OFFERS TO THE PUBLIC

1. Introduction:

At common law, a person who subscribed for shares or debentures could not complain if he were not told some fact which was of importance in making a judgment, so long as what he was told was not misleading by reason of the omission. If however the facts were mis-stated, he had remedies.

If there was any misrepresentation, he had the right to rescind the contract, but he might lose this right by delaying until the company went into liquidation, or by electing to affirm the contract. Unreasonable delay after knowledge of the misstatement might be regarded as evidence of an election to affirm the contract. The remedy of rescission was available whether the representation was innocent or fraudulent.

If the misrepresentation was fraudulent, he had the additional remedy of damages, and could recover them from the person who made the representation or any person on whose behalf that person acted.

In addition to civil liability, a person who made a fraudulent representation might be criminally liable for obtaining money by false pretences, or, if he acted in concert with others, for conspiracy to cheat and defraud.

In order to prove that a statement was fraudulent, it was necessary to prove not only that the statement was untrue, but that the person who made it did so either knowing the statement was untrue, or recklessly, without caring whether it was true or false. Unless this could be proved, the only remedy available was for innocent misrepresentation, even though the person making it might have been negligent in doing so. This was believed to be the law, at least, from the time of the decision in Derry v. Peek 14 A.C. 337 until the decision in Hedley Byrne & Co. Ltd. v. Heller and. Partners Ltd. (1964) A.C. 465, and would perhaps still be the law, but for the statutory provisions.

By statute, the subscriber was given further protection. Two steps were taken. The first was to require the issue of a prospectus, in cases where the shares or debentures were offered to the public, and to specify certain matters which must be dealt with in the prospectus (e.g. any interest of the directors in the property proposed to be acquired by the company). The second was

to subject the persons responsible for the issue of the prospectus to a stricter liability than that imposed by the common law. The liability was stricter in two respects:

(a) liability was imposed not merely for fraud, but also in cases in which the statement was made with an honest belief in its truth, but without reasonable grounds for such belief;

(b) the onus of proof was shifted from plaintiff to defendant, so far as belief and reasonable grounds were concerned.

The statutory provisions also imposed a stricter criminal liability than at common law, and also shifted the burden of proof to the accused in relation to belief in the truth of the statement, and the existence of reasonable grounds for that belief.

2. Definition of the Public:

It can be inferred that those who framed the original provisions relating to prospectuses limited their operation to the case of offers to the public, because they did not desire to impose the burden of preparing a prospectus on every person who wished to attempt to obtain capital for a company. The evil sought to be guarded against was the widespread search for subscribers by means of some general appeal for funds. The limitation chosen was that of confining the requirement to cases in which the offer was to the public, and even then, only to cases in which there was a written document of some sort (see Gower, Modern Company Law, 3rd Edn.p.296).

As pointed out in our Fifth Report, the essence of the concept of the public (apart from statutory modifications) is the generality of the offer: the offer must be one that can accepted by anyone who comes to hear of it. It is obvious that such a requirement can be easily avoided by addressing specific offers to particular persons by name, and telling them that the offer is personal to the offeree. It was attempted to overcome this difficulty by the provision that the term "public" includes "any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner" (English Act, section 55(1)). As Gower points out, however, this definition is so wide that "unless some limitation were imposed, it would be impossible for any company ever to issue any shares or debentures without making a public issue. And as a result no company could be a private one."

Because of this difficulty, section 55(2) of the English Act provides:

"The foregoing subsection shall not be taken as requiring any offer or invitation to be treated as made to the public if it can properly be regarded, in all the circumstances, as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation, or otherwise as being a domestic concern of the persons making and receiving it.....

"The result is to avoid the difficulty by virtually wiping out the provisions of sub-section (1).

The Australian Acts, on the other hand, do not contain a provision corresponding to subsection (2), although they do provide that offers to existing members or debenture holders are not offers to the public. But if Gower is right, it is impossible for a company to make an issue except to existing shareholders, without it being an offer to the public.

We have proposed that the difficulty should be overcome by adopting a numerical testy but the officers have objected that our proposal gives rise to other difficulties. They have also raised other matters which are not so much objections to our proposals as suggestions that certain situations are not provided for, either under our proposals or under the existing law.

3. Difficulties of Proof:

The officers have objected that the proposed numerical test would be difficult to police, as it would be necessary to produce evidence that more than fifty offers had been made. A suggestion that there should be a provision that proof that more than twenty offers had been made should be prima facie evidence that more than fifty had been made was accepted at Canberra, but the officers would appear still to be of opinion that this provision poses difficulties of proof. As was pointed out in Hobart, at least our proposal has the merit of certainty, whereas it .is impossible to predict what view a court will take of the existing provision. But if there is any way of removing this difficulty we should adopt it. One suggestion that has occurred to me is that we should propose the insertion of a provision enabling the Registrar, where he has reason to believe that the provisions of the section are being infringed, to require the company, through one of its responsible officers, to furnish a statement listing the persons to whom offers have been made or invitations issued during the three months preceding the date of the notice. Unless

(the officer in question lists all the offers, he runs the risk of being charged with making a false statement. If he does list them all, it can be ascertained whether the section has been infringed. A person who makes only a few offers would not be subjected to any embarrassment, as the Registrar would not be likely to exercise the power unless the facts known to him were such as to render it probable that more than fifty offers had been made.

4. The Position of Proprietary Companies:

Another matter that is troubling the officers is the position of proprietary companies under our proposals. By virtue of sections 15 and 27, a proprietary company is prohibited from inviting the public to subscribe for shares in or debentures of the company, or to deposit money with the company for fixed periods or payable at call, whether bearing or not bearing interest. The officers fear that if proprietary companies are allowed to circularise up to fifty persons in each period of three months, either for the purpose of getting more share capital, or (more importantly) for the purpose of obtaining deposits, the result may be to so change the character of some proprietary companies that the exemptions which they now enjoy will be quite inappropriate. So far as share capital is concerned, the position is not very serious, as the limitation to fifty shareholders in all, plus employees, is absolute. The problem as to deposits, however, requires more consideration. Presumably the present position is that a proprietary company may approach a limited number of people and request them to lend money to the company, either for a fixed term or payable at call, but at some point, at present undefined, its activities in approaching such persons would be held to amount to inviting the public to deposit money. If the activities are spread over a long enough period of time, and are not carried on by means of advertisement or indiscriminate circularisation, no breach of the Act would seem to be involved, even if the number of depositors rose in course of time to several hundreds. The difference that would result from our proposals, however, is that the company could resort to indiscriminate circularisation, so long as the number of persons circularised was kept down to fifty within each three months.

I do not see any answer to this problem at the moment, other than to place a numerical limit on the number of depositors or debenture holders that a proprietary company can have at any one time. Such a limitation would not be opposed to the general

principles on which proprietary companies are given exemption from some of the provisions of the Act, and it would be unlikely to affect many existing companies and in any case, a transitional provision could be introduced to deal with such cases.

Specific reference was made in Hobart to the provisions of section 27(7) of the Act. This provision was apparently inserted to meet the case of a solicitor in New South Wales who was accustomed to advertise that he could arrange investments. Persons who responded to the advertisements and entrusted their funds to the solicitor found that he had placed the money on deposit with a company in which the solicitor or members of his family were the shareholders. Several observations may be made as to the section.

In the first place, not every solicitor advertises that he can arrange investments, but clearly, any solicitor who displays a sign that all who pass can read, or who advertises in a newspaper, that he can arrange investments, is inviting the public to invest, whether the test is the old one or the numerical test that we propose. There would be no difficulty in showing that more than fifty persons must have read the advertisement, if openly displayed in a public place or published in a newspaper with a circulation of more than fifty, Assuming that the solicitor was acting with the authority of the company in accepting the funds from the lender, one would think that the acceptance of the deposit was a breach of section 27(8), even though the invitation did not specifically refer to the company. There might, however be difficulty in sustaining a case apart from sub-section (7) if it could not be proved that the solicitor had the prior authority of' the company to receive the money for investment.

It is to be noted that the sub-section does not tie the offence to cases in which the arrangement is made as a result of the advertisement. It would seem that if a proprietary company went to its usual solicitor and asked him to approach three or four named persons, selected by the company itself, inviting them to invest in the company, an offence would be committed, if it happened that the solicitor was a person accustomed to advertise that he could arrange investments,

In actual fact, if our draft is adopted, the terms of the new sub-section (6) of section 5 would not be apt to apply to section 27(7). It could therefore be left as it is. A proprietary company could, under our proposals approach a limited number of

persons seeking capital in the form of shares or debentures, or deposits, but could not employ for that purpose a person of the kind described in section 27(7). Other companies, of course, would not be affected by the provision.

A second solution is to confine the operation of the sub-section to cases in which the arrangement is made with a person who comes into contact with the agent as a result of the advertisement or other invitation, leaving the agent free to approach other persons without infringing the sub-section.

A third solution is to repeal the section altogether, but to insert a provision in the Act that any subscription for shares or debentures, or any deposit of money, that results directly or indirectly from any advertisement, is to be treated as having been made in response to an offer to the public, even though the advertisement did not refer specifically to the shares or debentures. Such a provision may be necessary to deal with the question of non-specific advertising ("Have you any lazy money?") and is further referred to below.

It is to be noted that if the suggestion of imposing a limit on the number of depositors or debenture holders is accepted, the need for section 27(7) is very much less. The limit on the number of depositors or debenture holders could be kept quite low without interfering with the legitimate operations of proprietary companies.

5. Verbal Offers or Invitations:

As pointed out above, the Act makes no provision for verbal offers, it being assumed that all offers to the public will be made by some form of written document. There are of course provisions in section 40 dealing with advertisements by way of broadcasting or television, to which we have proposed modifications, but there is no provision that deals with verbal selling by individual approaches, other than the share hawking provisions. These will ordinarily be sufficient to deal with attempts to sell shares or induce subscriptions by face to face contact, but do not provide against telephone selling.

It will be recalled that in our report on share hawking, we expressed the view that we did not think that it was necessary to provide for telephone canvassing, as we did not think that a salesman would be able to persuade a victim without such door to door contact as would infringe the share hawking provisions. Since

that report was written, our attention has been drawn to a case of telephone selling that appears to justify some sort of regulation of this practice.

In the case in question, it appears that a W.A. mining company has received some hundreds of applications for shares, most of them from Victoria, which bear some indications that the person who persuaded the applicant to apply for shares dictated the form of the application over the telephone. It also appears that the subscribers were already known to the "pusher" by reason of the fact that they had subscribed to a "trade directory". There is, of course, a category of trade directory that is compiled by the promoters ringing all the numbers in a particular class of business in the Pink Pages, on the basis that a certain proportion of them will agree to the space without further investigation, and it is probable that the pushers regarded the subscribers to such a directory as a ready made "sucker list" for mining shares. It should be added that when the matter came under investigation in Western Australia the company appears to have claimed that it did not authorise the selling of shares by the Victorian pushers, and also that they claimed (correctly) that what was being done was not an infringement of the Act. However, they said that as they were advised that it was contrary to the spirit of the Act they were taking steps to stop the telephone selling. A cynic may wonder whether this public-spirited attitude was adopted to head off further investigation of the company.

It may be added that since we wrote our report on share hawking, there have been reports from the United States of successful telephone selling by fraudulent operators to farmers in the Middle West. It can, I think, also be said that in our report on share hawking we failed to take account of the fact that such persons as the compilers of trade directories have a list of gullible prospects, who, as the Western Australian case shows, may be prepared to apply for mining shares on the faith of a telephone call from someone whom they already know as the compiler of the trade directory.

Although this problem has been raised in connection with our consideration of offers to the public, it is as much a matter of share hawking, as the evils of telephone selling are as great if shares already issued are being sold.

There would appear to be several possible methods of dealing with the situation.

The first is to treat a phone call as a visit to a person's house for the purpose of the share hawking provisions. This would in my view be unduly restrictive of normal business activity. Its adoption would mean that a person who telephoned three or four persons known to him for the purpose of asking then whether they would support his company by taking shares or debentures would be guilty of share hawking. So would a broker who tried to place shares by telephone.

A second approach would be to make it an offence to make more than fifty offers or invitations, whether in writing, verbally, or by telephone or other means, without issuing a prospectus. This would mean that in cases in which a person made more than fifty offers or invitations by telephone, or partly in writing and partly by telephone, he would be in breach of the prospectus provisions.

A third approach is to recognise the difficulty of making rules to cover every case, and to concentrate on prosecuting telephone canvassing in cases in which it can be proved that there was some misrepresentation of the investment. After all, the provisions about prospectuses were originally intended to make it easier to catch fraudulent or careless promoters who operated on a large scale. Persons who engage in telephone selling are unlikely to be in the class of people who innocently, but negligently, misrepresent the investment - it is much more likely that investigation will show that there is no real investment at all. In the Western Australian case there were over three hundred shareholders from Victoria, and it should be possible to prove fraud, if it exists, by interviewing a selection of the shareholders. The more the stories of the representations differ, the more obvious it will be that the scheme is fraudulent. If it be said that the task is big, the answer is that if one citizen were proved to have been deceived by a confidence man the police would not think it beneath their notice to prosecute for false pretences. The work involved in dealing with fifty frauds relating to one company would not be likely to be greater than if they were fifty separate frauds.

A fourth approach is to try to evolve some test to describe telephone canvassing in terms that will exclude the genuine seeker after capital who approaches a few people whom he thinks likely to respond to his approach, and catch only the person who spreads his net indiscriminately. Here again, a test

based on number would go far to provide the discrimen (see above). But it might also be provided in some way that an approach to persons unknown to the person making the approach would be an offence. It should be noted, however, that this would apparently not catch the pushers in the W.A. case, since the victims appear to have had some previous business contact with the pusher.

A fifth approach would be to prohibit telephone offers or invitations except when made by a person licensed to deal in securities or exempted from the relevant provisions of the Securities Industry Act. It may be noted that if the Victorian pushers in the W.A. case were receiving a commission or other reward for their efforts, which is very likely (even though it might be difficult to prove), they would probably be guilty of the offence of carrying on the business of dealing in securities, contrary to section 9 of the Act. As to proof of the fact that they were doing so for reward, the case of Martin v. Osborne 55 C.L.R.367, affords an illustration of a case in which an inference could be drawn that a person who engaged in a regular course of conduct, of a kind that would not ordinarily be carried on except as part of a business: was acting for reward. Of course, one possibility that always has to be remembered is that a person who is enthusiastic about the shares of a particular company may tell all his friends about it, without any thought of reward to himself. Any provision that makes the repeated urging of persons to apply for shares in a particular company an offence must take account of this possibility. The difficulty of the approach now suggested is that such conduct would be prohibited, even when done for altruistic motives, unless the person concerned were a licensed dealer.

One difficulty to which the W.A. case draws attention is the problem of proving that the offers made by the Victorian pusher were made with the authority of the company. This again is probably no more than a normal difficulty of proof. An investigation of the records would probably show that money had passed between the W.A. company and the Victorians. It would perhaps also turn up correspondence showing a closer link between the parties than they were prepared to admit. But if one accepts the position as they represent it to be, that the Victorians were pushing the shares without any authority from the company, and merely because they wanted to let their business customers in on a good thing, there is little fault to be found with a legal system that says that in

such circumstances the Crown ought to be able to prove fraud in order to succeed, or at least to prove that the invitations were made with the authority of the company in Western Australia.

6. Non-Specific Advertisements:

A problem that has not so far been considered, although one aspect of it gave rise to section 27(7) is that of the advertisement which does not refer directly to any company or any particular form of investment, but which invites the reader to communicate with the advertiser for the purpose of finding out more. Such an advertisement is probably not an advertisement calling attention to an offer, invitation or prospectus. Section 40 would therefore not be applicable, nor would section 40A of our draft, which was specifically designed to deal with "gun-jumping". Under the existing law, a person who publishes an advertisement merely inviting the reader to write for particulars as to how he can make his savings work for him can include in the advertisement material which would not be allowable in an advertisement calling attention to a prospectus. For example he can say that the earning rate will be not less than twelve per cent. However, if in response to enquiries he sends out any written material that amounts to an offer or invitation, he runs the risk of prosecution for sending out a prospectus without having first obtained the approval of the Registrar. He will not, however, be liable under the existing law if when he receives a reply from the reader of the advertisement, he rings him up on the telephone, and tells him how to apply for shares or debentures.

If our proposal for a numerical limit is adopted, the position will be that a promoter can advertise in a general way, and when he receives his replies he can send out not more than fifty offers or invitations to those replying. By this means he can increase the probable success-rate per offer, and perhaps make it worth-while to operate a scheme.

The foregoing suggests that two additional provisions would be desirable. The first is a provision to the effect that any offer or invitation that results from an advertisement or an answer to an advertisement, shall be deemed to be an offer or invitation to the public, even though less than fifty offers or invitations have been made. The second is a provision to the

effect that if in response to any advertisement a person applies for information, and as a result of such application is furnished with a prospectus, the advertisement shall for the purposes of section 40 be deemed to be an advertisement calling attention to a prospectus.