COMPANY LAW ADVISORY COMMITTEE – Companies Item No. 13

FIFTH INTERIM REPORT – OFFERS TO THE PUBLIC – COMMENTS OF OFFICERS PAPERS

1. In our Fifth Report, we recommended that a numerical test should be substituted for the present vague and unsatisfactory term "offer to the public" as interpreted by the Courts. We pointed out in paragraphs 5 and 6 of the report that, apart from the statutory extension of the term to be found in sub-section (6) of section 5 of the Act, the term was considered to mean that the offer must be made in such a way that anyone who heard of the offer could accept it. Sub-section (6) attempts to deal with this by saying that the term includes an offer made to a section of the public, whether selected as clients of the person making the offer or in any other manner. On the other hand it exempts certain kinds of offer (e.g. offers made by a company to its shareholders) from this enlarged concept. The result is that it is impossible to draw the line, except in the case of an offer to the specified classes (shareholders, etc.), between an offer to the public and a non-public offer. Any company seeking additional capital, however small must therefore be left in doubt as to whether it is infringing the Act if it makes offers to a small number of persons. In particular, if the company goes to a broker seeking additional capital, and suggests that the broker approach some of his clients, the express words of the Act would seem to make such an approach by the broker an offer to the public.

2. In order to overcome this difficulty we recommended that there should be a numerical limit to the number of offers or invitations that could be made without bringing the prospectus provisions into operation. We set this number at fifty, which is the limit imposed on the number of shareholders (other than employees) that a proprietary company can have, and indicated that we thought that a fraudulent promoter would hardly be able to engage in a profitable enterprise unless he made offers to more than fifty persons, bearing in mind that he could hardly expect more than a fraction of the offerees to accept the offer.

3. At a meeting between members of this Committee and the officers, the objection was raised that it would be unreasonable to expect the prosecution to collect evidence that more than fifty people had been approached. The suggestion was made that an

evidentiary section should be adopted making proof of twenty offers prima facie evidence that more than fifty offers had been made. This was accepted by the Committee as a reasonable provision to lighten the task of the prosecution.

4. The objection has since been raised to this proposal, that it would be impossible for a defendant to prove a negative, namely, that he did not make more than thirty offers in addition to the twenty proved by the prosecution. It is said that no matter what evidence, he brings, it could always be said that he might have made offers in addition to those to which his evidence relates. The Committee does not agree with this view. It has to be borne in mind that we are dealing with a situation in which the promoter or directors of the proposed company or the company are precluded from going from place to place by the share-hawking provisions. Accordingly, the offers will either have to be made by telephone or in writing, and will have to be made by some person who is authorised by the company or the promoters to make it. The number of persons so authorised will be known to the company or the promoters, as the case may be, and in the sort of case that we envisage as being properly protected by the exemption, only a limited number of persons are likely to be so authorised, indeed, the normal case will be one in which a small company invites a broker, solicitor, or accountant to make contact with a limited number of his clients with a view to their becoming share-holders, if any promoter or directors should authorise a large number of offers to be made, in circumstances in which they were unable to prove that not more than fifty offers had been made, they would deserve to be convicted under the section.

We would accordingly reaffirm our recommendations in the Fifth Report, so far as this objection is concerned. We have considered whether, in order to make it easier to supervise the observance of the provisions, it would be possible to provide that the exemption should only be available if prescribed records were kept of each offer made. Any offer not recorded would then become an offer to the public, and a prospectus would be required. We have decided, however, not to recommend such a provision. Anyone seeking to take advantage of the exemption will in fact be likely to take the precaution of keeping adequate records of offers made. We should add also that in our proposed section 50 sub-section (3) we had provided for a statement to be filed with each return of

allotment (where no prospectus had been issued) giving the reasons why no directors' proposal was necessary. For completeness, this statement should also set out the reasons why a prospectus was not required. This could be done by inserting the words "or prospectus" in section 50(3)(a).

6. The officers' paper raises a further difficulty, namely, that when the first of a series of offers is made, neither the offeror nor the administration knows whether or not the offer is an invitation to the public. This is true, but we do not see that it is a disadvantage. At least, if more than fifty offers are made, there is no doubt that the offer is public, and it is certainly an improvement over the present system, under which no-one knows until the matter goes to the High Court whether or not a particular offer is an offer to the public. One point has emerged from our consideration of the matter, viz. that under our draft where any offers have been made otherwise than by prospectus, it becomes impossible to make more than fifty offers, even if a prospectus is issued. This can be overcome by inserting in par. (d) of section 5(6), after "other than" the words "offers or invitations attached to a prospectus or".

The officers' paper makes a suggestion for overcoming the difficulties referred to, namely, that an instrument should be required to be lodged with the Registrar nominating the persons to whom it is proposed that offers will be made, There are, we think, strong arguments against requiring a person or company seeking capital to disclose in advance the names of all the persons who are to be approached, some of whom may be so far down the list that it is unlikely that they will ever be asked. A more serious objection is that the proposal would prevent the company from approaching a prospective subscriber whose name was not known to it at the time of the preparation of the list, unless a prospectus were prepared and approved, or unless three months had elapsed since the lodgment of the instrument.

8. The further suggestion is made that there should be combined with the procedure suggested in paragraph 8 of the officers' paper the retention of the concept of an offer to the public now contained in section 5(6). As to this, we wish to say that we have already pointed out the fundamental objection to which section 5(6) is subject. If we had not felt that it required drastic treatment we should not have recommended a numerical test. Further, we do not see how promoters could safely act on the

"general law concept", in the present state of the authorities, except in the case of a very small and very private approach, is any case, we assume that the proposal to retain the general law concept is made on the assumption that the proposal in paragraph 8 is adopted. For the reasons given above, we do not favour that course.

9. With regard to the question whether the limit of fifty offers is too high, our feeling is that if a small venture is to be able to raise capital without going to the expense of issuing a prospectus, it will need to be able to approach more than twenty people, and we do not think that the addition of institutions will greatly widen the field, since this is not an area in which institutions are accustomed to invest. If we are wrong in our view that fraudulent promoters will not find it profitable to operate within the restriction to not more than fifty offers, this means that we cannot achieve both objectives, and if we are forced to choose, we prefer to choose in favour of freedom to form, or to obtain capital for, small companies, bearing in mind that if fraudulent promoters do operate within the limits laid down, the result is not to permit them to carry on their fraudulent business, but to deprive the victim of one of his remedies, that is, the right to sue for damages for misrepresentation without proof of fraud. If fraud can be proved, not only does the victim have a remedy in damages, but the promoter will be criminally liable.

10. Paragraph 14 of the officers' paper raises a further question which has not been the subject of consideration hitherto, viz. whether the provisions of section 5(6) apply to offers of an interest as defined in section 76. Section 5(6) does not itself mention "interests" and if it applies to offers of interests, this must be the result of some other provision in the Act. Section 5(6) opens with the words: "Any reference in this Act to offering shares or debentures to the public ..... " Sections 81, 82 and 83 contain references to offering "interests" to the public, but clearly this in itself is not sufficient to bring sub-section (6) of section 5 into operation. Section 82 does in fact refer to shares offered or intended to be offered to the public but the reference is in the following terms: "Before a company .... offers to the public .... any interest the company shall issue or cause to be issued a statement in writing in connexion therewith which statement shall for all purposes be deemed to be a prospectus

issued by the company, and ..... all provisions of this Act and rules of law relating to prospectuses or to the offering or to an intended offering of shares for subscription or purchase to the public shall with such adaptations as are necessary apply and have effect accordingly as if the interest were shares offered or intended to be offered to the public for subscription or purchase and as if persons accepting any offer or invitation in respect of or subscribing for or purchasing any such interest were subscribers for shares."

11. In our view, the word "public" in the phrase "Before a company .... offers to the public .... any interest" must have its general meaning, unaffected by the provisions of section 5(6). It is only when the situation there referred to exists that a written statement is required, and that the provisions relating to prospectuses become applicable. We therefore think that the provisions of section 5(6) have no application to interests as defined in section 76. If the contrary view were taken of section 82, it would seem to follow that sections 81 and 83 would have a different scope from section 82, which is an unlikely intention to attribute to the legislature.

12. If our view is correct: the difficulties presented by the existing section 5(6) do not arise in relation to interests, though it would be desirable to give consideration to providing a statutory definition of "public" for the purposes of Division 5 of Part IV of the Act. But the problem dealt with in paragraph 14 of the paper does not arise either, as under the proposals in our Fifth Report the provisions of section 5(6) would also be inapplicable to Division 5. While a numerical limit might be adopted, our redraft of section 5(6) would not be appropriate for interests but the whole question might well be a matter for consideration by the proposed inquiry into mutual funds and unit trusts. We would add that the reference in paragraph 1% to "offers in real estate syndicates being offers commonly made to not more than 20 persons" may not be quite correct. It is true that real estate syndicates do not consist of more than 20 persons, but it is unlikely that 20 subscribers can be obtained without more than 20 invitations. The evil to be aimed at is the advertisement of such syndicates, and the widespread distribution of invitations to

participate in them. Here, as in the case of companies, we feel that it is necessary to distinguish between the number of offers that are made and the number of acceptances that may result.

R. M. EGGLESTON

J. M. RODD

25th October 1971.