Corporations Law Simplification program

Fundraising

Trade Practices Act, s 52 and Securities Dealings

Task Force
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Simplification Task Force
Attorney General's Department
Barton ACT 2600

FUNDRAISING

Scope of proposal

This proposal puts forward suggested changes to the rules in the Corporations Law concerning fundraising, including in particular those about:

- when a prospectus is required (sections 66, 1018, 1030)
- prospectus content (sections 1021, 1022)
- out of date application forms and restrictions on allotment (sections 1024E, 1028, 1031 and Part 7.12 Division 3)
- advertising (sections 1025-1027)
- secondary trading in unquoted securities (Part 7.12 Division 3A)
- debentures (Part 7.12, Division 4)
- liability for prospectuses (sections 764, 765, 994-996, Part 7.11 Division 3 and Division 4 Subdivision A and B, section 1325).

The remaining provisions of Part 7.12 Division 2 will be redrafted in plain English, as will the provisions dealing with hawking of securities (Part 7.12 Division 6) and exemptions from the fundraising provisions (Part 7.12 Division 7). As foreshadowed in the Plan of Action Stage 3, the Task Force has not reviewed the policy underlying the general disclosure test in section 1022, which will be carried forward substantially unaltered.

In effect, this proposal addresses all of Part 7.12 (apart from Divisions 5 and 5A, which the exposure draft of the Collective Investments Bill proposes to repeal) and the associated remedy provisions.

The Task Force has also examined the regulations made for the purposes of the fundraising provisions (Part 7.12 of the Corporations Regulations apart from 7.12.04, 7.12.12A and 7.12.15 to 7.12.16B) and proposes that some of them be moved into the Law.

Benefits

The proposal on fundraising will:

- improve the civil liability provisions by focusing primary liability on persons who are most directly concerned and tailoring the liability of others to the extent of their involvement
- make the same defences available to everyone who is potentially liable in relation to the prospectus
- clarify the application of the prospectus provisions to rights and options
- improve the operation of the prospectus provisions in relation to secondary offers which are in the nature of primary offers
- better integrate the operation of the provisions dealing with supplementary prospectuses, out of date application forms and restrictions on allotment
- remove restrictions on pre-prospectus advertising in relation to offers of securities in a quoted class
- improve the operation of the secondary trading provisions
- simplify the definition of debentures and bring the financial reporting requirements for borrowing corporations into line with those for other bodies.

These changes will:

- make fundraising easier for small and medium size enterprises by widening the limited offering exclusion

- provide greater certainty for business by streamlining the operation of the Law, especially in connection with civil liability.

REPORT TO MINISTERS ON SECTION 52 TRADE PRACTICES ACT

The Task Force has been asked to report to the Attorney-General and the Minister for Consumer Affairs on the application of section 52 of the *Trade Practices Act 1974* to fundraising and other dealings in securities regulated under the Corporations Law. This matter is being considered in the context of the proposal for simplification of the fundraising provisions because of the significance of the overlap between liability under section 52 and under the prospectus provisions of the Law.

The Task Force's proposal is set out on pages 18 to 21. The proposal suggests that the regulation of dealings in securities be addressed under the Corporations Law rather than under section 52 of the Trade Practices Act. The proposal is released for public comment as part of the process of consultation prior to reporting to the Ministers.

THE PROPOSAL - FUNDRAISING

Proposal	Issues for consideration
1. The rules on fundraising, including when a prospectus is required, will remain unchanged, except as set out below.	Should the Law require a prospectus when a corporation is seeking listing on the ASX, even if there is not an offer of securities at the same time, rather than rely on the ASX listing rules? If so, should the duties imposed on a corporation and the liability to which the corporation is subject be the same as in relation to prospectuses generally?
Prospectuses	
Rights and options over unissued shares	
2. Rights and options over unissued securities will be treated as securities in their own right for the purposes of the fundraising provisions. A prospectus offering rights or options will therefore need to contain information about the right or option, as well as information about the underlying security. This will also be the case if rights are offered for consideration.	
Secondary offers in the nature of primary offers	
3. Section 1030 will be repealed. Section 1018 will be amended to require a prospectus for a sale of securities within 1 year from the date of issue where those securities have been issued under the exclusions for: (a) amounts over $500,000 (paragraphs 66(2)(a) and 66(3)(a)) (b) institutional and other professional investors (regs 7.12.05(a) and (e) and 7.12.06(a) and (j)). This requirement will not apply to an excluded offer for sale.	(a) Consistent with the approach adopted in the United States, should the restrictions on resale apply for a period of 2 years? (b) Alternatively, should section 1030 be retained, but amended to: o remove subsection 1030(lA), and o make it clear that the resale purpose needed to trigger the section is that of the corporation which issued the securities?
Personal Offers	
4. Personal offers of securities (including collective investment interests) that result in the issue of securities to no more than 20 persons in a rolling 1 year period will not require a prospectus. Issues made under other exclusions will not be counted. The term 'personal offer' will be defined to mean an offer made to a particular person which can only be accepted by that person.	Should the exclusion continue to apply to offers instead of issues? If so, should the number be increased from 20 to 50?

Proposal	Issues for consideration
Offers for at least $500,000 5. The $500,000 exclusion will be amended to: (a) clarify that the exclusion turns on the amount paid for the security and not the amount of the offer or invitation	
(b) enable offers to be made to an existing investor where the amount paid by that investor for all the securities of the class offered after any issue under the offer is at least $500,000.	Should the limit relate to the value of the securities rather than the amount paid?
Offers to existing investors 6. Current exclusions for offers of debentures to existing holders of debentures, and offers of convertible notes to the existing holders of convertible notes, will be abolished.	Should the existing exemption for debentures be retained but limited to rollovers?
Content 7. Paragraphs 1022(3)(d) and 1022(3)(e), which allow regard to be had, in determining prospectus content, to what investors already know by virtue of being a shareholder or as a result of any law, will be repealed.	Are any changes to the incorporation by reference provisions needed to facilitate the use of short form prospectuses?
8. As well as applying to directors, proposed directors and experts, subsection 1021(6) will be extended to require disclosure of amounts paid to, and interests of: (a) promoters and other persons who issue the prospectus (b) stockbrokers or underwriters to the issue, and (c) persons named with their consent as performing any function in a professional, advisory or other capacity in connection with the prospectus.	
Registration 9. The period within which the ASC must register or reject a prospectus will be 14 days, as at present.	(a) Should the period be reduced to 2 working days (or some other period) so that ASC surveillance activities will be confined to post-registration vetting? (b) Should subsections 1021(14) and 1025(2)(b) be replaced with a prohibition against referring to the prospectus having been lodged or registered with the ASC?

Proposal	Issues for consideration
Restrictions on allotment 10. Sections 1024E, 1028, 1031 and 1035 to 1043 will be repealed and replaced with the rules set out in paragraphs 11 to 15. 11. A corporation will be prohibited from issuing securities under an application form if: (a) there is a false or misleading statement or omission ('deficiency') in the prospectus (including any supplementary prospectus) which is provided with that application form, or (b) before the securities are issued, there is a change or a new fact ('new matter') which is not reflected in the prospectus and the deficiency or new matter is materially adverse from the point of view of an investor. 12. A 'new matter' will include: (a) a shortfall on the minimum subscription of shares (b) if the prospectus indicates that the securities are to be quoted - the failure of the relevant securities exchange to approve their quotation within 3 months of the registration of the prospectus, and (c) the prospectus passing its expiry date. 13. Where the prohibition on issue applies, the issuer will have to: (a) return the money to investors; or (b) hold the application money in trust, and give the investor an update of the prospectus and an opportunity to withdraw their application for the securities. 14. Where securities are issued to an investor in breach of the prohibition on issue, the investor will have the right to have the securities cancelled and the application money repaid. 15. If the corporation does not repay money as mentioned in paragraph 13(b) or 14, its directors will be personally liable to repay the money.	

Proposal	Issues for consideration
Advertising	
16. For offers of securities in an already quoted class, pre-prospectus advertising and other forms of promotion will be permitted. However, the advertising and promotion must refer to the future availability of a prospectus.	Should there be some limited relaxation of the restrictions on pre-prospectus publicity for offers of other securities, for example, by allowing advertisements which only state that an offer is proposed and invite people to register to receive a prospectus?
Secondary trading	
17. Section 1043C will apply to secondary offers of securities of a corporation by a person who controls that corporation. A person will 'control' a corporation if they have the capacity to determine the outcome of decisions about the corporation's financial or operating policies.	
18. A person who controls a corporation will be allowed to make personal offers that result in the sales of securities of that corporation to no more than 20 persons in a rolling 1 year period without being required to lodge a section 1043C notice. Sales made under other exclusions will not be counted.	
19. A notice which complies with section 1043D will continue to be required for limited secondary offers of securities of a corporation, other than by a person who controls the corporation, unless the offer falls under another exclusion. There will be no exclusion for offers leading to 20 sales in 1 year.	Alternatively, should section 1043D statements be abolished and secondary offers regulated only by general provisions such as the prohibitions against insider trading and misleading or deceptive conduct?
Debentures	
20. Debentures' will be defined as a kind of legal right in the nature of a debt and not as a kind of document.	Are there any other aspects of the operation of the debenture provisions which need to be addressed?
21. Section 1045 of the Law, which places a restriction on how debentures may be described, will be repealed.	
Accounting requirements for borrowing corporations	
22. The specific accounting requirements for borrowing corporations in section 1058 will be repealed.	Should the Law require financial statements from all corporations which offer debentures under a prospectus, and from all guarantors of their obligations which are not their subsidiaries? If so, what should determine the content of the accounts of those corporations which are not companies or locally incorporated disclosing entities?

Proposal	Issues for consideration
Civil liability *The issue of liability under the Corporations Law needs to be considered in the context of recommendations on the Trade Practices Act set out on pages 18 to 21.* 23. Actions for damages or injunctions in connection with a prospectus will only be available under section 996 and not under section 995. 24. Section 996 will be amended to be consistent with section 995, so that in actions for damages and injunctions it will not be necessary to establish that the false or misleading statement or the omission was material. As at present, recovery of damages will depend on establishing that loss has been suffered and an injunction will remain a discretionary remedy. *Who should be liable* 25. The following persons will be liable for loss or damage resulting from the issue of a prospectus in which there is a false or misleading statement or from which there is an omission: (a) issuers of the prospectus, the corporation itself, directors, proposed directors, promoters, underwriters and brokers to the issue - for the whole of the prospectus (b) a person named with their consent as having made a statement in the prospectus, or as having made a statement on which a statement in the prospectus is based - for the statement in the prospectus (c) a person named in the prospectus with their consent as having performed any professional or advisory function in relation to the prospectus - for false or misleading statements for the correctness of which they are responsible in that capacity and omissions from statements for the completeness of which they are responsible in that capacity. Liability will also extend to persons who are shown to be involved in the issue of the prospectus under section 79.	(a) Should persons named as having performed these functions be able to reduce or exclude liability by a specific statement in the prospectus? (b) Should there be a prohibition on persons being named in the prospectus if they are not assuming liability for part or all of its content?

Proposal	Issues for consideration
A person who falls into category (b) or (c) will not be taken to issue a prospectus or be involved in the issue merely because they also perform other professional or advisory functions in connection with the preparation of the prospectus. *Available defences* 26. The following defences will be available to the persons referred to in paragraph 25 (in place of those in sections 1007 to 1011) in an action for damages in connection with a prospectus: (a) after taking reasonable precautions and exercising due diligence, the person believed that a defective statement was true and not misleading or that there was no material omission from the prospectus (b) the persons placed reasonable reliance on a statement or report supplied by another person which is included in the prospectus with their consent, or (c) the person withdrew their consent to being named in the prospectus. **Criminal liability** 27. The defences contained in subsection 996(2) will be replaced with the wider defences outlined in paragraph 26. As at present, the prosecution will need to establish that the false or misleading statement or omission was material.	(a) Should there be other defences instead of, or in addition to, these defences, for example, the defences set out in section 1011? (b) Should there be no defences available to the corporation which issued the securities on the grounds that it is always more appropriate for the corporation to bear any loss than the investor?

DEVELOPMENT OF THE PROPOSAL

Background

The prospectus provisions regulate capital raising by corporations. They do so essentially by requiring the disclosure of all relevant information in a prospectus and then allowing the market place to make decisions about the allocation of scarce capital resources.

The preparation of a prospectus and the associated imposition of liability is designed to provide a level of protection for investors which is reasonable having regard to the costs involved. The balance sought to be achieved is designed to facilitate the operation of an effective and efficient market place, especially in light of the position in overseas jurisdictions.

The types of fundraising regulated under the prospectus provisions include:

- initial public offerings by corporations seeking to list on the stock exchange
- rights issues by already listed companies
- offers by continuous issuers, typically interests in unit trusts and finance company debentures.

The prospectus provisions do not apply to all forms of fundraising. There are express exclusions for:

- small scale offerings where the potential regulatory burden far outweighs any investor protection benefit
- offers to sophisticated or professional investors and other persons who could be expected to be able to look after themselves
- offers by entities which are subject to supervision under other laws, for example banks and non-bank financial institutions.

The rules on fundraising introduced with the Corporations Law in 1991 involved significant departures from the rules under the former Companies Codes. In particular:

- a general prospectus content rule replaced the previous check list approach
- prospectuses were required for all offers unless expressly excluded, in place of the offer to the public test
- civil liability was substantially enhanced for prospectuses which are materially false or misleading or omit material matters
- advertising restrictions were relaxed so as to allow any advertising after the lodgment of the prospectus provided that it set out specified details and was not misleading or deceptive
- post registration examination by the regulatory agency replaced systematic detailed pre-vetting
- prospectuses were required for rights issues.

Significant amendments of the fundraising provisions were made in 1991 to finetune the operation of the liability provisions and to introduce a regime for secondary offer prospectuses. Further amendments in 1994 implemented a continuous disclosure regime and introduced other changes, including special rules for rights issue prospectuses for securities in an already quoted class.

When is a prospectus required?

Rights and options over unissued shares

The fundraising provisions of the Law apply to offers and invitations made in relation to securities of a corporation. The definition of 'securities' contained in subsection 92(2) of the Law does not, however, include rights or options over unissued securities. A prospectus is required if the offer of the right or option constitutes an offer of the underlying security and the disclosure required relates to the underlying security rather than the right or option itself.

It is proposed that the term 'securities' be redrafted so as to cover both rights and options over unissued securities. This will address potential problems with the relevance of information contained in a prospectus. Where the right is issued for no consideration, the existing exemption for offers for no consideration will continue to apply. However, in these cases, the right is usually short dated and the most relevant information relates to the underlying securities.

Secondary offers in the nature of primary offers

Section 1030 of the Law deems a document that offers securities issued for the purpose of on-sale to be a prospectus issued by the corporation which issued the securities. In the absence of proof to the contrary, securities sold within 6 months of their issue are deemed to have been issued for the purpose of on-sale. The purpose of this provision is to prevent avoidance by issuing securities to an intermediary under one of the exclusions and the intermediary then on-selling the securities at large.

Particular concerns arose in 1991 over the potential application of section 1030 to offers of securities which had been placed with institutions on the Stock Exchange Automated Trading System (SEATS). It was feared that the extended definition of 'document' in section 9 of the Law applied to offers displayed on SEATS screens. In turn, it was considered that section 1030 would deem the screen to be a prospectus. If this view were correct, the corporation which issued the securities would be exposed to liability because the deemed prospectus did not comply with the Law.

Subsection 1030(lA) was enacted to make it clear that section 1030 did not apply to offers made on SEATS. However, the provision has been criticised on the basis that it undermines the anti-avoidance purpose of section 1030 by allowing securities to be issued to an intermediary without a prospectus under an exclusion and then on-sold into the general market through SEATS.

Other difficulties which have been identified with section 1030 are:

- a corporation can be made liable for the content of a document which is prepared by a third party
- the provision taints for an indefinite period securities which have been issued for the purpose of resale
- it is not clear whether the resale purpose necessary to trigger the provision is that of the issuer of the securities or that of the subscriber
- irrespective of whose purpose is relevant, potential enforcement difficulties arise in that intent is often difficult to establish, particularly where a conscious effort is made to avoid the provision.

In 1992 a report on prospectus law reform by the Companies and Securities Advisory Committee (CASAC) Prospectus Law Reform Sub-committee (the CASAC Report) recommended that subsection 1030(1A) be repealed and the anti-avoidance purpose of section 1030 clarified.

The proposal adopts a different approach to that suggested in the CASAC Report with a view to overcoming all the problems identified above. In particular, it:

- provides commercial certainty by ensuring that securities can be on-sold into the general market after a fixed period without the potential adverse consequences
- avoids enforcement difficulties inherent in a purpose based test
- ensures the issuer of securities will not be fixed with liability because of the conduct of a third person which may be beyond the issuer's control.

The proposed approach is broadly consistent with that in North American jurisdictions. In the United States securities issued without a prospectus to professional and institutional investors can be sold for 2 years only to other professional and institutional investors. In Ontario the period for which securities are confined to the professional and institutional market is 6,12 or 18 months depending on the type of security.

The alternate approach, raised as an issue in the proposal, would avoid securities being confined to the excluded offer market for a fixed period and for this reason may be seen as desirable. However, it

would not deal with the problems of securities being tainted indefinitely, the issuer becoming liable for the conduct of others or the enforcement issues inherent in a purpose based test.

Exclusions

The prospectus provisions apply to an offer or invitation to subscribe for securities of a corporation unless the offer or invitation comes within one of the exclusions contained in the Law or Regulations. It is recognised that the fundraising provisions can be costly and restrict the capacity of small and medium sized enterprises (SMEs) to effectively raise capital. In reviewing the various exclusions, particular regard was had to the recent report of the National Investment Council - *Financing Growth: policy options to improve the flow of capital to Australia's small and medium enterprises* (August 1995) (the NIC Report).

a) Small scale offerings

Paragraphs 66(2)(d) and (3)(d) of the Law are aimed at permitting small scale private offers without a prospectus. These provisions are intended to enable a corporation to make up to 20 personal offers of securities, other than prescribed interests, in a rolling 1 year period without having to comply with the prospectus requirements of the Law.

It has been argued that this exclusion is unduly restrictive, especially for SMEs which sometimes seek to raise relatively small amounts for which it is not economical to prepare a prospectus. A particular difficulty said to arise is that the 20 offers can be exhausted before the required funds have been raised. The proposal overcomes this difficulty by permitting an unlimited number of personal offers resulting no more than 20 issues of securities in a rolling 1 year period.

The proposed relaxation of the limited offer exclusion, together with other initiatives such as the establishment of 'matching' facilities and specialised secondary markets is intended to free SMEs of restraints in fundraising without undermining investor protection.

b) Offers of at least $500,000

The prospectus provisions of the Law do not apply where an offer of at least $500,000 is made. This exclusion is aimed at persons who are considered to have sufficient resources to obtain independent professional advice or who, because of the size of their potential investment, have sufficient leverage over the corporation concerned to obtain the information which they need.

In the context of facilitating SME financing the NIC Report recommended that the $500,000 amount be reviewed against the option of reducing it to $250,000. This issue had previously been considered in the CASAC Report which did not recommend any reduction. In light of the proposal in relation to small scale offerings and the investor protection risk involved in reducing the amount, no change is proposed. However, the proposal picks up recommendations in the CASAC Report to:

- make it clear that the amount concerned is the amount invested, rather than the amount of the offer
- allow investors to top up existing investments to over $500,000.

c) Offers to existing investors.

Exclusions presently exist for offers of debentures to existing debenture holders and offers of convertible notes to existing convertible note holders. The exclusions are not limited to rolling over existing debentures, but permit an offer of new debentures of any kind and any magnitude. The exclusions pose a risk to investor protection and are inconsistent with the requirement for rights issue prospectuses. It is therefore proposed that they be removed.

Prospectus registration

Section 1020A of the Law requires the ASC to register a prospectus as soon as possible and in any event within the prescribed period of 14 days (reg 7.12.08). The ASC is empowered to refuse

registration if it appears that the prospectus does not comply with the Law, is materially false or misleading or contains a material omission. In practice, the ASC only gives prospectuses limited examination prior to registration unless they have reason to believe that a closer examination is warranted. A post-registration vetting program is conducted by the ASC to ensure the integrity of prospectuses.

The 14 day registration period will be retained. Figures available from the ASC for the years ending 30 June 1994 and 30 June 1995 indicate that about 70% of prospectuses received are registered within 7 days of lodgment. The figures also indicate that 35%-40% of prospectuses examined postregistration were subject to remedial action, such as the ASC issuing a stop order, the withdrawal of the prospectus or the issuing of a supplementary prospectus.

In the event that the registration period were reduced, the ASC would have less time to examine prospectuses, arguably leading to an increase in the need for remedial action at the post-registration stage.

Although prospectuses are required to include a statement that the ASC takes no responsibility for their contents (paragraph 1021(14)(c)), a common misconception exists that registration somehow involves ASC approval of its contents. The proposal raises the issue of whether references to prospectuses having been lodged and registered should instead be prohibited.

Prospectus content

As indicated in the Plan of Action Stage 3, the general prospectus content rule in subsection 1022(1) has not been reconsidered. The current rule was supported by the CASAC Report and is consistent with the approach of the market taking responsibility for prospectus content. However, consideration has been given to finetuning the operation of the provision.

Profit forecasts

There has been some controversy whether subsection 1022(1) should require the inclusion of a profit forecast. The CASAC Report concluded that forecasts in prospectuses with appropriate disclosure of assumptions and risks were generally desirable, but that it would be contrary to the philosophy behind the general disclosure test in section 1022 to make the inclusion of forecasts in prospectuses mandatory. Whether a forecast is required depends upon whether, in the circumstances, an investor or an adviser would reasonably require or reasonably expect to find one in the prospectus to make an informed assessment of the prospects of the corporation *(Pancontinental Mining Ltd v Goldfields Ltd* (1995) 13 ACLC 577; 16 ACSR 463). The Task Force considers that it would not be appropriate to require the inclusion of profit forecasts in all prospectuses.

Subsection 765(2) deems representations about future matters to be misleading unless the person making the representations prove that there were reasonable grounds for the representation. The CASAC Report recommended that the reverse onus of proof should not apply to forecasts in prospectuses. Section 765 serves to prevent the making of forecasts which have no basis. If it is removed, an investor could find it difficult to establish a contravention. There does not appear to be sufficient justification for treating forecasts differently to other representations about future matters. The onus of proof in relation to future matters is similarly reversed under the *Trade Practices Act 1974.*

Short form prospectuses

The Task Force has considered whether there should be a specific regime for short form prospectuses. Although no specific provision is made in the Law for short form prospectuses, a number of provisions in the Law which were introduced with the *Corporate Law Reform Act 1994* have the practical effect of allowing their use.

First, the incorporation by reference provision (section 1024F) allow for a prospectus to be issued in a shortened form provided that the incorporated documents are lodged with the ASC, the prospectus contains a summary of the documents or relevant parts and states that the documents will be

provided by the issuer upon request. Secondly, section 1022AA specifies the content requirements for prospectuses relating to primary offers of quoted securities made by certain disclosing entities. The effect of this provision is to reduce the amount of information which is required to be included in a prospectus on the basis that the information will already be known to the market. Corporations which have a 12 month track record of continuous disclosure to the ASX can use the shortened form of prospectus.

Given that these provisions only came into force in September 1994, it seems preferable to allow market practices to develop before considering further amendments. However, the proposal raises the issue of whether any amendments are desirable.

Factors to be considered

Paragraph 1022(3)(d) of the Law was intended to enable a prospectus to omit information which had been disclosed to the market under the listing rules. However, in practice, persons issuing prospectuses were reluctant to omit the information because of uncertainties about the meaning of the provision. The provision has been supplanted by the rights issue and incorporation by reference provisions for listed entities (sections 1022AA and 1024F). Paragraph 1022(3)(d) will therefore be repealed.

Paragraph 1022(3)(e) allows a prospectus to omit information known to investors by virtue of any law. The effect of this provision is uncertain. On one view, it enables relevant statutory provisions to be omitted from prospectuses. On another view, it enables information made available to investors under any law to be excluded from prospectuses.

Regardless of which interpretation is correct, the provision is considered incorrect in principle. It is unclear why information of this kind should not be made available in a prospectus if it is reasonably required by investors to make an informed decision about the offer. The extent to which this information should be included in a prospectus should therefore be determined in accordance with the general disclosure test in subsection 1022(1) and paragraph 1022(3)(e) be repealed.

Specific content rules

Section 1021 of the Law sets out specific content rules for prospectuses. Subsection 1021(6) requires the disclosure of interests (not more than 2 years old) which directors, promoters and experts have in a float. Although the operation of this provision was revised in the *Corporate Law Reform Act 1994,* problems remain with its operation. In particular, other persons involved in the fundraising often have interests which ought to be disclosed to investors.

Subsection 1021(6) requires disclosure of interests which some of those involved in the preparation of a prospectus have in the fundraising. A party whose interests may be affected by the disclosure will ordinarily argue that the information is not relevant to any decisions which might be made by investors. The result is that detailed information of this nature may not be provided under a 'general disclosure' requirement. Given that the rationale for the provision is to ensure the disclosure of interests, it is unclear why it is confined to directors and experts when other persons involved in the preparation of the prospectus (such as promoters, stockbrokers and underwriters) may have an equal, if not greater, interest in the outcome of the offer. Subsection 1021(6) will therefore be extended to apply to these persons.

Restrictions on allotment

Divisions 2 and 3 of Part 7.12 contain several provisions which prohibit the issue of securities in certain cases. There are also provisions dealing with the consequences of breaches of these provisions.

The operation of these provisions has raised the following problems:

- Section 1024E does not apply to the issue of securities under a prospectus after the issuer learns that the prospectus is deficient and before it issues a replacement or supplementary prospectus.

- Section 1031 makes an issue of securities ineffective if quotation is not arranged within an arbitrary period, irrespective of the wishes and expectations of the subscribers. The provisions for extending time and for undertakings result in practical difficulties for the ASX and the corporation (see *Premier Pacific Pharmaceutical Industries Ltd v Australian Stock Exchange Ltd* (1995) 13 ACLC 744;17 ACSIZ 36; on appeal 13 ACLC 979;17 ACSR 426).
- Unlike section 1031, section 1033 does not make an issue made in breach of a stop order ineffective.
- Section 1035 does not apply to the issue of securities by a corporation other than a company.
- Section 1041 preserves issues made under a prospectus past its expiry date.
- Section 1043 and subsection 1031(6) make separate provision for money to be held in bank accounts. They differ in detail and there is no provision for money to be held in trust when an issue may be rendered void under section 1024E or 1037.

The operation of these provisions is inconsistent and not well integrated with the provisions dealing with supplementary prospectuses and out of date application forms. The new rules will address these difficulties.

Pre-prospectus advertising

Restrictions on advertising and the publication of other notices (sections 1025 and 1026) are designed to ensure that investment decisions are made on the basis of information contained in a prospectus. To remove entirely these restrictions as they apply at the preprospectus stage would detract from the role of a prospectus as the principal fundraising document. If there were no restrictions on pre-prospectus advertising, those seeking to raise funds could generate expectations amongst potential investors about the desirability of a proposed offer before all relevant information reaches the market. Experience shows that pre-prospectus advertising can create a stampede for securities.

Given the possible adverse consequences, the prohibition on pre-prospectus advertising will be retained for offers of securities other than those which are in an already quoted class. The prohibitions on misleading and deceptive conduct, the market offence provisions in Part 7.11 and the availability of an externally determined market price based upon continuous disclosure of price sensitive information should be sufficient to achieve adequate investor protection in relation to already quoted securities. However, it is proposed that, consistent with the principle of seeking to ensure reliance on a prospectus, pre-prospectus advertising or publicity for quoted securities must refer to the intended release of a prospectus.

Secondary trading

Under the Companies Code, secondary offers of securities required a statement setting out limited information in relation to the securities and the issuer (section 552). From its commencement, the Corporations Law extended the requirement for a prospectus to all offers for sale of securities. It also contained provisions dealing with offers for sale (sections 1079, 1080), based upon the Code provisions. However, as the more stringent prospectus provisions were applicable to secondary sales, these provisions were regarded as irrelevant.

Concerns about the application of the provisions to sales of small holdings of securities led to further amendments as part of the *Corporate Law Reform Act 1994* which introduced the present 2 tier regime in relation to secondary trading. Under section 1043C, prospectus type disclosure is presently required for sales of at least 30% of the voting shares of a company. The 30% threshold was effectively a proxy for control of the company. In relation to other sales, reduced disclosure requirements apply under section 1043D. These later requirements are based on those previously set out in the Companies Codes.

Difficulties have been identified with the obligations imposed under these provisions. First, significant secondary sales of shares by a person who controls a company can be made without being required to comply with section 1043C simply by limiting the sale to less than 30%. In addition, section 1043C applies to shares of a company but not other securities. To address these problems

section 1043C will be amended to apply to secondary offers of securities of a corporation by a person who controls that corporation. Control will be defined along the lines of section 258E of the Second Corporate Law Simplification Bill. It is not clear how the limited offer exclusions apply to secondary offers. One interpretation is that all offers made by security holders and the entity itself must be counted for the purpose of the exclusion. If this is correct, anyone wishing to sell their securities could not do so with any degree of certainty that they were acting in accordance with the Law.

Given that obligations in relation to offers to which section 1043C applies are comparable to those applying to primary offers, it is proposed there be an equivalent to the limited offeree exclusion. Offers to which section 1043D applies raise different issues. In these cases the limited disclosure obligations mean that there does not appear to be any basis for providing relief for them merely because the offer is small scale or limited. However, the other exclusions will remain applicable.

Debentures

The existing restrictions in the Law on how debentures may be described will be repealed. This will bring our legislation into line with that of overseas jurisdictions. Any description of debentures, whether contained in a prospectus or otherwise, will be regulated under the more general prohibition on misleading and deceptive conduct contained in section 995.

'Debenture' is currently defined in terms of a class of documents, rather than by reference to the underlying legal rights. This is out of line with other aspects of the definition of 'security' and is conceptually clumsy.

A number of more specific concerns have been raised about the operation of the definition of 'debenture'. These will be addressed in the course of redrafting the definition in terms of the underlying legal rights.

Accounting requirements and borrowing corporations

Part 7.12 Division 4 of the Law regulates the conduct of corporations which make offers of debentures. A trust deed for debenture holders is required containing certain covenants together with a qualified trustee.

Subsection 1058(6) requires a borrowing corporation which is a holding company to prepare financial statements every 6 months and lodge them with the ASC and the trustee. The financial statements must be consolidated for the borrowing corporation and each subsidiary that has guaranteed the repayment of the money lent to the borrowing corporation, and are generally required to comply with the accounting provisions of the Law.

Except where the debentures are mortgage debentures, subsection 1058(5) of the Law requires a guarantor body which is not a subsidiary of the borrowing corporation to prepare financial statements for itself every 6 months and lodge them with the ASC and the trustee. If the body is incorporated in the United Kingdom or a state or territory of the United States, a copy of financial statements lodged with the Department of Trade or the Securities and Exchange Commission will suffice. In other cases, the financial statements are generally required to comply with the accounting provisions of the Law. The trustee may also require a guarantor body which is a subsidiary of the borrowing corporation to comply with the requirements of subsection 1058(5).

These provisions were first introduced into the Uniform Companies Acts in 1964 and have not been fundamentally revisited since then. They largely overlap with the provisions of the Law relating to financial statements generally, and contain special rules and exemptions, some of which are inappropriate and others better left to accounting standards.

Civil liability

Conduct resulting in liability

The civil liability provisions in Part 7.11 of the Corporations Law underpin the prospectus disclosure requirements. Two prohibitions form the main basis for civil actions. Section 996 prohibits the causing or authorising of the issue of a prospectus in which there is a materially false or misleading statement or from which there is a material omission. In addition, section 995 prohibits misleading and deceptive conduct in relation to dealings in securities. Section 1005 enables persons who suffer loss resulting from contraventions of these sections to recover that loss from a person who contravened or was involved in the contravention. Remedies are also available under sections 1324 and 1325.

There is potential for overlap between these 2 provisions. Conduct which constitutes a contravention of section 996 is likely also to be a contravention of section 995. While certain defences are applicable to recovery of damages for breaches of section 996, it is unclear whether these defences are available in relation to breaches of section 995. In order to avoid the overlap and remove any uncertainty as to the availability of defences, it is proposed that civil actions for prospectuses be taken only under section 996. It is also proposed to remove the existing requirement in section 996 for the defect to be material to achieve consistency with section 995.

Extent of liability

The following are potentially liable at present for damages in relation to a prospectus in which there is a materially false or misleading statement or from which a material matter has been omitted:

- persons who cause or authorise the issue of the prospectus
- persons referred to in subsection 1006(2) who are effectively deemed to be involved in the issue of the prospectus
- other persons who are actually involved in the issue of the prospectus under section 79.

The liability of some of the persons referred to in subsection 1006(2) is potentially limited by sections 1009 and 1010. However, difficulties exist with the operation of those provisions:

- Persons who are named as bankers, auditors and solicitors of the corporation or in relation to the issue generally do not make specific statements in the prospectus as appears to be contemplated by subsection 1009(2). Nor is their involvement generally limited to part only of the prospectus as contemplated by subsection 1010(1).
- The involvement of the stockbroker and underwriter to the issue is generally not limited to part only of the prospectus as is contemplated by subsection 1010(1).
- Persons performing advisory functions in relation to the prospectus will not necessarily be able to be named in part only of the prospectus as contemplated by subsection 1010(1).

The proposal overcomes these difficulties by making it clear that the liability of the persons concerned is related to the extent of their involvement in the preparation of the prospectus. The issuer of the prospectus, the corporation, directors and proposed directors and stockbrokers and underwriters to the issue will continue to be liable in relation to the prospectus as a whole.

Available defences

Persons taken to be involved in the issue of a prospectus which contains false or misleading statements or from which there is a material omission have certain defences by virtue of various provisions in Part 7.11 Division 4 of the Law. These defences are based upon previous provisions of the former Companies Codes and the liability provisions of Part VI of the Trade Practices Act. They have been criticised as lacking coherence and a clear underlying policy. Another difficulty is the lack of defences for persons who are liable on the basis that they are involved in the contravention of section 996 by virtue of section 79.

These difficulties will be addressed by providing a common defence for all persons who are potentially liable in relation to prospectuses. The elements of the proposed defence are drawn from existing defences in Part 7.11 of the Law. A person will not be liable if, after exercising due diligence and taking reasonable precautions, they believed that the prospectus did not contain any materially false or misleading statements or omit any material matter.

As aspects of the prospectus will not necessarily be within the expertise of all persons who will be potentially liable, there will also be a defence based on reliance on other persons. However, to ensure that this defence does not leave investors without a person to proceed against, it is limited to reliance on persons who have consented to having the relevant statement included in the prospectus (and who thereby expose themselves to liability).

A defence will also be available to persons named in the prospectus as performing a professional or advisory function if their consent to being so named has been withdrawn.

Application of fundraising provisions to collective investment schemes

The prospectus provisions in the Law will apply to collective investment schemes in the same way as they apply to securities. The fundraising provisions relating to collective investment schemes contained in the Regulations will be moved into the Law.

Continuous disclosure provisions

Under section 148A of the *Australian Securities Commission Act 1989* the Attorney-General must seek the advice of CASAC on the effectiveness of the continuous disclosure regime as soon as possible after March 1996, with the review to be completed within 6 months. It would therefore be inappropriate to rewrite these provisions at this time as part of the Simplification Program because the CASAC review is to take place during the period in which the Third Bill will be prepared.

Proportionate liability

The Standing Committee of Attorneys-General is currently considering a separate proposal that joint and several liability be replaced by proportionate liability for certain claims. If this proposal proceeds it will require an amendment to section 995 of the Corporations Law (as well as changes to negligence actions for property damage or purely economic loss and statutory liability for loss arising from misleading or deceptive conduct under the Trade Practices Act, and the fair trading legislation of the States and Territories).

APPLICATION OF SECTION 52 OF THE TRADE PRACTICES ACT

In June 1995 the Attorney-General asked the Task Force to consider and report to him and the Minister for Consumer Affairs on the application of section 52 of the Trade Practices Act 1974 (TPA) to fundraising and other dealings in securities. Because of the particular relevance of section 52 to the fundraising provisions of the Law, this review is being conducted in the context of the Stage 3 review of these provisions.

The proposal

Conduct in respect of fundraising, takeovers and other dealings in securities will be governed by the Corporations Law and not by section 52 and associated provisions of the Trade Practices Act.

Both the Corporations Law and the TPA apply to fundraising, takeovers and other dealings in securities. The following table outlines the current scope of section 52 of the TPA and relevant provisions in the Corporations Law and illustrates the overlap between the provisions.

	s52 TPA[1]	S995 CL	S996 CL	ss704-705 CL
Misleading and deceptive conduct	*	*		
False/misleading statements and omissions			*	*
Remedies:				
Damages	*	*	*	*
Injunctions	*	*	*	*
Criminal			*	*
Defences:				
to actions for damages		?[2]	*	*
for other civil actions				*
for criminal actions I			*	*

Notes

[1] Other provisions in the TPA prohibit unfair practices in more specific terms. These are set out in Part V of the TPA. For example, section 53 prohibits false or misleading representations in relation to the supply of goods and services.

[2] Where the misleading or deceptive conduct is constituted by a false or misleading statement in or an omission from a prospectus, arguably the defences in Part 7.11 will apply.

The 2 regimes operate in significantly different ways.

The Corporations Law imposes a positive duty of disclosure on those responsible for providing information to the investing public. The availability of information is central to ensuring that investors are capable of making informed decisions and that markets operate efficiently.

To this end, section 1022 of the Law requires prospectuses to contain all the information which investors and their professional advisers would reasonably require for the purposes of making an informed assessment about the corporation and the securities being offered. The information required to be disclosed is that known to the persons involved in the preparation of the prospectus and that which they could find out by making reasonable inquiries. Since the commencement of the Law, there has been no systematic pre-vetting of prospectuses prior to their issue.

The general disclosure requirement was introduced and regulatory pre-vetting was abandoned to shift the obligation for determining prospectus content away from the legislature and the regulator to the marketplace. In contrast, under the former Companies Codes, there were extensive checklists for prospectus content coupled with detailed pre-vetting by the regulator.

To underpin the new approach, the civil liability provisons were enhanced by imposing liability on a significantly wider range of persons than had previously been the case. The enhanced liability was coupled with a system of defences which allowed those involved in the preparation of prospectuses to protect themselves from liability by taking precautions. This approach is designed to enhance the quality of disclosure. Although the terms of these defences differ in form, they basically involve protecting persons who have made reasonable inquiries or have exercised due diligence.

The takeover provisions in Chapter 6 of the Law similarly involve a combination of positive obligations to disclose, underpinned by civil liability provisions and appropriate defences.

In contrast, section 52 of the TPA does not impose a duty to disclose information. Rather, it sets out a standard for conduct in trade and commerce. A contravention of section 52 may occur without knowledge or fault on behalf of the corporation and notwithstanding the exercise of reasonable care.

Given the obligations which the Law imposes on those involved with fundraising and takeovers to disclose all relevant information, defences play an important role. They ensure an appropriate balance is struck between the rights of investors and the obligations of business. This carefully chosen balance is undermined if investors can succeed in an action under the TPA where defences are not available, in circumstances where there are defences under the Law.

The different operation of 2 regimes provides an uncertain environment for business. Despite taking every possible precaution to comply with the requirements of the Corporations Law, business is likely to remain exposed to liability because it is not able to rely on the Corportions Law defences. The result is to increase the cost of fundraising by Australian business.

Furthermore, this approach is inconsistent with international practice for the regulation of fundraising and takeovers. The approach of imposing stringent liability coupled with due diligence style defences is in line with the approach taken to regulating fundraising in comparable overseas jurisdictions.

The proposals on civil liability, on pages 7 - 8, will reinforce the balance which the Law has set. Where the Law requires disclosure, imposes civil liability and provides defences, section 995 will not be available. Where the Law does not impose disclosure obligations, business will be required to meet under section 995 a standard which is the same as that set by the TPA and defences to civil actions will not be available.

As part of the review, the Task Force has sought the views of peak business, professional and consumer organisations on:

- the interaction between section 52 of the TPA and matters regulated under the Law, so far as it concerns fundraising, takeovers and other aspects of dealings in securities, and
- the matters that should be taken into account by the Task Force in its report on this issue.

The options identified in this consultation were:

- repealing provisions of the Corporations Law dealing with civil liability in relation to prospectuses, takeovers and dealings in securities and leaving civil liability in relation to these matters to be regulated under the TPA alone
- retaining the current overlap between the TPA and the Law, but amending the TPA to provide statutory defences to civil proceedings similar to those contained in the Law
- excluding the application of the TPA from those prospectuses and takeovers regulated under the Law, but retaining the overlap in relation to other dealings in securities, and

- excluding the application of the TPA from all dealings in securities including those prospectuses and takeovers regulated under the Law.

The response on behalf of consumer organisations to this preliminary consultation pointed to concern that the effectiveness of consumer protection measures should not be reduced. Business and professional groups overwhelmingly support the Corporations Law alone applying to fundraising, takeovers and other dealings in securities.

In light of these considerations, the Task Force's proposal is that conduct in relation to fundraising, takeovers and other dealings in securities should be dealt with solely under the provisions of the Corporations Law and the common law and that section 52 and associated provisions of the TPA should not apply.

Investors will continue to have the benefit of full disclosure coupled with a very strong liability regime which, in effect, requires those involved in fundraising to actively search for relevant information and to fully disclose it in a manner which is not false or misleading. That regime is generally regarded as being as rigorous as any in comparable overseas jurisdictions.

The Task Force will be preparing its report to Ministers in light of the comments made on this proposal by interested parties.