ejusdem generis* reading of the definition suggests that only written offers are caught. It follows that, with the possible exception of advertisements, all written offers of securities to the public will be prospectuses and will have to comply with the prospectus provisions of the legislation. The doubt about advertisements stems from the curious wording of s.40 of the U.C.A.

Section 40(1) deems every advertisement<sup>53</sup> offering or calling attention to an offer, or intended offer, of securities to the public for subscription or purchase to be a prospectus if it contains any information other than that permitted by the section, or if the advertisement does not state that applications for shares will proceed only on one of the forms of application referred to in, and attached to, a printed copy of the prospectus. Section 40(3) states that the section shall apply to advertisements published or disseminated in the State by newspaper, broadcasting, television, cinematograph or by any other means whatsoever. It seems strange for s.40 to deem something to be a "prospectus" which may, in any event, be a prospectus under s.5(1). The only way to avoid this result is to confine s.40 to advertisements of a type not falling within s.5(1). This would mean limiting s.40 to oral advertisements and any advertisement which merely draws attention to an intended offer of securities. These advertisements may not be prospectuses under s.5(1). This limitation seems unjustifiable in that the clear intention of s.40 is to control *all* advertisements relating to offers of securities to the public. It is likely that the legislature has overlooked the fact that advertisements are mentioned in the definition of prospectus. The confusion caused by the wording of ss.40 and 5(1) could be overcome either by deleting the reference to "advertisement"

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53. The section is not limited to advertisements made by or on behalf of the person from whom the securities will be subscribed for or purchased: *cf. A.G. for N.S.W. v. Australian Fixed Trusts Ltd.* [1974] 1 N.S.W.L.R. 110, at 117 per Street C.J.; *A.G. for N.S.W. v. Mutual Home Loans Fund of Australia Ltd.* [1971] 1 N.S.W.L.R. 162.

S.40 of the N.S.W. Companies Act 1961-1974 differs from the section discussed in the text. The N.S.W. provision does not deem an offending advertisement to be a prospectus; rather it simply prohibits advertisements which contain information other than that specified in the section. It seems, however, that the reforms suggested in the text are applicable to the N.S.W. section because even if an advertisement satisfies s.40 it may still be a prospectus under s.5(1) and may, therefore, have to comply with s.39.



in s.5(1) or by amending s.40 so that an advertisement will be deemed not to be a prospectus if it complies with the section.

Section 40 was intended to prevent advertisements undermining the effectiveness of a prospectus. By prohibiting advertisements containing material other than that permitted by the section the legislature has attempted to prevent the public being conditioned, either before or after the release of a prospectus, by the selective disclosure of those promoting the offer. Investors are to be fully informed of the contents of the prospectus rather than be informed only of the favourable aspects of the offer. Apart from deeming something to be a prospectus, which is arguably already a prospectus, s.40 is interesting because it is implicit in the section that a prospectus must be used whenever a public securities offering is to be advertised. The advertisement will be deemed to be a prospectus, *inter alia*, if it does not state that applications for the securities will proceed only on one of the forms of application referred to in, and attached to, a printed copy of the prospectus. Not only must there be a prospectus but applications must proceed on one of the forms of application attached to the prospectus. The reference to "form of application" seems to mean that, in respect of an advertised offer of securities, it is impossible to *accept* that offer in the strict contractual sense. In order to take up the securities an application form will have to be completed and sent to the offeror. A form of application has been held to be a document whereby the applicant *offers* to take up shares rather than a document whereby one accepts an offer of securities<sup>54</sup>.

#### (1) Oral Offers or Invitations

Oral offers or invitations relating to securities would not seem to be within the definition of prospectus<sup>55</sup>, although spoken advertisements whether on radio, television or on the soundtrack of a cinema film are, except in New South Wales, deemed to be a prospectus under s.40 if the advertisement does not comply with that section. Offers by telephone would not be a prospectus under either s.5(1) or s.40. Oral offers made during a personal meeting between offeror and offeree would likewise appear to be outside ss.5(1) and 40<sup>56</sup>.

Although it is common sense that an oral offer should not be considered a prospectus because a prospectus must, according to s.39 and s.42, be in written form, there is no reason why the law should not require a written prospectus to accompany an oral offer. If an oral offer can only be accepted by completing a form of application issued or circulated in connection with the offer, an applicant will be entitled to possession of a written copy of a prospectus which complies with the Act. Section 37 makes it an offence for a person to issue, circulate or distribute any form of application for securities, which securities are offered to the public, unless the form of application is issued, circulated or distributed together with a prospectus, a copy of which

54. *Government Stock and Other Securities Investment Co. Ltd. v. Christopher* [1956] 1 All E.R. 490, per Wynn-Parry J.

55. "A prospectus or form of application for shares . . . must necessarily be in writing or printing", per Reed J., *obiter*, in *Maddaford v. DeVantee* [1951] S.A.S.R. 259, at 269.

56. Section 374(1) prohibits a person going from place to place offering securities, which have not been exempted under s.374(2), for subscription or purchase to the public or any member of the public. An oral offer made in contravention of this section would render the offeror liable to a criminal penalty and a court before which an offeror is convicted may order that any contract made as a result of the offer is void and may give such consequential directions as it thinks proper for the repayment of any money or the transfer of any securities: s.374(10).

has been registered by the Registrar. Offers or invitations relating to securities for subscription may usually only be taken up on a form of application issued by the offeror. If the usual procedure is followed, a prospectus must accompany the circulated application form.

Section 37 was apparently enacted to overcome the problem caused by forms of application being inserted in newspapers which applicants had merely to cut out, fill in and forward to the appropriate person<sup>57</sup>. The legislature thought it was undesirable for members of the public to be able to apply for securities in such a way without first having received a copy of a prospectus. Section 37 does not, however, ensure that members of the public who are orally offered securities for subscription or purchase and choose to take up securities will have a copy of the prospectus before the decision to take up the securities is made. Section 37 can have no effect if securities are offered to the public on the basis that members of the public, who wish to take up the securities, should prepare and forward their *own* forms of application. In that event no person would have issued, circulated or distributed a form of application. It is also clear that s.37 is irrelevant if no form of application is utilised in the distribution of the securities to the public. Although unusual, it is possible to take up securities without there being any written offer or agreement to that effect even if the securities are offered for subscription<sup>58</sup>.

It is undesirable that members of the public who are personally and verbally offered securities for subscription or purchase should not be entitled to a prospectus merely because they can take up securities otherwise than on a form of application issued in connection with the offer or invitation. Although it is true that personal contact should produce the opportunity to ask questions about the investment and otherwise solicit information, it is unrealistic to believe that this opportunity is in any real sense a substitute for a formal prospectus. Oral offers or solicitations may well be accompanied by high pressure sales tactics which render illusory the member of the public's opportunity to solicit information. A prospectus may be studied at leisure and, of at least equal importance, it provides a record of the terms upon which the member of the public agrees to acquire securities. If the information contained in the prospectus turns out to be false or misleading the prospectus can be relied upon in subsequent litigation. The evidentiary problems faced by a person trying to establish oral misrepresentations are largely overcome if the misrepresentations are contained in a written document. There appears to be no sound reason why a person who takes up securities pursuant to an oral public offering should be in any worse position than a person who responds to a written or advertised offer.

In most North American jurisdictions attempts have been made to ensure that all persons who acquire securities offered to the public during a distribution of those securities are afforded the protection of prospectus or like information. Under the 1933 United States Securities Act, it is sometimes

57. A. Stiebel, "The Companies Act, 1929" (1929) 73 Sol. J. 412, at 442. Why could not the advertisement, containing the form of application, itself be within the definition of prospectus? See: *In re Shortland Flat Gold-Mining Company (Ltd.)* (1910) 29 N.Z.L.R. 931, where a form of application was held to be within the definition of prospectus.

58. *Ritso's Case* (1877) 4 Ch.D. 774 (C.A.): *Re International Contract Co. (Levita's Case)* (1867) L.R. 3 Ch. App. 36; *Re New Theatre Co. Ltd. (Bloxam's Case)* (1864) 33 L.J. Ch. 574; *Maddaford v. De Vantee* [1951] S.A.S.R. 259, at 269-270 per Reed J.

possible for a member of the public to orally agree to take up securities, in a distribution of those securities, without first receiving a copy of the relevant prospectus. Where this does occur, however, a copy of the prospectus must accompany or precede delivery of the securities<sup>59</sup>. In Ontario no distinction is drawn between oral and written offers. In both cases, if the securities are distributed in a transaction which is not exempt from the prospectus provisions, a prospectus has to be registered and supplied to the subscriber or purchaser either before the transaction or within two days of an agreement being entered into. If a prospectus is supplied to an investor after he has agreed to acquire the securities, the investor may cancel the agreement within two days of receiving the prospectus<sup>60</sup>. The purchaser's right to cancel would ordinarily be expected to encourage an offeror to provide a prospectus before an agreement is made.

## (2) *Stock Exchange Transactions*

*The Report of the Senate Committee on Securities and Exchange on the Australian Securities Market and their Regulation*<sup>61</sup> has highlighted the possibility that the prospectus provisions of the Uniform Companies Act may easily be avoided by disposing of securities to the public on a stock exchange. This method of disposition to the public is, of course, only available if the securities are of a class listed for trading on an exchange. A recounting of the Rae Committee's study of the way Vam Ltd. raised \$676,600 from a share issue will disclose the nature of the problem.

Sometime prior to July 29, 1969, Vam Ltd. informally agreed to allot 100,000 shares to a Sydney share broking firm, Ralph W. King and Yuill or to Pan Australian Nominees Ltd., a company owned by King and Yuill. On the 29th July, 1969, in anticipation of receiving these shares, King and Yuill began to sell them, in the name of Pan Australian Nominees Ltd., on the Sydney, Melbourne and London Stock Exchanges. The sales continued for seven weeks until all 100,000 shares were sold<sup>62</sup>. Vam Ltd. did not inform the stock exchanges or the investing public of the agreement to allot the 100,000 shares until the 19th September, 1969, after all the as yet unissued, unallotted, and unquoted shares had purported to be sold on the market. The proceeds of the sales had been credited to Vam Ltd.'s account in Pan Australian Nominees Ltd.'s books. Periodically, the full amount of the proceeds less brokerage and stamp duty was paid to Vam Ltd. In all, Vam Ltd., received \$676,619.70 or an average of \$6.76 per share. It was after the sales had been completed, and Vam Ltd. had received that amount, that Vam Ltd.'s directors informed the Sydney Stock Exchange on the 19th September, 1969, that 100,000 shares had been placed through Ralph W. King and Yuill for \$676,600. It was also not until the 19th September, 1969, that Pan Australian Nominees Ltd. formally applied for the 100,000 shares it had already sold. The shares were formally allotted on the 22nd September, 1969.

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59. For a general discussion of the United States Securities Act see Loss, *supra* n.26, partic. Vol. I pp. 225-226.

60. The right of a purchaser to rescind within two days of receiving a prospectus, although reaffirmed in cl.69 of Ontario Bill 75 of 1974, is certainly not new to Ontario securities law. It first appeared in s.63 of the 1966 Ontario Securities Act.

61. Hereafter referred to as the *Rae Report*. Vol. 1, chapter 10 of the Report, entitled "*Abuses and Malpractices in the Making and Disposal of Private Issues*", is particularly germane to this discussion.

62. The price of Vam Ltd.'s shares fell from about \$7 to about \$5 over the seven-week period, during which time the sales of Pan Australian Nominees Ltd. accounted for about 22% of all dealings in Vam Ltd.'s shares reported by the Sydney and Melbourne Stock Exchanges: *Rae Report* Vol. 1 §10, p.12.

There was no doubt in the Committee's mind that the as yet unquoted securities ought not to have been sold on the exchanges. There was also little doubt that several stock exchange listing requirements had been breached<sup>63</sup>. Yet the fact remains that the shares were offered and sold to the public in an exercise designed to increase Vam Ltd.'s capital<sup>64</sup> and that no prospectus was issued and no disclosure of the nature and purpose of the exercise was made until after the capital had been raised. Were the prospectus provisions of the U.C.A. violated?

A strong *prima facie* case could be made out, on the above facts, that Pan Australian Nominees Ltd. was acting as the agent of Vam Ltd. in making the public offer. The fact that the full amount of the sales proceeds, less brokerage and stamp duty, was paid to Vam Ltd. by Pan Australian Nominees Ltd. is certainly weighty evidence that Pan Australian Nominees Ltd. was not selling the shares on its own behalf to make a trading profit. Rather, it seems that, in return for an agency-type commission, the shares were being sold on behalf of Vam Ltd. The formal application for shares by, and subsequent allotment of those shares to, Pan Australian Nominees Ltd. were arguably colourable transactions designed to conceal the true nature of the relationship between the companies. Even if Pan Australian Nominees Ltd. was not Vam Ltd.'s agent, there can be little doubt that under s.43 of the Uniform Companies Act, Vam Ltd. had agreed to allot the 100,000 shares to Pan Australian Nominees Ltd. with a view to the shares being offered to the public, so that any document whereby the shares were offered to the public would be deemed to be a prospectus issued by Vam Ltd.

Whether or not the prospectus provisions were breached depends upon whether the public was offered the shares by means of "any notice, circular, advertisement or invitation" so as to be within the definition of "prospectus" in s.5(1) or, if s.43 is applicable, whether Pan Australian Nominees Ltd. offered the shares to the public by means of a document. It seems clear that nothing in the nature of "a form of application" pertaining to the offer

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63. In particular, A.A.S.E. Listing Requirement 3A (1), which requires a listed company to immediately notify the exchange of any information concerning the company necessary to avoid the establishment of a false market in the company's securities and, possibly, 3A(5)(6) which requires the company to immediately notify the Exchange of any alteration to the issued securities of the company.

64. The idea of a company raising share capital by issuing its shares to persons prepared to pay the highest price on a stock exchange is certainly novel in Australia. The words "sale" and "purchase", which are appropriate for normal stock exchange transactions, would appear to be inappropriate to describe an agreement whereby a person becomes a member of a company. A company does not, in theory, "sell" its shares. Despite the theoretical problems of companies disposing of their shares to the highest bidder on a stock exchange, there is much to recommend a system whereby any company which is raising share capital, otherwise than by making a *pro rata* issue to existing shareholders, receives the full market value for its shares. In England, some companies call tenders for new shares. When the tenders are received a price is calculated (the striking price) at which the company can allot all of the shares to those who have tendered at or above that price. The tender system, which is utilised at the public level in Australia, ensures that the company receives the maximum benefit from a new issue and does away with the problem of "stags", i.e. those who apply for new shares solely in order to make a profit by immediately reselling them in the market place. The tender system, as described by Gower, *supra* n.2, 286, has the disadvantage that those who want to be certain of obtaining shares are encouraged to put in extravagantly high tenders. This tends to artificially increase the striking price. This problem could be overcome if all shares were in fact auctioned to the highest bidder and the advantages to the issuing company of the tender system would also appear to be preserved. If a public auction is desirable, what better place to hold the auction than a stock exchange?

was issued or circulated so that s.37 is irrelevant<sup>65</sup>. It has already been submitted that only written offers can be prospectuses under s.5(1). It therefore follows that unless a document, whether taking the form of an advertisement or not, was utilised to offer the shares to the public on the stock exchanges, no prospectus would have had to be prepared or registered under the Act.

In regard to the United Kingdom equivalent of s.43, the view has been expressed that a "document", to which the section can attach, is used to effectuate London Stock Exchange sales<sup>66</sup>. As part of the procedure for obtaining quotation of securities on the London Stock Exchange, companies are obliged to publish what is known as a "Notice for Information" in newspapers giving certain information about the securities to be quoted. Pennington has written that: "Admittedly, the notice for information does not invite the public to subscribe for the securities to any named dealer, but when the dealers with whom the securities have been placed hold themselves out as ready to sell the securities to the public, any contract for sale by them is clearly intended to be read in conjunction with the notice, so that in substance the notice is an invitation to purchase the securities, and is therefore a prospectus"<sup>67</sup>. The question has not yet been resolved by the courts but it is arguable that a document which is necessary as one of the steps to obtain the chance to have securities traded on a stock exchange ought not to be viewed as a document whereby the securities in question are actually offered for sale to the public.

Whatever the United Kingdom position, it seems clear that the Pennington argument can have no application in Australia as no public advertisements are required in order to obtain quotation of securities. It is difficult to isolate any other relevant public document which is necessarily involved in the listing and sale of securities in Australia. The offer to sell to the public is made by a series of markings on the stock exchange boards indicating the price at which sellers are prepared to sell and identifying the brokers prepared to sell at least one marketable parcel of the securities at that price. If the markings on the board were considered to be an offer to sell by means of a "prospectus", as defined in s.5(1), then the absurd situation would arise that the board would have to reflect all of the information required to be in a registered prospectus and, indeed, a new prospectus would presumably be required every time the bids altered.

It is likely, therefore, that stock exchange offers and sales are not within the prospectus provisions of the U.C.A. There should be legislation requiring prospectus type disclosure to be made whenever a company directly or indirectly raises capital from the public by a distribution of securities through a stock exchange<sup>68</sup>. As the Rae Committee has concluded, it is simply not

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65. It is the seller who contractually offers to sell at least one marketable parcel of securities on the stock exchange floor and it is the purchaser who accepts that offer. A form of application "contains an *offer* to purchase" not an acceptance of an offer to sell.

66. Pennington, *supra* n.38, 217-218; Gower, *supra* n.2, 296.

67. Pennington, *supra* n.38, 217.

68. A stock exchange listing requirement to this effect would not seem to be adequate as, traditionally, the only penalty for failure to comply would be the delisting of the company's securities. Although the A.A.S.E. Listing Requirements currently stipulate what must be contained in the prospectus of a listed company, the Requirements are silent as to precisely when a prospectus must be prepared.

reasonable to rely upon the adequacy, and enforcement of, the stock exchanges' own listing requirements<sup>69</sup>.

### **Summary, and Comments on the Australian Corporations and Securities Industry Bill 1974**

The Australian Government introduced the Corporations and Securities Industry Bill 1974 in the Senate on December 5, 1974. If passed the Bill will, *inter alia*, regulate the disclosure that must be made by Australian public trading or financial corporations and by foreign corporations when raising share or loan capital<sup>70</sup>. The Bill's provisions will be administered and enforced by a Corporations and Exchange Commission set up pursuant to Part II of the Bill. The provisions of the Bill are intended to exclude any provision of a State or Territory law that deals with like matters<sup>71</sup>.

It is proposed to briefly summarise the key points made in the foregoing analysis of the Uniform Companies Act regulatory scheme and to comment on the changes to that scheme envisaged in the Corporations and Securities Industry Bill.

#### *(1) Offers or Invitations to the Public*

The U.C.A. prospectus provisions only apply if securities are offered to the public or a section of the public. The statutory definitions of "prospectus" and "offer to the public" make this clear. What neither the U.C.A. nor the courts have been able to do is to clearly define what is involved in the concept of a public offering. In so far as the courts have interpreted the concept, they have concentrated on such considerations as the number of offerees or invitees, and on whether anyone other than the offerees or invitees directly approached could take up the offer or invitation. Anglo-Australian courts have not followed the lead of their United States counterparts in interpreting the "public offer" concept in terms of the need of particular offerees or invitees for prospectus-type disclosure. It was suggested that the primary aim of the law in this area ought to be to ensure that everybody who is directly approached to take up corporate securities should, at the least, have access to prospectus quality information and, preferably, possession of that information. If the courts are unable to construe the U.C.A. so as to achieve this aim then the Act itself ought to be amended. Useful examples of the legislative possibilities are to be found in the existing and proposed legislation in Ontario, Canada and in the United States.

The Corporations and Securities Industry Bill adheres to the concept of "public offering". The Bill's definition of "prospectus" does not refer to an offer to the public<sup>72</sup>. Instead, cl.161 prohibits any offer or invitation relating to securities for subscription to be made to the public unless the offer or invitation is made per medium of a prospectus. "Public" has been redefined in cl.12. Clause 12(1) provides that a reference in the Bill to an offer or invitation to the public encompasses the situation where the same or substantially similar offers or invitations are made to persons constituting a

69. *Rae Report*, Vol. 1 §15, pp.18ff.

70. The prospectus provisions are contained in Part VII of the Bill which is entitled —"Raising of Moneys From the Public by Corporations". The prospectus provisions of the Bill apply only to corporations to which Part III of the Bill applies (e.g. cls.161-171 are each expressly limited to Part III corporations). Cl.45 states the corporations to which Part III of the Bill applies. The corporations specified must register with the C.E.C.: cl.46.

71. Cl.18.

72. Cl.3.

section of the public whether selected by reason that they are members or debenture holders of the corporation or clients of the person making the offers or issuing the invitations or in any other manner. Offers to a corporation's existing securities holders will, therefore, not be exempt from the prospectus provisions. This departure from the Uniform Companies Act position follows upon the recommendation of the Eggleston Committee in its Fifth Interim Report. However, whereas the Eggleston Committee had recommended a rather informal "Directors' Proposal" which would not have to be registered with the appropriate administrative agency, the Bill requires a registered prospectus. It is likely, however, that a full prospectus may not be required for rights offerings because cl.162(4)(b) allows the Corporations and Exchange Commission to draw up regulations making special provision for prospectuses that are circulated solely to existing securities holders of a corporation and relate only to securities of that corporation.

Clause 12(2) deems offers or invitations to enter into underwriting agreements, and offers or invitations to persons who are wholly or partly engaged in the business of purchasing or selling securities, not to be offers or invitations to the public. Unlike s.5(6) of the U.C.A., cl.12(2) of the Bill does not specifically exempt offers of shares by a corporation to another corporation on the latter corporation winding-up or disposing of some or all of its property to the offeror corporation in consideration, *inter alia*, of the sale of the property. Such offers are nevertheless unlikely to be construed as being made to the public<sup>73</sup>.

Apart from bringing offers to a corporation's existing securities holders within the prospectus provisions the definition of "public" is in no way materially clarified. The Eggleston Committee's suggestion that a "public offering" be defined as one involving the making of more than 50 offers or invitations in a three-month period has not been implemented. The Government has advanced two main reasons for rejecting the suggested formula<sup>74</sup>. Firstly, the formula refers to offers rather than offerees and, therefore, may not catch one offer made to fifty or more persons as where an offer or invitation is posted on a notice board in a public place. Secondly, even if the formula referred to the number of offerees or invitees, the difficulty referred to by Professor Loss of counting offerees would arise. Professor Loss's own suggestion of a formula geared to purchasers rather than offerees or invitees has also been rejected partly because of the difficulty of counting the number of buyers where purchases are made by trusts, joint ventures, husbands and wives, etc. This "difficulty" could, of course, be overcome by legislation. The Government was also concerned that the American Law Institute's proposed Federal Securities Code, from which Professor Loss's suggestion was drawn, makes it unlawful for an offeror or reseller in a limited (non-prospectus) offering to engage in "general advertising". The concept of "general advertising" is arguably as vague as the concept of a "public offering". The Government has taken the view that "pending further consideration of the proposals submitted by the Eggleston Committee and Professor Loss, the Bill should not provide for the question whether an offer is made to the public to be determined by reference to a test involving the number of

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73. See: *Booth v. New Afrikaner Gold Mining Company Ltd.* [1903] 1 Ch. 255 (C.A.).

74. *Explanatory Memorandum to the Corporations and Securities Industry Bill 1974* (tabled by the Attorney-General when introducing the Bill in the Senate), paras. 150-153.

offers, offerees or buyers"<sup>75</sup>. Whilst it is unfortunate that the Government has not been able to utilise this excellent opportunity to rethink and clarify the nature and purpose of the key trigger mechanism for the operation of the prospectus provisions, it is hoped that the Government's future examination of the problem will embrace the legislative possibilities outlined in this article, as well as the proposals of the Eggleston Committee and Professor Loss.

(2) *The Subject Matter of the Offer or Invitation*

The Uniform Companies Act prospectus provisions fail to discriminate between offers and invitations relating to previously unissued securities and offers and invitations relating to issued securities. The definition of prospectus catches both offers of securities for subscription and offers of securities for purchase. This failure to discriminate between issued and unissued securities, apart from being indefensible as a matter of policy, also results in an unjustifiable overlap between the prospectus provisions and s.374 of the U.C.A. which regulates written offers of securities for purchase. The role of s.43 is also difficult to understand within a legislative framework which demands that the prospectus provisions must be complied with whenever a document or advertisement offers securities for sale to the public.

The Corporations and Securities Industry Bill does much to overcome the problems inherent in the U.C.A. Perhaps the most substantial variation from the present law is that the definition of "prospectus", in cl.3, is limited to offers of, and invitations relating to, securities for subscription. *Prima facie*, therefore, only offers pertaining to unissued securities will have to take the form of a prospectus if they are made to the public. Because of this important restriction on the operation of the prospectus provisions it is imperative to have a section like s.43 of the U.C.A., to ensure that corporations cannot avoid the prospectus requirements by privately placing securities with a view to the private placee offering the securities for sale or purchase to the public. Clauses 163 and 164 of the Bill attempt to meet this problem<sup>76</sup>.

Clause 163 is essentially a revamped counterpart of s.43. It is an improvement on s.43 in three main respects. Firstly, there is a clear rebuttable presumption that a corporation did allot or agree to allot securities with a view to some or all of those securities being offered to the public if the securities are in fact offered to the public within six months of the corporation allotting or agreeing to allot them, or if, at the time the securities were offered to the public, the corporation had not received the full consideration payable for them<sup>77</sup>. Secondly, the clause covers the case where an allotment is made with a view to an invitation, as opposed to an offer, being made to the public<sup>78</sup>. Section 43 may not cover invitations as it refers to offers for sale. However, given the judicial interpretation of the word "offer" in other sections of the

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75. *Ibid.*, §154.

76. Cl.49 of the Bill requires a registered corporation which allots shares in a non-prospectus issue to lodge with the C.E.C. a written report specifying the number of shares allotted and containing such other information as is prescribed. The report must be filed within one day of the private placement and a copy of it must be sent to every stock exchange on which the corporation's securities are traded. Compliance with this provision should enable the C.E.C. to carefully scrutinise share issues as they are made. The public securities market will also be more fully informed than was the case with many of the private placements reviewed in ch. 10 of the *Rae Report*.

77. Cl.163(3) and 163(4).

78. Cl.163(1)(a).



U.C.A., this is unlikely<sup>79</sup>. Lastly, cl.163 overcomes the doubt inherent in s.43 as to whether the offer or invitation made to the public must be made by the original allottee of the securities from the issuing corporation. Under cl.163(2), if the issuing corporation did have the requisite intention, any document used by the allottee, or a person associated with the allottee<sup>80</sup>, to offer the securities to the public will be considered a prospectus issued by the issuing corporation. It should be noted that, like s.43, cl.163 can only operate if a document is used to offer securities to the public. Thus oral offers or invitations and stock exchange offers would appear to be outside the ambit of the provision. Clause 164 might go some way towards closing these loopholes in cl.163.

Clause 164 prohibits a person, who has subscribed for securities from a corporation with a view to offering any of the securities to the public, offering the securities to the public unless the offer or invitation is made by a document, in accordance with the prescribed form and containing the prescribed particulars, a copy of which has been registered with the Corporations and Exchange Commission<sup>81</sup>. Clause 164 thus concentrates on the intention of the subscriber rather than the issuing corporation. If the issuing corporation allotted the securities with a view to any of them being offered to the public cl.163, and not cl.164, will apply<sup>82</sup>. Clause 164 is drafted in similar terms to cl.163 in that there is a rebuttable presumption that the subscriber had the necessary intention if the securities are offered to the public within six months of them being allotted by the corporation or if, at the date of the offer or invitation, the corporation had not been paid in full for the securities<sup>83</sup>. Clause 164 will also apply whether the offer or invitation to the public is made by the subscriber or a person associated with the subscriber.

Clause 164, although no doubt inspired by the definition of "underwriter" in the 1933 U.S. Securities Act<sup>84</sup>, is new to Anglo-Australian law and deserves some comment. The "with a view to" test inevitably means that a distinction will have to be drawn between subscribers who, at the time of their subscription for securities, intend to hold the securities for investment purposes and subscribers who intend to realise a profit by offering the securities to the public soon after their acquisition. This, basically, is the distinction made by United States courts in determining whether a person is an "underwriter" because he acquired securities with a view to their distribution to the public. The United States "change of circumstances" doctrine is likely to take root here as are letters of investment intent. The "view to distribution" test is a subjective test which can hardly be said to have operated successfully in the United States. The Ontario Merger Report considered the "investment intent" concept unworkable. "In the case of private placements, even where there is a *bona fide* investment intent at the time of purchase, the variety of legitimate circumstances which can alter that intent are almost infinite. The ingenuity of those who may have no *bona fide* investment intent, whatever their declaration, may be conjured with"<sup>85</sup>. As criminal penalties may be incurred for

79. E.g. *A-G. for N.S.W. v. Mutual Home Loans Fund of Australia Ltd.* [1971] 1 N.S.W.L.R. 162, at 165 per Sugerman A.C.J. Note that this term does not include a purchaser from the allottee: cf. n.31, *supra*.

80. See cl.14 for meaning of "associated persons".

81. It seems that the document will have to contain information similar to that contained in a prospectus: cl.164(2).

82. Cl.164(1)(b).

83. Cl.164(3) and 164(4).

84. See p.147 *supra*.

85. *Merger Report*, *supra* n.21, 66.

breaching cl.164, the evidence would have to be very clear and strong for a conviction. To some extent the evidentiary problem might be overcome in the case of subscribers who offer their securities to the public within six months of acquiring them or offer securities which they have not paid for in full. The subscriber in such cases will have the burden of establishing that the securities were acquired for *bona fide* investment purposes and, presumably, that the sale of those securities was necessitated by a change of circumstances. Stags (i.e. those persons who subscribe for securities solely in the hope of being able to resell them in the market at a profit) had better beware of cl.164.

Two final points need to be made about cl.164. Firstly, the clause may apply to all offers and invitations made by subscribers to the public, whether in writing, orally, on a stock exchange or otherwise. Nothing turns on the manner in which the offer is communicated. Secondly, the clause is not apparently confined to offers by subscribers who acquired securities in a non-public, non-prospectus issue; it is not confined to offers to the public made by private placees. It is arguable that, like its United States counterpart, cl.164 should be restricted to offers of securities which have not previously been offered and issued to the public. If this limitation was adopted then, of course, stags would have little to fear from participation in a corporation's public securities offering.

Clause 164 is not the only provision in the Bill which may require offers of issued securities to be made by means of a disclosure document falling short of a full prospectus. Clause 195(3) prohibits a person making any offer in writing to any person of any securities for purchase of a prescribed corporation unless it is made by means of a document that is signed by the offeror and dated; identifies the securities and contains in clearly legible characters the terms of the offer and the prescribed particulars; and prominently displays the words "If you are in any doubt about this offer you should consult your professional adviser." The document must contain no other material. Clause 195(4) regulates advertisements which offer or refer to offers of securities for purchase. Such advertisements must only contain the prescribed particulars and a statement that a copy of a document complying with cl.195(3) will be sent by post on request in writing being made to a specified address, and that the offer is capable of being accepted only by completion of a form of acceptance contained in the document. Any acceptance of an advertised offer for securities for purchase otherwise than on the form of application is void and the offeror is bound to notify any person who invalidly accepts the offer of that fact<sup>86</sup>. Although cl.195(3) refers to an offer in writing to "any person" (*cf.* a "member of the public" in s.374(3) of the U.C.A.) and cl. 195 (4) purports to apply to all advertisements relating to offers of securities for purchase, cl.195(2) exempts nine classes of offer from the operation of the clause as a whole. The more important of the exemptions relate to—

- (i) any offer which is subject to the prospectus provisions, including clauses 163 and 164;
- (ii) take-over offers;
- (iii) an offer made to a person whose ordinary business, or a part of whose ordinary business, is to purchase or sell securities, whether as principal or agent;
- (iv) an offer not made in the course of the carrying on of a business;

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86. Cl.195(5).

- (v) an offer made to a corporation;
- (vi) an offer of securities of a corporation that is made to the holder of shares in that corporation;
- (vii) an offer of securities of a kind that are permitted to be traded on a registered stock exchange provided that the offer states that fact and names the exchange; and
- (viii) an offer made to the spouse of the person making the offer or to a relative of the person or of the person's spouse.

As the Government has stated, these "exceptions are included for transactions of a family nature and for transactions with buyers who should be able to look after themselves"<sup>87</sup>. It is interesting that the Government had adopted the "need to know" approach for offers of previously issued securities but not, as yet, for offers of unissued securities. It is still incongruous that a person who is offered securities for purchase may be entitled to a formal disclosure document in circumstances where, if the same person was offered similar securities for subscription, no formal disclosure document may be required. The approach in cl.195 of listing numerous exceptions to a general prohibition in order to best achieve the aim of the legislation is similar to the approach adopted in the Ontario Securities Bill of 1974 in regard to offers of securities for subscription<sup>88</sup>. The Government should consider following the Ontario lead.

### (3) *The Form of the Offer or Invitation*

#### (a) Offers of Securities to the Public for Subscription

The prospectus provisions of the Uniform Companies Act require the preparation, registration and dissemination of a prospectus whenever a document or advertisement is used to offer securities to the public. Unadvertised oral offers and stock exchange offers would not require a prospectus unless the offer can only be accepted on an application form issued in connection with the offer. It was argued that there is no justification for the U.C.A.'s implicit exemption of oral and stock exchange offers from the prospectus requirement. The Corporations and Securities Industry Bill ensures that a prospectus must be in the possession of anyone who subscribes for securities pursuant to a public offering prior to the decision to subscribe being made.

The Bill's cl.3 definition of "prospectus" makes it clear that a prospectus must be in written form. It refers to "a written notice, circular or other instrument" offering or inviting offers for securities for subscription. Thus an oral offer or a stock exchange offer would not be a prospectus. However, oral offers and, presumably, offers made on stock exchange trading boards, are implicitly prohibited by cl.161. It provides that a person shall not offer securities to the public for subscription or invite the public to subscribe for securities unless the offer or invitation is issued or made by means of the issue, circulation or distribution of a prospectus. All offers or invitations relating to unissued securities to the public must, therefore, take the form of a registered prospectus. Further, under cl.165(3), if unissued securities have been offered to the public for subscription in the mandatory prospectus, the corporation cannot allot any of the securities referred to in the prospectus unless the person to whom they are allotted has furnished to the corporation a form signed by him or on his behalf that was attached to the prospectus. An allotment of

87. *Explanatory Memorandum, supra* n.74, para. 183(a).

88. See p.142 *supra*.

securities is not void or voidable by reason only that it was made in contravention of the clause<sup>89</sup> although there is a penalty of \$2,000 or imprisonment for six months for any violation of the provision. Clause 165(1), in like vein, prohibits a person issuing or circulating a form of application otherwise than as an attachment to a registered prospectus or clause 164(1)(c) document<sup>90</sup> unless the form is not issued or circulated to the public and the invitation or offer, in connection with which the form is issued or circulated, is not issued or made to the public. The highly desirable combined effect of these provisions is that all persons or their agents who take up securities pursuant to a public offer or invitation must have a copy of a registered prospectus before the decision to subscribe is made. The provisions of cl.165 do not apply where a prospectus is issued or circulated solely to existing securities holders of a corporation and relates solely to securities of that corporation<sup>91</sup>.

The Bill draws an interesting distinction between notices and circulars which offer, or invite offers for, securities for subscription and notices, circulars and advertisements which draw attention to such offers or invitations. As we have seen, the former type of notice and circular must take the form of a prospectus if a public offer or invitation is involved. The latter type of notice, circular or advertisement apparently does not have to take the form of a prospectus even if it draws attention to a public offer or invitation. This seems to be implicit in cl.168 which prohibits the publication of certain notices, circulars and advertisements calling attention to offers or invitations pertaining to unissued securities. There is no restriction on the publication of anything that is not communicated to the public and which does not relate to an actual or intended public offer or invitation. All other notices, circulars or advertisements drawing attention to offers or invitations relating to unissued securities must not contain material other than that prescribed by cl. 168 (2). To comply with cl. 168 (2), and presumably with the concept of "drawing attention to an offer or invitation", the published notice, circular or advertisement must, *inter alia*, call attention to a prospectus a copy of which has been registered by the Corporations and Exchange Commission and contain a statement that an allotment of the securities referred to in the prospectus will be made only on the basis of a form attached to the prospectus. Clause 168 would overcome the problems associated with the current s.40 of the Uniform Companies Act.

#### (b) Allotments With a View to the Securities Being Offered to the Public

The major defect in s.43 of the Uniform Companies Act is that it can only apply if a document is used to offer the securities for sale to the public. Thus a prospectus will not be required if a corporation allots securities to a private placee, intending that the securities should subsequently be offered to the public, and the securities are orally offered to the public or, seemingly, if they are offered to the public on a stock exchange. The Corporations and Securities Industry Bill's equivalent to s.43, cl.163, does not require the subsequent offer or invitation to the public to be by means of a prospectus unless a document is used to make that offer or invitation<sup>92</sup>. Thus there is no implicit or explicit prohibition of oral or stock exchange offers or invitations to the public in cl.163, as there is in the case of offers or invitations made

89. Cl.165(4).

90. See p.160 *supra*.

91. Cl.165(5).

92. Cl.163(2)(a).

by or on behalf of the issuing corporation itself<sup>93</sup>. The defect in s.43 of the U.C.A. is, therefore, repeated in cl.163 of the Bill although it does appear that, no matter how the subsequent offer or invitation to the public is made, those persons who accept the offer or invitation will be regarded as subscribers for the securities from the corporation.<sup>94</sup> It is strongly submitted that cl.163 should be amended so as to require a prospectus no matter what form the subsequent offer or invitation to the public takes. Such an amendment is necessary if capital raisings of the Vam Ltd. type, described earlier in this article, are to be adequately regulated.

Clause 164 which, of course, has no counterpart in the Uniform Companies Act, can only apply if the allottee of securities and not the issuing corporation intended that the securities should subsequently be offered to the public. If both the allottee and issuing corporation intended the securities to be offered to the public then cl.163 is exclusively relevant. This is made clear by cl.164 (1) (b) which makes, as one condition precedent to the operation of the clause, the fact that cl.163 would not apply to any document by which any offer or invitation to the public, which would otherwise be with cl.164, is issued or made. If only the allottee had the intention, at the time of the allotment, to offer the securities to the public then a document complying with cl.164(1)(c) must be utilised by the allottee when making the offer. There is a prohibition on the offer or invitation being made otherwise than by means of the prescribed document. It seems strange that cl.164 should effectively prohibit oral and stock exchange offers when cl.163 does not. An important point to stress is that the cl.164 requirement, that offers or invitations be made by means of the prescribed document, implicitly means that persons caught by the provision cannot dispose of the securities to the public in the normal course of trading on a stock exchange. Offers to sell on stock exchanges are not usually made by means of a document. Quære whether the draftsmen had addressed their minds to this effect of the clause?

#### *(4) Offers of Securities for Purchase*

Section 374(3) of the Uniform Companies Act prescribes the matters to be contained in certain written offers of securities for purchase. Section 374 (12) of the U.C.A. provides that "offer in writing" includes an offer by means of broadcasting, television or cinematograph. There is no specific regulation of the content of oral offers made by telephone or otherwise on a person to person basis, nor is there any requirement that such oral offers be supplemented by a written disclosure document unless, of course, a form of application issued to the public is used to accept the offer. The only regulation of oral offers is the indirect one contained in s.374(1) of the U.C.A. That section prohibits a person going from place to place offering securities of a class which have not been exempted under s.374(2) for subscription or purchase.

Clause 195 of the Corporations and Securities Industry Bill specifically regulates the content of both written offers of securities for purchase and advertisements relating to such offers. However, like the U.C.A., the Bill's only regulation of unadvertised or unpublished oral offers is the indirect one implicit in the prohibition on persons going from place to place, whether by appointment or otherwise, for the purpose of dealing in securities of a prescribed corporation<sup>95</sup>. Significantly, offers made by telephone will remain totally unregulated.

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93. Cl.161.

94. Cl.163(2)(b).

95. Cl.194.