COMPANIES
AND
SECURITIES
LAW REVIEW COMMITTEE

REPORT TO
THE MINISTERIAL COUNCIL

PRESCRIBED INTERESTS

August 1988

REPORT OF THE

COMPANIES AND SECURITIES LAW REVIEW COMMITTEE

ON

PRESCRIBED INTERESTS

To: The Ministerial Council for Companies and Securities

The CSLRC presents to the Ministerial Council its Report on Prescribed Interests. This is the Seventh Report of the Committee, the others being:

* Report on the Takeover Threshold (November 1984)
* Report on Partial Takeover Bids (August 1985)
* Report on Forms of Legal Organisation for Small Business Enterprises (September 1985)
* Report on the Civil Liability of Company Auditors (September 1986)
* Report on the Issue of Shares for Non-Cash Consideration and Treatment of Share Premiums (September 1986)
* Report on a Company's Purchase of its own Shares (September 1987)

Terms of Reference

The Committee received a reference from the Ministerial Council to inquire into and review the appropriateness of the provisions of the Companies and Securities legislation relating to prescribed interests including the consideration of alternatives:

(a) for the regulation of existing forms of scheme; and

(b) as legislative criteria for determining, in advance of the development of new forms of scheme, whether or not the Companies and Securities legislation should apply to those forms.

In May 1987 the Committee published Discussion Paper No. 6: "Prescribed Interests". A list of respondents to the Discussion Paper is found in Appendix A.

Structure of the Report

Part 1 of this report looks to the problem of defining the residual investment opportunities, other than shares and debentures, the public offering of which should be regulated under legislation relating to companies and securities. Part 1 covers the matters dealt with in Chapters 1 - 3 of Discussion Paper No 6. The Committee's main recommendation is that the legislation should include a statement of purpose and object to assist in the interpretation of the necessarily very general definition of the residual investment opportunities that should be regulated and the administration of the regulatory scheme. The Committee provides a suggested statement of purpose and object and recommends that it be enacted.

In Part 1 the Committee recommends some modifications to the current definition of 'prescribed interest'.

Part 2 of the Report deals with miscellaneous matters relating to prescribed interests that seemed to the Committee to be deserving of the attention of the Legislature. The scope of Part 2 can be seen from the Summary of Recommendations.

The Committee deals first with the particular matter (b) mentioned in the Reference.

Summary of Recommendations

1. The Committee recommends inclusion in companies and securities legislation of a statement of the purpose and object of the legislation regulating prescribed interests. A suggested statement appears in paragraphs [33] - [36].

2. The Committee recommends that the existing definition of 'prescribed interest' and it's component, 'participation interest', be retained with some refining amendments to meet some of the issues that have been raised in the courts and elsewhere : paragraph [28].

The refinements recommended are:

(i) that the definition of 'participation interest' be amended so that in respect of paragraphs (a) and (b) as well as (c) regard may be had to the substance of a particular investment opportunity irrespective of the form in which it is offered: paragraph [41];

(ii) that where the definition of 'participation interest' refers to 'interest' there be some indication that something more than a proprietary interest is intended, whenever that is the case : paragraph [43];

(iii) that the definition should state that it is immaterial whether a person's right to participate is enjoyed in the capacity of creditor, partner, agent, beneficiary under a trust, party to a contract or any other capacity : paragraph [44];

(iv) that the definition should expressly include rights to participate or interests in profits even though the profits referred to in paragraph (a) of the definition of 'participation interest' are to be earned by the investor severally rather than jointly : paragraph [45];

(v) that paragraph (b), in the definition of 'participation interest' be extended to the case where the investor is led to expect that property, rent or interest will come from the efforts of the promoter or a third person whether or not he has contracted to make those efforts: paragraph [46].

(vi) that paragraph (c) in the definition of 'participation interest' be widened so as not to require that the contract itself contemplate that the investor's payment is by way of investment: paragraph [47];

3. In relation to exclusions from the definition of 'prescribed interest':

(i) the Committee recommends that public offerings of interests in unlimited companies not in the form of shares be excluded from Part IV Division 6 of the Companies Act and be dealt with in Part IV Division 1: paragraph [50];

(ii) the Committee concurs in the view of the National Companies and Securities Commission that pure investment products of life insurance companies or other authorised providers of life cover should be within the definition of 'prescribed interest': paragraph [51];

(iii) the Committee recommends that the exclusion relating to an interest in a partnership agreement should be limited to the case where the offeror is offering interests in a partnership in which the offeror will be a partner: paragraph [53];

(iv) the Committee recommends that the limiting provision now in the exclusion relating to partnership interests should reach promotions by or on behalf of any associate of the person who conducts the business of promoting: paragraph [54];

(v) the Committee recommends that there should be an exclusion from the definition of 'prescribed interest' of a loan for a fixed rate of interest not dependent upon whether the borrower earns profits: paragraph [57];

(vi) the Committee recommends that the National Companies and Securities Commission be given a wide power to grant exclusions in respect of a class of investment opportunities: paragraphs [60] and [79];

(vii) the Committee recommends that the power of the National Companies and Securities Commission to grant an exclusion be made exercisable in accordance with the proposed legislative statement of purpose and object and a legislative statement of criteria suggested in paragraph [61]: paragraph [79];

4. The Committee recommends the introduction of a procedure by which an intending offeror of investment opportunities may voluntarily apply to the National Companies and Securities Commission for a clearance conclusively indicating that the particular investment opportunity is not a prescribed interest: paragraph [62].

5. By way of incidental recommendation in relation to offers to the public (a matter not directly within the reference to the Committee), the Committee recommends:

(i) that section 5(4)(ca) of the Companies Act be amended so that it also refers to offers of loan securities made available by the management company but not including debentures offered by the management company for raising finance for its own purposes as distinct from the purposes of the scheme: paragraph [66];

(ii) that an amendment be made so that the operation of section 5(4)(ca) will not be excluded by the fact that the relevant deed has been amended, provided the amendments do not go beyond the power of amendment allowable under the deed: paragraph [68];

(iii) that section 5(4)(ca) be amended to ensure that its operation will not be ended because there has been a change of management company: paragraph [69];

6. The Committee further recommends in relation to the powers of the National Companies and Securities Commission that its powers under section 215C of the Companies Act be supplemented by like powers in relation to the Securities Industry Act: paragraph [80].

7. In relation to deeds the Committee recommends:

(i) that model provisions for deeds be included in the legislation and that they be excludable except as indicated in recommendation 7(iv) below: paragraphs [83] and [88];

(ii) that the model provisions should state the highest appropriate standard of fiduciary administration: paragraph [85];

(iii) that it be required that at the time of particular prescribed interests being offered to the public there should be prominent disclosure in the prospectus as to:

(a) the extent to which an investor will not have the benefit of fiduciary administration of the standard required by the model provisions: paragraph [86]; and

(b) the extent to which the particular deed departs from the law of trusts in other respects or departs from desirable standards in the model provisions: paragraph [87];

(iv) that the model provisions as to amendment of the deed should not be modified without the approval of the National Companies and Securities Commission and that any future amendments of the power to amend should require the approval of the National Companies and Securities Commission : paragraph [89];

(v) that a provision comparable with section 578 of the Companies Act be enacted to apply for the benefit of schemes of prescribed interests in respect of which a deed has been approved under Part IV Division 6 so that the rule against perpetuities is excluded: paragraph [99];

8. In relation to prescribed interests generally, the Committee recommends:

(i) that once an investment opportunity permanently ceases to answer the definition of 'prescribed interest' it should no longer be subject to the system of regulation under companies and securities legislation: paragraphs [20.3] and [42];

(ii) with respect to the secondary market in prescribed interests, that Part IV Division 6 should be declared not applicable to:

(a) a public offering by a person other than one in the business of promoting the particular type of prescribed interest where the transaction is not part of a profit-making scheme; or

(b) an offer made on an Australian or Territorial stock exchange: paragraph [103];

(iii) with respect to takeovers of prescribed interest schemes that there be legislation to ensure that interest-holders under a scheme subject to Part IV Division 6 should receive relevant information where a company seeks to supplant the existing management company: paragraphs [123] and [127];

(iv) that, to meet any possible need for reconstruction of a scheme, including conversion to a company, there be enacted provisions comparable with sections 314 to 317 of the Companies Act: paragraph [133];

9. In relation to the effect of non-compliance with the legislation:

(i) the Committee recommends an amendment to make it clear that the system of regulation should not provide a basis for any transaction being affected in civil proceedings by the defence of illegality: paragraph [93];

(ii) that the National Companies and Securities Commission should have a general power to excuse non-compliance in a case where, if an application for an exemption had been made, the Commission would have granted an exemption but not where the Commission is aware that a person would be unfairly prejudiced by so excusing: paragraph [81];

(iii) the Committee recommends that persons convicted of a breach of section 174 of the Companies Act should be disqualified from managing a corporation and from promoting further schemes to be offered to the public: paragraph [137];

(iv) the Committee recommends that persons convicted of offences in connection with the promotion, formation or management of a corporation should be disqualified from participation in the promotion, formation or management of any scheme of prescribed interests to be offered to the public: paragraph [137].

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PART I

LEGISLATIVE CRITERIA FOR DETERMINING THE APPLICATION OF COMPANIES AND SECURITIES LEGISLATION TO INVESTMENT OPPORTUNITIES OTHER THAN SHARES AND DEBENTURES

Introduction

[1] Given current general acceptance that legislation is needed to regulate the offering to the public of intangibles, there is a threshold problem of defining those offerings which should be regulated. The protection of offerees generally is not contained in one compendious system of regulation covering all types of offer, such as wagers, real estate deals, consumables and securities but is dealt with in separate legislative and administrative regimes. The particular regime to which the Ministerial Council's reference relates is that which primarily governs company securities. While the typical company securities, shares and debentures, are well defined, there is a further category of things more or less resembling shares and debentures the public offering of which calls for regulation in association with the regulation of public offerings of shares and debentures. In the existing legislation the things that fall within that further category are called 'prescribed interests'.

[2] The expression 'prescribed interests' is an artificial construct which lacks any meaning other than that ascribed to it by the Companies Act and the Securities Industry Act. At the outset of this report, it is necessary to adopt some better generic expression that will indicate the financial items possibly intended to be covered by a definition. However, a central question involved in the matter

referred to the Committee is the identification of the criteria marking off those items offered to the public which should be covered by the definition of 'prescribed interests'. It follows that any generic expression adopted at this stage will be merely tentative and provisional. For the limited purpose of exposition this report adopts the expression 'investment opportunity'. Admittedly, that expression begs questions but it is adopted for convenience to cover all items which could possibly be candidates for inclusion in the companies and securities system of regulation.

The current definition of 'prescribed interest'

[3] Section 5(1) of the Companies Act 1981 (Cth) contains the following definitions:

'prescribed interest' means:

(a) a participation interest; or

(b) a right, whether enforceable or not, whether actual, prospective or contingent and whether or not evidenced by a formal document, to participate in a time-sharing scheme,

but does not include a right or interest, or a right or interest included in a class or kind of rights or interests, declared by the regulations to be an exempt right or interest, or a class or kind of exempt rights or interests, for the purposes of Division 6 of Part IV;

'participation interest' means any right to participate, or any interest:

(a) in any profits, assets or realisation of any financial or business undertaking or scheme whether in the Territory or elsewhere;

(b) in any common enterprise, whether in the Territory or elsewhere, in relation to which the holder of the right or interest is led to expect profits, rent or interest from the efforts of the promoter of the enterprise or a third party; or

(c) in any investment contract,

whether or not the right or interest is enforceable, whether the right or interest is actual, prospective or contingent, whether or not the right or interest is evidenced by a formal document and whether or not the right or interest relates to a physical asset, but does not include:

(d) such a right that is a right to participate in a time-sharing scheme;

(e) any share in, or debenture of, a corporation;

(f) any interest in, or arising out of, a policy of life insurance; or

(g) an interest in a partnership agreement, unless the agreement or proposed agreement:

(i) relates to an undertaking, scheme, enterprise or investment contract promoted by or on behalf of a person whose ordinary business is or includes the promotion of similar undertakings, schemes, enterprises or investment contracts, whether or not that person is, or is to become, a party to the agreement or proposed agreement; or

(ii) is or would be an agreement, or is or would be within a class of agreements, prescribed by the regulations for the purposes of this paragraph;

'investment contract' means any contract, scheme or arrangement that, in substance and irrespective of the form of the contract, scheme or arrangement, involves the investment of money in or under such circumstances that the investor acquires or may acquire an interest in or right in respect of property, whether in the Territory or elsewhere, that, under, or in accordance with, the terms of the investment will, or may at the option of the investor, be used or employed in common with any other interest in or right in respect of property, whether in the Territory or elsewhere, acquired in or under like circumstances;

'time-sharing scheme' means a scheme, undertaking or enterprise:

(a) participants in which are, or may become, entitled to use, occupy or possess, for 2 or more periods during the period for which the scheme, undertaking or enterprise, whether in the Territory or elsewhere is to operate, property to which the scheme, undertaking or enterprise relates; and

(b) that is to operate for a period of not less than 3 years;

[4] Regulation 14A of the Companies Regulations provides that for the purposes of the definition of 'prescribed interest' in section 5(1) of the Companies Act, any right to participate, or any interest, as franchisee in a franchise is declared to be an exempt right or interest for the purposes of Division 6 of Part IV of the Companies Act.

[5] Section 4(1) of the Securities Industry Act 1980 (Cth) contains definitions in the same terms as those in the Companies Act save that in the definition of 'prescribed interest' the reference to a right or interest declared by the regulations to be an exempt right or interest is not confined to a right or interest that has been declared to be exempt for the purposes of Division 6 of Part IV of the Companies Act 1981 (Cth). Regulation 5A of the Securities Industry Regulations provides that for the purposes of the definition of 'prescribed interest' in section 4(1) of the Act, any right to participate, or any interest, as franchisee in a franchise is declared to be an exempt right or interest.

[6] The significance of the definition of 'prescribed interest' in the Securities Industry Act is that prescribed interests are included in the definition of 'securities' in section 4(1). Several items are excluded from the definition of 'securities'. They are bills of exchange, futures contracts, promissory notes, certificates of deposit issued by a bank, shares or debentures carrying a right to participate in a retirement village scheme (as defined in section 4(1)) and a right to participate in a retirement village scheme.

The legal and economic significance of prescribed interests

[7] The investment opportunities other than shares and debentures that have, over the years, been seen to be covered by the definition are diverse. They have differed in legal structure. Some are equitable beneficial interests under trusts in respect of various kinds of property, whether shares, land or other investments. These trusts are broadly similar in function to investment companies. There have also been trading trusts which in some ways are similar to trading companies. In addition there have been schemes in which the participants do not acquire interests in property but have only contractual rights. Some prescribed interests are really company securities governed by ordinary company law except that they are not shares or debentures. This is true of interests in an unlimited company which are not part of share capital.

[8] Most of these investment opportunities have an established economic role. Industry generally has been assisted to raise capital through the marshalling of the contributions of many investors in equity trusts. Specific branches of industry whose capital requirements have been significantly catered for by these schemes include primary production (e.g. plantations and animal production), the building industry (property trusts), distribution (franchising, before exclusion by regulation), the entertainment industry (film syndicates) and the leisure industry (time-sharing).

The functions of the definition of 'prescribed interest'

[9] The definition of 'prescribed interest' currently performs several functions in companies and securities legislation.

* It marks off investment opportunities, which in addition to shares and debentures, cannot be offered to the public unless certain prescribed information is provided by way of a copy of a prospectus which has been registered after examination by the National Companies and Securities Commission ('NCSC') or its delegate.

* It marks off investment opportunities, which in addition to shares and debentures, are not to be hawked.

* It marks off investment opportunities, other than shares and debentures, in respect of which the legislation requires a structure involving not only the promoter or manager but also a trustee or representative.

* It marks off investment opportunities, other than shares or debentures, in respect of which the legislation requires documents constituting the investment scheme to contain certain prescribed provisions. Although there are some requirements as to the content of a company's memorandum of association, the requirements as to the contents of a company's articles of association are less extensive than the requirements for the contents of deeds governing prescribed interests that may be offered to the public.

* It marks off investment opportunities, in addition to shares and debentures, the dealing in which is regulated by the Securities Industry legislation.

[10] If a definition is required for each of the above functions, nothing in the Committee's enquiries or in the submissions received has prompted any suggestion that the one definition should no longer perform all of such functions as may be necessary. In what follows it will be assumed that the definition will continue to be uniform for all those functions.

[11] There is a question (considered in the following paragraphs of this report) as to whether the law might be simplified without loss if future offerings of investment opportunities to the public were to be required to be made in the form of company securities. If that were to happen, a definition of 'prescribed interest' would be needed only for the purpose of marking off those publicly-offered investment opportunities that are required to be offered as company securities.

Should publicly-offered investment opportunities now regulated as prescribed interests be required to be in the form of company securities?

[12] One may ask why after the community provides a facility for collective investment by incorporating companies and an elaborate system of law governing external relationships of companies as well as the internal relationships of investors in companies, those persons who raise capital from the public by way of schemes of 'prescribed interests' analogous to shares and debentures should seek to do so by offering something other than an interest in a company. There have been several reasons why these public offerings outside company law have been made. The first lay in the law of income taxation under which it was preferable to be an investor by way of a trust rather than a company because company income bore tax twice, once in the hands of the company and again in the hands of the shareholder when distributed in the form of dividend, whereas trust income, if fully distributed in the year of receipt, bore tax only once. A second reason has been found in the disadvantage attached to a company limited by shares that subscribed capital cannot be returned to shareholders before winding up without following a procedure that involves passing a special resolution of the company in general meeting and obtaining an order confirming the reduction of capital from the Supreme Court of the relevant State or Territory. By contrast, a trust or other non-company form of scheme can both quickly and informally return capital to investors who wish to retire from the scheme.

[13] With the introduction of dividend imputation and the introduction of the principle of taxing public trading trusts as if they were companies, there will be less incentive to form public trading trusts. But so long as the restraints on limited companies buying back their own shares remain there will be a substantial reason for creating public investment schemes outside the company model. Even if those restraints were to be removed, there could still be some schemes which would have a heavier tax liability as companies and whose shareholders would not get the full benefit of imputation: they would wish to continue as trusts.

[14] If it were possible to reach the position in which there are no disadvantages in taxation and the matter of return of capital, consideration could then be given to the desirability of a change in the law so that any investment opportunity offered to the public under any new scheme would have to be a security in a company. Some people may disregard the matter of tax efficiency in this context.

[15] Several advantages would accrue from such a change.

* The investing public would be offered rights of a known character in a well-developed legal structure. Those rights are well established for all aspects of the life of a company from flotation to winding up and dissolution. Many of the incidents of an interest in a non-company scheme throughout the life of the interest are ill-defined.

* There would be a reduction in uncertainty as to the law. Entrepreneurs and their professional advisers would not have so many unresolved problems to grapple with : there would be a reduction of costs in forming and administering schemes.

* Savings to the community would result from the legislature, the regulatory authorities and the courts having to deal only with one form of well-established legal structure.

* There would be fewer obstacles to the general public obtaining an understanding of the activities of the financial community.

* Most members of the public know that shareholders bear a heavier investment risk than holders of loan securities. There is less understanding as to the position in other investment opportunities.

* It would be possible to provide investors with the same rights in relation to take-overs as are provided for shareholders without having to create new legislation.

* By channelling all publicly-offered investment opportunities through a company form, it would be readily possible, by the formation of a limited company, to resolve any doubt about the liability of investors for the debts of the scheme.

[16] If prescribed interests analogous to shares and debentures were to be brought within the fold of company securities, any special features of the existing system of regulation of prescribed interests thought worthy of retention could be accommodated in the company setting.

[17] For example, if there is merit in the present requirement of Part IV Division 6 of the Companies Act that there should be a trustee or representative for the passive investors in prescribed interests offered to the public, a public investment company could be required to be so structured that under its articles the board of directors (the analogue to the management company) would be required to consult with and act in co-operation with a trustee or representative in much the same way as is required under unit trust deeds. It is the relative passivity of unit-holders that calls for the appointment of a trustee or representative just as the similar passivity of the debenture-holding public calls for the appointment of trustees for debenture-holders. The point is still valid even though in a unit trust the relative passivity of the unit-holders is required in order to avoid any suggestion that the unit-holders constitute an unincorporated joint-stock company that would infringe section 33(3) of the Companies Act.

[18] Because in the company structure shareholders in a public company have a non-excludable statutory power to remove directors, it may be that in most cases a trustee is not required. Alternatively, it may be considered that because in public companies shareholders are passive there may a case for allowing companies the option of extending the protection in the form of a trustee. The matter could be left as one in which investors could exercise a choice.

[19] Because the Committee considers that there may still be good reasons for structuring a scheme of investment opportunities in non-company form, the Committee does not, at this stage, recommend that future issues of publicly-offered investment opportunities now covered by the definition of 'prescribed interest' be required to be in the form of company securities. Before any such recommendation could be made the whole field of regulation of investment companies and the existing legislation in the Companies Act Part XIII Division 2 would have to be considered. In any event, there may be some novel forms of investment opportunity which call for regulation but which could not fit into company structures.

For the present, the scheme of the legislation could be improved so that public offerings of interests in unlimited companies not in the form of shares are dealt with in the same Division as public offerings of shares rather than as prescribed interests. The Committee recommends that change.

Analysis of the existing definition of 'prescribed interest'

[20] The legislative history of the definition of 'prescribed interest' down to May 1987 is set out in the Appendix to the Discussion Paper.

The history of judicial interpretation of the definition discloses that the following issues have arisen.

20.1. Interpretation by reference to underlying purpose or object. If the natural meaning of the words used in the definition points to the inclusion of a particular investment opportunity, should the interpreter's reasonable inability to discern a reason for regulating that investment opportunity cause the interpreter to conclude that there was no legislative intention to include it? The answer given in Australian Softwood Forests Pty Ltd. v A-G (NSW) (1981) 148 CLR 121, 36 ALR 257 is that any such investment opportunity is included despite doubts about the policy merits of its inclusion.

Speaking of the term 'interest', as it appeared in companies' legislation before being embellished with the adjective 'prescribed', Mason J said (148 CLR at 130, 36 ALR at 262):

'That a very wide meaning should be given to "interest" is attested by the exclusion from the statutory definition of shares and debentures (para (d)), interests in life assurance policies (para (e)) and, subject to some qualification, interests in partnership agreements (para (f)). The presence of the power to exempt by regulation other rights or interests from the definition (para (g)) is also of telling significance.

There are real difficulties in the suggestion that the court can read down the very comprehensive definition of "interest" by reference to the supposedly unintended consequences of a literal reading on everyday commercial transactions. The definition is so general and all-embracing that it is impossible to say that it necessarily excludes particular transactions which appear to be covered by the general words. The hazards of adopting such a course are not dispelled by the absence of a supporting context. It would be different if we could glean from the legislative provisions an overall purpose which, being limited in scope, justified a reading down of the definition. Unfortunately in this case the search for a legislative purpose takes us back to the very words of the definition for the intended scope of the operative provisions depends so heavily on the comprehensive language of that definition. As Young CJ observed in A Home Away Pry Ltd. V Commissioner for Corporate Affairs (1980) 5 ACLR 299 at

302; (1980) CLC 34,444 at 34,446, in discussing the meaning of "interest" as defined in s76(1): "If it were said that we should give effect to the purpose Parliament wished to achieve, we must first ascertain the purpose and that can only be ascertained from the language used." '

Since those words were spoken in the Australian Softwood case sections 5A and 5B have been inserted in the Companies (Interpretation and Miscellaneous Provisions) Act 1980 (Cth).

Section 5A provides:

In the interpretation of a provision of a relevant Act, a construction that would promote the purpose or object underlying the relevant Act (whether that purpose or object is expressly stated in the relevant Act or not) shall be preferred to a construction that would not promote that purpose or object.

Section 5B, so far as material, provides in sub-section (1):

Subject to sub-section (3), in the interpretation of a provision of a relevant Act, if any material not forming part of the relevant Act is capable of assisting in the as certain merit of the meaning of the provision, consideration may be given to that material:

(a) to confirm that the meaning of the provision is the ordinary meaning conveyed by the text of the provision taking into account its context in the relevant Act and the purpose or object underlying the relevant Act; or

(b) to determine the meaning of the provision when:

(i) the provision is ambiguous or obscure; or

(ii) the ordinary meaning conveyed by the text of the provision taking into account its context in the relevant Act and the purpose or object underlying the relevant Act leads to a result that is manifestly absurd or is unreasonable.

Neither section 5A nor section 5B would assist in the interpretation of the definition of 'prescribed interest' since each of them depends on the purpose or object of the provision being apparent. Neither section 5A nor section 5B has been regarded in later cases as reducing the authority of the Australian Softwood case; Carragreen Currency Corporation Pty Ltd. v CAC (NSW) (1986) 5 ACLC 148 at 165.

The purpose or object of the definition of 'prescribed interest' is not only not apparent but, more fundamentally, has never been articulated by anybody. The legislative history of the definition discloses that particular investment opportunities were thought to call for regulation.

In framing the legislation it was apparently thought necessary to go beyond providing for those specific investment opportunities. The coverage of the legislation was expressed in generic terms but there does not appear to have been any attempt to define the overall legislative policy in a way that would show the outer limits of the field ~f investment opportunities intended to be covered.

Hence, there are two issues.

* Would the legislation be improved by the provision in it of a statement of the underlying purpose or object?

* If so, what should be the terms of that statement?

Before the statement can be made it will be necessary to isolate those features of an investment opportunity that make it appropriate that dealings in it should be regulated in the companies and securities legislation rather than other legislation. That will be dealt with later. In the meantime, other issues raised by judicial interpretation of the definition need to be identified.

20.2. Consideration of the substance of a scheme irrespective of its form. Both paragraphs (a) and (b) of the definition of 'participation interest' differ from paragraph (c) in that neither (a) nor (b) contains authority given to the interpreter by (c) to consider the substance irrespective of the form of a scheme. A court

following accepted canons of statutory interpretation will have greater freedom to look at the overall effect of a scheme when applying paragraph (c); to consider what the scheme actually does rather than being obliged to consider what the scheme purports by its form to do.

Thus, there is an issue whether the problems involved in defining the reach of the regulatory system over investment opportunities other than shares and debentures can be reduced by extending the liberty to consider the substance of a scheme irrespective of its form to every part of the definition. It may be objected that the further use of a test by reference to substance rather than form will increase unpredictability as to application of the regulatory system.

It may be said that a 'substance test' will work in favour of bringing more investment opportunities within the system and is unlikely to operate to exclude more than are excluded now. Professional advisers may not feel confident in advising by using a 'substance test'. However, a 'substance test' having general application in respect of all parts of the definition could be useful as part of guidelines for the exercise of an excluding power given to the appropriate regulatory authority. Express inclusion of a 'substance test' in the definition itself would also be useful to a court which has to consider the application of the definition to a particular scheme.

20.3. The time for considering the existent of a prescribed interest. The definition does not fix the time at which the existence of a prescribed interest is significant. Thus, at one point of time a particular investment opportunity may fall within the definition and yet because one or more of its elements required by the definition disappears it would no longer be a prescribed interest. There is a question whether the fact that the terms of the scheme contemplate the possibility of that change is enough to take the scheme outside the definition. In the Australian Softwood case (1981) 148 CLR at 141, 36 ALR at 271 Wilson J said: 'The time for considering the existence of an "interest" is the time when the arrangement is implemented.'

The critical time for considering whether an investment opportunity is a prescribed interest may depend on the particular part of the companies and securities legislation for which the definition functions. Thus, it may be that for the purposes of the Companies Act Part IV Division 6 dealing with the issue of prescribed interests to the public (or the offering to the public for subscription or purchase, or the making of invitations to the public to subscribe for or purchase, prescribed interests) the critical time is when the issue, offer or invitation is made.

The fact that the terms of the scheme allow for possible future change in characteristics would not prevent the scheme being within the definition if, at the time of its issue or being offered, its characteristics attracted the definition. But when the Securities Industry Act 1980 (Cth) section 43(1) provides that a person shall not carry on a business of dealing in 'securities', which includes certain 'prescribed interests' (see definition of 'securities' in section 4(1) and Securities Industry Regulations regulation 26(2)), does this include investment opportunities that were at one time prescribed interests but no longer answer the definition? Or does an investment opportunity that once was a prescribed interest retain that character until it ceases to have those features which call for regulation in protection of potential and actual investors? That approach requires isolation of the features of an investment opportunity that makes it necessary to regulate the investment opportunity under companies and securities regulation. As noted earlier in paragraph [20.1] isolation of those features is needed in order to state the underlying purpose or object of the regulation of prescribed interests and will be dealt with later.

The problem of change in characteristics in those prescribed interests that are interests in companies such as membership in an unlimited company otherwise than as a holder of shares is less pressing since the rights of members of companies are relatively well-established by company law.

The Committee is of the view that once an investment opportunity ceases permanently to answer the definition of 'prescribed interest' it should no longer be subject to the system of regulation.

20.4. 'Right to participate', 'interest', 'right or interest'. The definition of 'participation interest' expressly indicates that a right or interest is included regardless of whether it is enforceable. This is consistent with a policy of giving protection to offerees of investment opportunities whether the opportunities are real or illusory.

The definition also makes it clear that it covers a right or interest whether it is actual, prospective or contingent. Again this is consistent with a policy of reaching offers of investment opportunities regardless of whether fully effective legal rights are to be provided to the investor.

The fact that the right or interest is or is not evidenced by a formal document is also declared to be immaterial. The investor's need of protection exists regardless of the amount of formality surrounding the offering. One matter left without express mention in the definition is whether 'interest' appearing in the first line of the definition is used in a technical sense so that it refers only to those rights which are proprietary rather than merely personal. The matter could be important since the opening words of the definition separate 'any right to participate' from 'any interest' so that 'interest' could apply where there is no element of participation with others. However, although an interpretation of 'interest' as meaning proprietary interest can be maintained in reading paragraph (a) it may be too narrow when used in paragraph (b) since that paragraph refers to interest in any common enterprise. In the event, courts have interpreted 'interest' broadly as not being limited to proprietary interests: Australian Softwood Forests Pry Ltd. V A-G (NSW) (1981) 148 CLR at 133, 36 ALR at 265. Although the exact limits of the underlying policy in terms of the investment opportunities covered may not be clear, there can be little doubt that the protection of investors should not stop short of offerings of merely contractual, as distinct from proprietary, rights. In any revision of the existing definition opportunity might be taken to make that clear.

The definition of 'investment contract' has as one of its elements 'an interest in or right in respect of property'. 'Interest' here appears to be used in the sense of a proprietary interest. However,

'right in respect of property' goes beyond interest in its technical sense so that a non-proprietary right such as that of a licensee on land is covered. But when the definition of 'investment contract' is transposed into the definition of 'participation interest' the use of the word 'interest' in two senses can be seen.

'Participation interest' means any right to participate, or any interest:

(c) in any contract, scheme or arrangement that ... involves the investment of money in ... such circumstances that the investor acquires or may acquire an interest in or right in respect of property ... that, under ... the terms of the investment will ... be used or employed in common with any other interest in or right in respect of property ... acquired in ... like circumstances;

Rather than use 'interest' in two senses in the one definition, it would seem better to use some such word as 'involvement' in place of 'interest' where it is used in conjunction with 'right to participate'.

The right to participate or involvement is expressly declared to be within the definition of 'participation interest' regardless of whether it relates to a physical asset.

20.5. Paragraph (a) - 'Profits. assets or realisation of any financial or business undertaking or scheme'. The words 'financial or business undertaking or scheme' have not posed much difficulty for the courts.

(i) It has been said of them they 'are of very wide import. For example, all that the word "scheme" requires is that there should be "some programme, or plan of action" (Clowes v FC of T (1954) 91CLR 209 at 225).' per Mason J in Australian Softwood Forests Pty. Ltd. v A-G (NSW) (1981) 148 CLR at 129, 36 ALR at 262.

(ii) The statutory definition is not concerned with the identity of the person or persons who carry on the undertaking or scheme: 148 CLR at 129, 36 ALR at 262.

(iii) An undertaking or scheme is within the definition even though the same persons do not participate in every aspect of the undertaking or scheme.

(iv) A single venture can be a 'financial or business undertaking' : A Home Away Pty Ltd. v CAC (Vic) (1980) 5 ACLR 299.

The expressions 'profits, assets or realization' have been read as having a wide signification.

(i) The word 'profits' in association with 'scheme', coloured by the opening words 'right to participate', might have been taken as implying that the investor would need to have a right to participate in some scheme which would either involve receipt of revenue and the setting off of expenditure necessary to derive that revenue or receipt of a share of a product. On that basis a loan for a fixed rate of return not dependent on whether the borrower earned profits might have been thought to be outside the definition. However, such a loan has been held to be within the definition: Waldron v Auer [1977] VR 236 at 241. There may well be a need to regulate public solicitation by individuals for loans but the Committee believes that where an individual does no more than solicit a loan for a fixed rate of interest, there is missing that element of participation which would make it appropriate for regulation of the solicitation to be part of companies and securities law. It is true that solicitation of the public to lend money to corporations is regulated by the Companies Code but that is needed because of the special legal character of the would-be borrower as a corporation. Accordingly, there should be an exclusion from the definition of 'prescribed interest' of a loan for a fixed rate of interest not dependent upon whether the borrower earns profits.

However, the Committee recommends that in the revision of the definition of 'prescribed interest' opportunity should be taken to make it clear that it is immaterial whether an investor's right to participate in profits, assets or realization is as creditor, partner, party to a contract, beneficiary under a trust or in any other capacity.

There are problems where one person, the promoter, conducts a financial undertaking or scheme with a view to deriving profit for himself and that promoter has, by contract, made himself personally liable to another person to do something (e.g. supply services or goods or make payment) in certain events. The promisee's entitlement under the promise is not tied in law or equity to the profits expected by the promoter. Ordinarily, the promisee would not be regarded as having any right to participate or interest in those profits.

It has been held, however, that the terms of a particular investment opportunity may link the investment opportunity with the promoter's own expected profits in such a way as to give the investor an interest in a non-technical sense in those profits. The test has been expressed as 'whether there is such a communality as between the [promoter] and its customers in respect of the [promoter's] undertaking or scheme that one can say that the customer's profits as well as the [promoter's] profits are profits of this undertaking or scheme?': per Hodgson J in Carragreen Currency Corporation Pry Ltd. v CAC (NSW) (1986) 5 ACLC 148 at 166. That community of interest may appear where the promoter holds out the prospect that the dealing with him will make profits for the offeree rather than merely result in some service or property being acquired by the offeree.

(ii) It seems that the word 'assets' does not bring a scheme within the definition unless the investor obtains some right in relation to a particular asset. An investor would not have a right to participate or an interest in the assets of a promoter merely because the promoter has made a contract under which he has made himself personally liable to the investor to make a payment in certain events to the investor: the investor would not have a right to participate or interest in the promoter's assets simply because enforcement of the personal contractual right might lead to execution against the promoter's estate or sequestration in bankruptcy: Carragreen Currency Corporation Pty Ltd. v CAC (NSW) (1986) 5 ACLC 148 at 165.

Moreover, there will be no right to participate or interest in 'assets' merely because an investor has a right to use assets. In Butterworth v Lezemo Pty Ltd. (1983) 8 ACLR 737 Nicholson J said: 'I think that participation goes beyond a mere right of use and bears a

connotation that the participant, even if he has no proprietary interest in the asset, has an eventual right or expectation of receiving something in respect of it.'

Thus, while an investor in a forestry plantation scheme with a right to enter land and remove trees might have a right to participate in the asset, being the land, a franchisee having a contractual right to use industrial property owned by the franchiser did not have a right to participate or interest in that asset: Butterworth v Lezemo Pty Ltd.; Streeter v Pacific-Seven Pty (1985) 3 ACLC 430.

(iii) Turning to a right to participate or an interest in 'realisation' it is difficult to state positively what it involves beyond what is already covered by a right to participate in profits or assets. A right to participate or an interest in the 'realisation' of a financial or business undertaking or scheme would not arise from a promoter making himself personally liable to pay money: even if the promoter is carrying on a financial or business undertaking or scheme and the promoter will raise the money from that undertaking or business in order to perform his promise, that does not give the promisee an interest in realisation of the promoter's business. Nor does the possibility that the promoter's estate might have to be sequestrated give the promisee an interest in realisation: Carragreen Currency Company Pty Ltd. CAC (NSW) (1986) 5 ACLC 148 at 165.

20.6. Paragraph (b) - 'common enterprise' For paragraph (b) to apply one must find a right to participate or interest in a:

'common enterprise' that is:

* between one investor and his co-investors as in a unit trust or the mortgage investment scheme considered in CAC (NSW) v M G Securities (Australasia) Ltd. (1974) CCH ASLR 85218 and Waldron v M G (Australasia) Ltd. [1975] VR 508;

** clearly where the contributions of each investor are to be pooled but the investor is to retain beneficial ownership as in a unit trust; or

** it would seem, where the contributions are to be received by the one person from investors on terms that they lose ownership of the money but the contributions of several investors are to be used by the promoter for a common purpose, as where investors collectively enable some person to carry out bulk purchasing and each has a contractual right to be paid some amount if that person makes profits: CAC (NSW) Lombard Nash International Pty Ltd. (No 2) (1987) 5 ACLC 651 at 661.

* between the investor and the promoter as in franchising schemes (before they were excluded by regulation): Streeter v Pacific-Seven Pty Ltd. (1985) 3 ACLC 430;

* presumably, between the investor and some person who is neither the promoter nor another investor;

* the contributions of operation by each co-entrepreneur not being required to be uniform;

'An enterprise may be described as common if it consists of two or more closely connected operations on the footing that one part is to be carried out by A and the other by B, each deriving a separate profit from what he does, even though there is no pooling or sharing of receipts or profits. It will be enough that the two operations constituting the enterprise contribute to the overall purpose that unites them. There is then an enterprise common to both participants and, accordingly, a common enterprise': per Mason J in Australian Softwood Forests Pty Ltd. v A-G (NSW) (1981) 148 CLR at 133, 36 ALR at 265.

'in relation to which' the investor is led to expect profits, rent or interest:

* 'from the efforts of the promoter of the enterprise':

** as where a management company of a unit trust proposes to manage investments or where the promoter is an intending film production company intending to produce a film; or

** as where in a franchising scheme (before exclusion by regulation) the promoter contracts to expend a substantial amount in advertising and to employ staff to locate customers for a franchisee: Hamilton v Casnot Pty Ltd. (1981) 5 ACLR 279; or

* 'from the efforts of a third party' as where the investor's contribution will be lent on to a third party whose efforts may generate profits, rent or interest.

It is not enough that the investor 'expects' profits, rent or interest: he must be 'led to expect' them. This could suggest that there must be present some promotional element in the sense of conscious activity on the part of some person (apparently the promoter) directed to inducing an offeree to invest. (See D. R. Magarey, Lecture on Prescribed Interests page 14 - The University of Sydney Faculty of Law Continuing Legal Education 1987 - Current Commercial Law.) Doubtless, there is an implication that it is only those statements or circumstances that could lead a reasonable investor to the expectation that are relevant. Doubtless also, that hypothetical reasonable investor does not have to be a person experienced in business matters but could be any member of the community not necessarily versed in financial matters.

The efforts must be efforts continuing after the offer of the investment opportunity: Streeter v Pacific-Seven Pty Ltd. (1985) 3 ACLC 430.

The profits, rent or interest expected by the investor must be from efforts which are substantially not his alone: a promoter may promise supportive efforts but those efforts may not constitute the substantial future cause of the expected profits, rent or interest: Butterworth v Lezemo Pty Ltd. (1983) 8 ACLR 737; Streeter v Pacific-Seven Pty Ltd. (1985) ACLC 430; R v Commons (1986) 4 ACLC 551 at 558. Those cases suggest that there is a question as to the degree to which profits are likely to come from the contribution of effort by persons other than the investor.

Given the possibility of an expectation of profits partly from the efforts of the investor and partly from the efforts of the promoter or a third party, the case can still be within the definition even though it is not possible to identify any particular part of the profits as resulting from some discrete effort on the part of the promoter or third party: R v Commons (1986) 4 ACLC 551 at 560 per de Jersey J.

There is a suggestion that the definition does not catch a case in which there is an expectation in relation to profits from the efforts of the promoter to be made in the future and the investor has a legal right that the promoter make those efforts. Thus in Maunder-Hartigan v Hamilton (1984) 2 ACLC 438 a sale of a home unit subject to a lease on terms that each buyer of home units in the block would appoint the same agent to collect rent and administer the letting was not a case in which the unit owner was led to expect rent from the efforts of the agent. Such a case might be caught within paragraph (a) by the 'community of interest' test.

However, the Committee believes that as a matter of policy the definition should extend to the case where there is an induced expectation that profits, rent or interest will come from efforts of the promoter whether or not he has contracted to make the efforts.

20.7. Paragraph (c) 'investment contract':

A clear example of schemes within paragraph (c) is provided by schemes under which investors contribute sums to be channeled into existing mortgages along with money to be contributed by other investors so that the beneficial ownership of a mortgage debt would become vested in several investors to the extent of their individual investments: CAC (NSW) v M G Securities (Australasia) Ltd. (1974) CCH ASLR 85218; Waldron v M G Securities (Australasia) Ltd. [1975] VR 508 at 531.

Before paragraph (c) applies there must be an investment of money. This has been held to involve more than the mere payment of money. It must be payment in the expectation or contemplation of 'some form

of return, whether of the money itself or by way of income or profit or otherwise': Munna Beach Apartments Pty Limited v Kennedy [1983] 1 Qd R 151 (1983) 1 ACLC 721 7 ALCR 257 per McPherson J.

It is not enough that the investor has investment in mind. Paragraph (c) requires a 'contract, scheme or arrangement that ... involves the investment' and that has been held to require that the contract should somehow contemplate that the payment is by way of investment: Munna Beach Apartments Pty Limited v Kennedy [1983] 1 Qd R 151 (1983) 1 ACLC 721, 7 ACLR 257.

The contract must be one in or under such circumstances that the investor acquires (or may acquire) an interest or right in respect of property.

That interest or right (under or in accordance with the terms of the investment) must be one that will (or may at the option of the investor) be used or employed in common with any other interest in or right in respect of property acquired in or under like circumstances.

The need for these elements was considered in Munna Beach Apartments Pty Ltd. v Kennedy [1983] 1 Qd R 151 (1983) 1 ACLC 721 7 ACLR 257 in relation to a claim that an offer of a strata home unit, together with an undivided share in common property fell within paragraph (c). It was held that the offer did not fall within paragraph (c) because the contract for the sale of the unit did not provide that payments by the purchaser were for investment and the ownership of a share of the estate in fee simple in the common property was not capable of being 'used or employed in common with' the similar ownership of others: each owner exercised his own right.

While the existence of a prescribed interest cannot be allowed to depend on the intention of an investor, there is a question whether the language of paragraph (c) should be enlarged to refer to a scheme that refers to the payment of money rather than investment of money. If that were done, it would be necessary to exclude schemes under which the investor is simply acquiring an interest in property to be held in common with other persons.

In what respects is the existing definition of 'prescribed interest' unsatisfactory?

[21] The existing definition has one part by which certain things are included in the definition and a second part under which certain things are excluded. The words of the including part are general and problems arise because the exact reach of those general words is not discernible. The excluding part of the definition is not in general terms but specifies the things to be excluded. The main difficulty is with the including part.

[22] The breadth of the including part of the definition when combined with literal interpretation could produce a situation in which it is very difficult to predict with certainty whether a particular investment opportunity falls within the system of regulation. Uncertainty in this area is unsatisfactory because it could lead to increased business costs through law-abiding entrepreneurs incurring considerable expense and experiencing unreasonable delay in complying with the legislation in cases where that may not really be necessary. Mistaken belief that an investment opportunity falls within the system of regulation could cause a meritorious innovation to be deterred. Uncertainty as to the reach of the definition could also lead to the incurring of costs of litigation in cases where there is a contest as to whether a particular investment opportunity is a prescribed interest. Uncertainty in the minds of regulatory officials, professional advisers and their clients could add real but unquantifiable cost burdens.

[23] As noted earlier in paragraph [20.1] a major difficulty has been that the legislation does not show expressly or impliedly the purpose or object underlying the definition of 'prescribed interest'. An interpreter has a general appreciation that the legislation is concerned with protection of potential investors but there is no guidance as to just which investment opportunities are clearly analogous to shares or debentures.

In the Discussion Paper page 30 the Committee said:

'Although it does not seem possible to eliminate all uncertainties at the borderline of the definition, a clearer indication of legislative

purpose may assist courts and administrators in applying the legislation.'

[24] The Discussion Paper page 87 canvassed a representative range of possibilities for reformulating the including part of the existing definition. They were as follows:

1. minor modifications to the current definition which do not change its basic form;

2. no modification to the current definition but the addition of a statement of the legislative purpose of the definition.

3. minor modifications to the current definition together with a statement of the legislative purpose of the definition;

4. replacement of the current definition with a closed list of situations covered;

5. replacement of the current definition with a closed list of situations covered together with a power to add to the list by the NCSC or the Ministerial Council by proclamation;

6. replacement of the current definition with an open-ended list of situations covered, that is, including some undefined general term like 'investment contract';

7. replacement of the current definition with an open-ended list of situations covered, that is, including some undefined general term like 'investment contract', together with a statement of the legislative purpose of the definition;

8. replacement of the current definition with an entirely new general test of broad ambit, the definition itself being the statement of legislative purpose; and

9. replacement of the current definition with an entirely new general test of narrower ambit, the definition itself being the statement of purpose.

[25] The Discussion Paper in Chapter 2 examined the definitions adopted in the USA, Canada, the United Kingdom and New Zealand for the purpose of distinguishing the investment opportunities that fall within their respective laws about securities regulation. A problem common to all the countries and Australia is how the definition can be given capacity to embrace novel forms of investment opportunity and yet not be so general in its language as to give inadequate guidance as to the ambit of the definition. The examination of the definitions in the other countries revealed that no country had found an ideal balance between certainty and flexibility. No country whose law was examined has a definition that is so demonstrably better than the existing Australian definition as to suggest a model for an entirely new definition.

[26] Several submissions were received on the question of possible change in the definition. The Corporate Affairs Department, Western Australia favoured retention of the existing definition without opposing the inclusion of a statement of purpose. The Australian Stock Exchange Limited preferred the third formulation, namely that there should be minor modifications to the current definition, together with a statement of legislative purpose. The Trustee Companies Association of Australia strongly favoured the replacement of the present definition with a closed list of situations with a power to add to that list residing in the NCSC or the Ministerial Council.

[27] The ideal definition which will both show the exact limits of the area of control and be capable of embracing new forms of investment opportunity is incapable of being devised. Given that the perfect solution is not attainable, it would seem retrogressive to scrap the existing definition and thereby lose the benefit of all the judicial consideration that has been given to the existing definition. For professional advisers the reported cases have gradually elucidated many implications. The history of regulation of investment opportunities in Australia and other countries shows that the community through its delegates, the regulators, has had to learn by experience. If anything is clear, it is that new and unique schemes with characteristics that cannot be predicted will continue to emerge. That fact points in favour of the existing form of broad definition tempered by a power to exempt. A closed list approach,

even with power to expand it by administrative fiat, would be inadequate: it would leave the community exposed to unsatisfactory schemes which might not be susceptible to being undone even if they were in due course included in the definition by special declaration.

[28] It seems to the Committee that the better course is to retain the existing definition and to try to improve the prospects for ascertaining the outer limits of the including part of the definition by:

* giving the interpreter guidelines as to the underlying purpose or object of the legislation by a statement of them in the legislation;

* refining the existing definition to deal with issues that have been raised in the decided cases and otherwise; and

* authorising the interpreter to have regard to the substance of the investment opportunity without regard to form.

These measures should be supported by a list of specific kinds of investment opportunities that are excluded accompanied by some process by which exclusion of a particular investment opportunity or a class of investment opportunities can be speedily promulgated.

Guidelines as to purpose and object of the definition

[29] It is one thing to recommend that there should be a legislative indication of policy: it is another to state the policy behind the concept of prescribed interest. In the Discussion Paper page 80ff there is discussion of the criteria that should govern the application of companies and securities legislation to investment opportunities beyond shares and debentures. The Discussion Paper at page 82 suggested that the appropriate process is to identify those features of shares and debentures that necessitate legislation for protection of investors and then to have a policy of extending the protection of companies and securities legislation to investors in other types of investment opportunity that exhibit the same

features. That process by concentrating on quasi-shares and quasi-debentures would leave aside some investment opportunities but they may attract other forms of protection such as that provided by legislation for buyers of real estate or buyers of goods.

[30] The criteria common to shares and debentures, on the one hand, and other investment opportunities, on the other hand, have been the subject of discussion in the USA. The Discussion Paper at page 82 stated a set of criteria[1] that has received much consideration in the USA.

[31] The criteria stated in the Discussion Paper were as follows:

(i) an investor gives up value to a recipient;

(ii) the investor is led to understand that the value given up will be used in an enterprise which is intended to be productive and profit-making;

(iii) the investor will not in practical terms have any significant management or control of the use of the value given up;

(iv) the investor gives up value primarily in the quest for future financial gain;

(v) the financial gain, if it results at all, will result from efforts which are not substantially those of the investor; and

(vi) the transaction in which the value is given up will be of a kind that occurs or could occur in public markets.

The Discussion Paper discussed each of the criteria.

Criterion (i) was seen as not giving rise to difficulty.

1 The criteria were stated originally by R J Coffey in "The Economic Realities of a 'Security': Is there a More Meaningful Formula?" (1967) 18 Western Reserve Law Review 367 at 374.

Criterion (ii) was noted as generally excluding betting syndicates and consumer loans. If the enterprise has to be both productive and profit-making, it could also exclude such things as futures contracts. The present definition is directed at opportunities which hold out the prospect of being profit-making. If criterion (ii) is to be used, it would better to drop the word 'productive'.

Criterion (iii) looks to whether the investor retains management or control of the value that is given up. The matter should be looked at in a practical manner to see whether the investor will after the transaction have significant management or control of whatever substantially represents the value given up. This issue has arisen under the existing definition in relation to franchise agreements (before their exclusion by regulation). It also arises in schemes where the investor as a result of the transaction becomes the owner of certain property but the transaction looks to the investor leaving the management or control of that property to a substantial degree with another person (e.g. forestry schemes in which an investor buys a tree which is to be nurtured by others, or buys a vending machine which is to be leased out by others, or buys a home unit on terms that some other person is to control the letting of it).

Criterion (iv) would confine the protection to 'investment' opportunities and would exclude offerings for personal consumption. As noted earlier, the existence of a prescribed interest cannot be made to depend on the intention of the investor. In a statement of purpose or object of the legislation, the point could be made that the regulatory system is intended to cover offerings in which the ordinary reasonable person might recognise an opportunity to make financial gain. In the absence of other criteria this could mean that some contracts of sale of land or goods could be caught. But such contracts would ordinarily be excluded by criterion (v). If the transaction holds out to a reasonable member of the community generally the prospect of financial gain by resale of land or goods, or from the letting of land or goods, or other use of land or goods resulting in each case to a substantial degree from the efforts of persons other than the buyer, the transaction calls for regulation.

Criterion (v) is intended to exclude those investment opportunities under which the financial gain (if any) can accrue exclusively or

substantially from the efforts of the investor. This is an issue that arose in connection with franchise agreements before they were excluded by regulation. The principle is that the protection is intended only for passive investors who subject their funds to the control of other persons.

Criterion (vi) is of less value than the earlier criteria. Insofar as it suggests that transactions which involve private negotiation between parties are outside a field of regulation concerned with the integrity of securities markets, it could have value. But if the aim of regulation is the protection of investing members of the public, it should not matter whether there is any element of private negotiation in any particular investment opportunity. Exclusion on the basis of an element of private negotiation could invite avoidance by structuring investment opportunities to take advantage of the exclusion.

It has been suggested by a commentator on the Discussion Paper that there may be in criterion (vi) an implicit reference to an element in the present definition that the value given up is used in common with value similarly given by other investors and that that element deserves express reference. (See D. R. Magarey, Lecture on Prescribed Interests page 22 - The University of Sydney Faculty of Law Continuing Legal Education 1987 - Current Commercial Law.)

How then, might the purpose and object behind the definition of prescribed interest and the regulation of offerings and dealings in prescribed interests be stated?

A possible legislative statement of purpose and object

[32] The Committee recommends the inclusion in the legislation of a statement of the purpose and object of the legislation regulating prescribed interests.

[33] The statement should be framed with several aims:

(i) to guide interpreters of the definition when in doubt as to whether a particular investment opportunity is a prescribed interest;

(ii) to guide the Commission having power to exclude schemes from the definition as to how those powers should be exercised; and

(iii) to guide the Commission in giving exemptions from a requirement of the regulatory system.

[34] The opening part of a statement of purpose and object would need to refer to the recital in the Formal Agreement of 22 December 1978 between the Commonwealth and the States appearing in the Schedule to the National Companies and Securities Commission Act 1979 (Cth).

[35] The statement would relate to that part of the recital which refers to the general acknowledgement in the interests of the public and of persons and authorities concerned with the administration of the law relating to:

(a) companies; and

(b) the regulation of the securities industry,

'that the confidence of investors in the securities market should be maintained through suitable provisions for investor protection'.

There could then be a statement that the securities market is seen as extending beyond a market in shares and debentures to other types of securities. Those other securities are denominated 'prescribed interests'.

[36] The statement could then proceed to say that the purpose and object of the definition of 'prescribed interest' is to assist in protecting investors, rather than consumers, by comprehending every opportunity to invest that:

(i) involves:

(a) one person giving up value to another person;

(b) the person giving up value having a reasonable understanding that the value given up will in whole or part be used in an enterprise which is intended to be profit-making;

(c) the person giving up value having, in practical terms:

1. no significant management or control of the use of the value or anything representing it; or

2. having such a community of interest with a promoter or third person in a financial or business undertaking or scheme that profits expected by the investor as well as profits of the promoter or third person can, in a practical sense, be characterised as profits of that undertaking or scheme;

(d) the person giving up value doing so with the intention of making some future financial gain; and

(e) the person giving up value having a reasonable understanding that the financial gain (if any) is to result from efforts which are not substantially his efforts; and

(ii) is not:

(f) regulated under other legislation administered by a statutory regulatory authority; or

(g) excluded from the definition by the Companies Act [Code], by regulation or by the Commission.

It should be declared to be part of the purpose and object of Parliament that the definition should extend to novel forms of opportunity falling within the foregoing statement of purpose and object so that they may be offered to the public or be the subject of dealing only in compliance with the provisions of the companies and securities legislation unless and until the Commission excludes them from the operation of that legislation.

[37] That suggested statement of purpose does not include a requirement that the investment opportunity in question should be seen to be analogous to a share or debenture. The addition of that requirement would make the definition liable to leave forms of offering unregulated. That result may be thought to be undesirable

but whether it is inescapable depends on how one should read the Formal Agreement when it subsumes the legislation for which the Ministerial Council is responsible under the headings of 'companies' and 'the regulation of the securities industry'. It may be that a requirement of an analogy with shares or debentures is more constricting than the expression 'securities industry' requires.

Given that the regulation of offerings under companies legislation before the Formal Agreement of 22 December 1978 extended as far as offerings of opportunities having features (a) to (e), it is strongly arguable that the expression 'securities industry' embraces opportunities having features(a) to (e) even if those opportunities are not similar to shares or debentures.

[38] There is a political question as to how far the Ministerial Council wants to go beyond regulating dealings in interests in companies and government and public authority securities.

But given the wide meaning of the equivalent of 'prescribed interest' in companies legislation at the time the Formal Agreement was made, it seems to the Committee that the Ministerial Council could deal with investment opportunities which have features (a) to (e) even though there might be argument as to whether they are analogous to shares or debentures.

Accordingly, the Ministerial Council has an option to approve legislation that does not require the investment opportunity to be analogous to a share or debenture before it could come within the statement of purpose or object.

[39] In order to deal with the problem of novel investment

opportunities it may be beneficial to legislate to introduce a voluntary clearance procedure. That matter is dealt with in paragraph [62].

Possible refinement of the including part of the existing definition

[40] Some of the problems of uncertainty that have arisen in the past may be solved by the inclusion of the statement of purpose and object and by giving the Commission power to exclude certain investment

opportunities. However, that does not remove the need to try to improve the wording of the definition.

[41] For reasons stated in paragraph [20.2] the Committee recommends that the existing definition be amended so that in respect of paragraphs (a) and (b) as well as (c) regard may be had to the substance of a particular investment opportunity irrespective of the form in which it is offered.

[42] The difficulties referred to in paragraph [20.3] as to what is the appropriate time at which the nature of an investment opportunity is to be considered could be addressed by the legislation. The Committee recommends that once an investment opportunity permanently ceases to answer the definition of 'prescribed interest' it should no longer be subject to the system of regulation.

[43] The Committee recommends that where the definition uses the word 'interest' there be some indication in the legislation that something more than a proprietary interest is intended, whenever that is the case.

[44] Opportunity should be taken to say that it is immaterial whether a person's right to participate is enjoyed in the capacity of creditor, partner, agent, beneficiary under a trust, party to a contract or any other capacity.

[45] The definition should expressly include rights to participate or interests in profits even though the profits referred to in paragraph (a) are to be earned by the investor severally rather than jointly with any other person, where there is in a practical sense such a community of interest as between the promoter and the investor in respect of profits each will derive from the relevant financial or business undertaking or scheme that profits to be derived by the investor as well as profits to be derived by the promoter could (having regard to the purpose and object of the definition) properly be regarded as profits of the undertaking or scheme.

[46] As to paragraph (b) the Committee recommends that it should extend to the case where the investor is led to expect that profits, rent or interest will come from the efforts of the promoter or a third person whether or not he has contracted to make the efforts.

[47] In relation to paragraph (c) the Committee believes that the proposition referred to in paragraph [20.7]] that the contract should itself contemplate that the payment by an investor is by way of an investment is too limiting. Paragraph (c) should be amended to remove that limitation.

Possible changes to the specific exclusions from the existing definition and a provision conferring power to exclude or exempt

[48] At present there are specific exclusions from the 'participation interest' element in the definition of 'prescribed interest'.

[49] The first is a right that is a right to participate in a time-sharing scheme as defined. The Committee sees no need to make any comment about this exclusion.

[50] The second is any share in, or debenture of a corporation. As noted earlier this exclusion relates to only some of the securities that might be issued by a corporation. It does not cover interests in unlimited corporations other than interests in share capital. In any future revision of the prospectus provisions of the companies legislation relating to shares and debentures, opportunity might be taken to bring other forms of securities which relate to the issuing corporation's capital raisings into the part of the legislation that deals with shares and debentures. Those securities could then be excluded from the definition of prescribed interest.

[51] The next specific exclusion is any interest in, or arising out of, a policy of life insurance. In its Review of the Licensing Provisions of the Securities Industry Act and Codes (1985) Chapter 4 the NCSC considered this exclusion so far as it affected the definition of 'securities' in the Securities Industry Act and Codes. The NCSC in paragraph 4.22 proposed a recommendation that the definition of 'prescribed interest' in section 4 be modified to exclude interests which are clearly and exclusively policies of life cover. In paragraph 4.2! the Commission said that this would mean that the pure investment products of life insurance companies and

other authorised providers of life cover would fall within the definition of prescribed interest which would require the promoters of those products to comply with Co-operative Scheme legislation. The Committee concurs with the NCSC in that view.

[52] A further specific exclusion relates to an interest in a partnership agreement unless the agreement:

* relates to an undertaking, scheme, enterprise or investment contract promoted by or on behalf of a person conducting a business of promoting them or something similar to them; or

* is one prescribed by regulation for the purpose of removing the exclusion in respect of the agreement.

[53] It has been pointed out that the partnership exclusion is not limited to the case where the offeror is offering interests in a partnership in which the offeror will be a partner. (See D. R. Magarey Lecture on Prescribed Interests - The University of Sydney Faculty of Law Continuing Legal Education 1987 - Current Commercial Law.) The Committee believes that the exclusion should be limited to such cases.

[54] There is another weakness in that the provision might be thought to be avoidable by having a new single project company promote each partnership, even where they are owned by the one holding company. To meet that the legislation should refer also to promotions by or on behalf of any associate of the person who conducts the business of promoting.

[55] Another specific exclusion is a retirement village scheme provided it is not a time-sharing scheme. In relation to the Companies Act this is provided for in section 215D(2). The exclusion is not for the purposes of the whole of the Companies Act but only Divisions 1,2,5 and 6 of Part IV and section 552. On the other hand, in the definition of 'securities' in the Securities Industry Act a right to participate in a retirement village scheme is excluded generally. The Committee's only comment about this exclusion is to question why the exclusion for the purposes of the Companies Act should not give an exclusion for the purposes of that Act generally.

[56] A further specific exemption outside the definition of 'prescribed interest' is found in section 215B of the Companies Act having the effect of exempting banking business from section 552 (security hawking). Exemption is also given from Divisions 1 (prospectuses and advertising) and 5 (debentures and public borrowing except where the bank is a trustee for debenture holders.)

[57] For reasons stated in paragraph 20.5 the Committee recommends that there should be an exclusion from the definition of 'prescribed interest' of a loan for a fixed rate of interest not dependent upon whether the borrower earns profits.

[58] In regard to possible additions to the list of specific exclusions in the definition, the Committee believes that any further specific exclusions should be carried out by an order of the Commission or the Ministerial Council in exercise of a power to make exclusions in respect of particular investment opportunities or particular classes of investment opportunities. Ideally, the making of all future exclusions should be a matter for the Commission because it is an expert body close to the market place with personnel experienced in relation to the raising of capital and with a demonstrated capacity to act quickly. However, in the co-operative scheme it has been thought necessary that there be a capacity for a particular State or Territory to bring about an exclusion in relation to offerings in that State or Territory.

[59] At present there are various general provisions in the legislation which confer power to grant exemption. The latter part of the definition of 'prescribed interest' refers to interests that may be declared to be exempt by regulation. It is under this provision that regulation 14A of the Companies Regulations and regulation 5A of the Securities Industry Regulations have been made. They declare 'any right to participate, or any interest, as franchisee in a franchise' to be an exempt right or interest, in the one case for the purposes of Division 6 of Part IV of the Companies Act and in the other for the purposes of the Securities Industry Act. There is no definition of 'franchise'. The Committee does not essay a definition. Delimitation of the exemption by defining a franchise might be thought to be possible but any attempt at such a

definition is likely to encounter all the difficulties inherent in trying to provide a final definition of a prescribed interest. The matter is best approached by the Commission acting in the light of its experience to declare that a particular type of investment opportunity is exempt. If it were not for the need to allow particular States or Territories to have power to take particular investment opportunities out of the regulatory system, the best course would be to confide the whole power of giving exemptions to the Commission because it is the most suitable authority for the reasons stated in paragraph [57] above.

[60] Section 215C gives the NCSC various powers. Under section 215C(2) of the Companies Act it may exempt persons from the provisions of Part IV Divisions 1,2,5 and 6. Under section 215C(6) it may declare that any such Division or regulation made for the purposes of any such Division shall have a modified effect in its application to a particular person. A similar power to modify the effect of application of section 552 is given by section 215C(7). These provisions do not appear to give the Commission a broad power to exclude a class of investment opportunities from the definition of 'prescribed interest' of the kind which the Committee believes is necessary. Accordingly, the Committee recommends that the Commission be given a wide power to grant exemptions in respect of a class of investment opportunities.

[61] That power should be made exercisable in accordance with the purpose and object stated in the legislation and also after considering whether the exclusion or inclusion of an opportunity or class of opportunities in the regulatory system for companies and securities is economically justifiable having regard to:

(a) the private costs of compliance and the public cost of regulating; and

(b) any detriment to the public which might be caused having regard to (amongst other things) the interest of the public in:

(i) the encouragement of enterprises beneficial to the public;

(ii) the raising of venture capital; and

(iii) the protection of the public against the results of fraud or inadequate disclosure of investment information.

Voluntary Clearance Procedure for novel investment opportunities

[62] In order to deal with the problem of novel investment opportunities it would be beneficial to legislate to provide for a voluntary notification of an investment opportunity to the NCSC by a person who plans to promote a novel scheme. There could be provision that if the NCSC does not indicate within a certain time that it regards the scheme as falling within the definition of prescribed interest, the scheme shall in the absence of fraud be deemed to be outside the definition as it stood when the scheme was notified. The procedure envisaged would be similar to that provided for by the Foreign Takeovers Act 1975 (Cth) section 25 and by provisions for clearance that used to be part of the Trade Practices Act 1974 (Cth). The Committee recommends that such a procedure be provided for.

Problems inherent in the concept of an offer to the public

[63] The Committee did not raise for discussion the difficulties that have been encountered in marking off offerings to the public from private offerings. The matter is one that transcends the law about prescribed interests.
In passing, the Committee notes that under the Companies Act section 215C(6) the Commission has power to modify the effect of the provisions about public offerings to meet particular cases. Thus, in relation to a particular proposed offering of prescribed interests which could, on a literal interpretation, be an offer to the public but which in substance would be a private offer, the Commission would appear to have power to allow the prospectus provisions or approved deed provisions to be modified so that the offering could proceed as if it were not to the public. While the Committee makes no recommendation, it notes that section 215C falls short of allowing the Commission to declare that a class of offer of, or invitation in respect of, prescribed interests is not to be regarded as an offer to the public.

[64] There is a specific matter arising in relation to the Companies Act section 5(4)(ca). That provision excludes from the notion of an offer to the public an offer of prescribed interests made to existing holders of prescribed interests pursuant to the same deed governing both lots of prescribed interests. Where unit holders have been issued with units under a unit trust and later an offer of loan securities is made to those unitholders there is no similar express exclusion. This is in contrast to the position where a company offers debentures to its existing shareholders: in that case there is an exclusion under section 5(4)(c).

[65] The submission from the Corporate Affairs Department, Western Australia supported an expansion to the exclusion in section 5(4)(ca).

[66] The Committee recommends that section 5(4)(ca) be amended to extend the exclusion to the case where an offer or invitation is made or issued to holders of prescribed interests made available by a corporation pursuant to an approved deed and is an offer or invitation that relates to loan securities made available by the management company of the scheme to which the interests relate pursuant to a deed that has been approved. But this is not to include debentures offered by the management company for raising finance for its own purposes as distinct from the purposes of the scheme to which the approved deed relates.

[67] Another question arises under section 5(4)(ca). That provision excludes from the concept of an offer or invitation to the public an offer or invitation made or issued to holders of prescribed interests made available by a corporation pursuant to a deed that is an approved deed for the purposes of Division 6 of Part IV and is an offer or invitation that relates to prescribed interests made available by that corporation pursuant to the same approved deed. The issue is whether a deed that has been approved ceases to be an 'approved deed' for the purposes of section 5(4)(ca) if it is amended. As a matter of policy, the question of whether a new issue should be the subject of fresh disclosure should depend on the nature of the amendment and the way in which it was made. Thus, an

amendment that in the opinion of the trustee does not prejudice the rights of existing interest-holders might not prevent the deed still being treated as an approved deed. An amendment approved by a special resolution of a meeting of interest-holders (not counting the votes of the manager or its associate) could be similarly regarded.

[68] Elsewhere in this report, paragraph [83], the Committee recommends that the legislation provide for the formulation of model provisions of approved deeds. Those model provisions would normally include provision for the amendment of the deed. In the section of this report dealing with model provisions the Committee recommends that the model provisions relating to amendment should be of a higher status than other model provisions in that the Commission should have a clear power to refuse to approve a deed containing provisions which confer wider powers of amendment.

The Committee recommends that section 5(4)(ca) should not be excluded by the fact that the relevant deed has been amended, provided the amendments do not go beyond the power of amendment allowable under the deed.

[69] There is another matter in relation to section 5(4)(ca) that needs attention. The reference to 'that corporation' could confine the exception to the case where there has been no change in management company. The Committee recommends an amendment along the lines of substituting 'the management company' for 'that corporation'.

PART II

OTHER MATTERS RELATING TO PRESCRIBED INTERESTS

Introduction

[70] Turning from the question of how best to define 'prescribed interest', there are various other matters that the Committee considered.

Differing regulatory requirements for different prescribed interests

[71] The concept of a prescribed interest is unavoidably wide. It comprehends a range of investment opportunities so diverse that the requirements of Part IV Division 6 may turn out to be partly inappropriate to a particular type of investment opportunity.

[72] Ideally, that problem should be met by amendment of Part IV Division 6 by an amending Act. That method is consistent with parliamentary democracy and leaves nothing to the discretion of the executive arm of Government. However, parliamentary time is rationed and the processes of amendment by Act of Parliament are too slow to meet the needs of commerce.

[73] Another approach is to provide in the Act a set of requirements to be applied to every type of prescribed interest that could possibly arise with provision for an exemption to be given without having to make an Act of Parliament.

[74] One way of providing for exemption is to include in the basic Act a power in the Executive to make regulations for exempting. But even the regulation-making process is too slow to allow an exemption to be given in a particular case with the speed that is required for an efficient capital-raising market. Moreover, a particular request

for an exemption may be in respect of a relatively small part of the regulatory requirements so that the effort involved in getting a regulation made may be out of proportion to the adjustment needed.

[75] Alternatively, power to exempt could be given to particular regulatory authority responsible for administering the system. In the present context that is the Commission.

[76] The foregoing assumes that the basic Act is in such terms that it will never be necessary to add to the requirements. Once it is suggested that new burdens not provided for by existing law could be imposed on a citizen by anything less than an Act of Parliament there is widespread and justifiable concern. The imposition of new burdens by regulations made by the Executive has been a controversial matter and is tolerated only because there is machinery for scrutiny of regulations by a parliamentary committee which may recommend disallowance by Parliament.

[77] In the Discussion Paper the Committee canvassed the possibility of the Commission being given rule-making power including power to enlarge the regulatory requirements. Since the issue of the Discussion Paper the Commonwealth's plans for an Australian Securities Commission have been foreshadowed. Even if the Committee favoured the giving of a rule-making power on the NCSC, there would be little point in doing so at this stage.

[78] In any event, it would only be necessary to consider conferring such a power if it could be shown that Part IV Division 6 is insufficiently wide to provide for any particular type Of prescribed interest. Experience over the years has demonstrated that the regulatory regime provided for in Part IV Division 6 has not needed major supplementary requirements. With the use of the exempting powers given to the NCSC Part IV Division 6 has been made reasonably appropriate to various kinds of prescribed interests. There are some additions to Part IV Division 6 that the Committee recommends : see paragraphs [32] - [47] and in paragraph [83] the Committee recommends that model provisions for trust deeds be framed but it does not think that the granting of rule-making power is necessary at this stage.

[79] However, the Committee recommends that the exempting power should be made wide enough to enable exemption to be given in respect of a class of prescribed interests as well as in the case of particular prescribed interests. The power to exempt should continue to include a power to impose conditions. In any revision of the Companies Act and the Securities Industry Act, the Commission could be directed to exercise its powers to impose conditions after considering the stated purpose and object of the definition of prescribed interest as well as the matters stated in paragraph [61].

[80] There should be included in the Securities Industry Act a power as wide as the NCSC's exemption powers under section 215C of the Companies Act.

[81] The Committee recommends that the Commission should have not only a power to exempt from compliance but also a power to excuse non-compliance in a case where, if application had been made for an exemption the Commission would have granted an exemption. This power should not be exercisable where the Commission is aware that a person would be unfairly prejudiced by the non-compliance being excused.

Model provisions for approved deeds

[82] A considerable fund of knowledge about what are desirable provisions in an approved deed has been built up. It would be useful to apply that knowledge in the framing of model provisions for approved deeds for various types of prescribed interests. The model provisions would deal only with the matters which are common to schemes for each type of prescribed interest. For example, the investment policy of various collective investment schemes will vary and the model provisions would not deal with investment policy.

[83] The Committee recommends that model provisions be drawn up and included in the legislation. The Committee sees such model provisions as serving the same function as Tables A and B in Schedule 3 to the Companies Act so that they are available for adoption. There should be provision that if they are not excluded by the deed they will apply in the same way that Table A and Table B operate.

However, the modification of model provisions as to powers to amend the deed should be subject to approval by the National Companies and Securities Commission: see paragraph [89].

[84] The model provisions could serve another function. The Discussion Paper in Chapter 4 drew attention to the fact that some prescribed interest schemes - in particular, unit trusts - involve fiduciary relationships and divided administration as between a trustee and a manager. While it is clear that in unit trusts the trustee occupies a fiduciary position in relation to unit holders, the extent of the manager's fiduciary duties and the nature of its fiduciary relationships is not entirely clear.

[85] The Committee recommends that the drawing up of model provisions should provide a convenient repository for a statement of the highest standard of fiduciary administration by both trustee and manager consistent with commercial realities and the nature of the particular type of prescribed interest. But although the legislation may state the highest standards in the model provisions, it should be open to the framers of a particular scheme to adopt other provisions that relax those standards short of sanctioning dishonesty or departure from the standard required by the covenants referred to in the Companies Act section 168(1)(a) and 168(1)(c).

[86] In the Discussion Paper at page 100 the Committee tentatively suggested a classification of prescribed interests in prospectuses as being (1) wholly fiduciary, (2) partly fiduciary and (3) non-fiduciary. The Committee does not recommend that classification. It supports, instead, prominent disclosure at the time of offering as to the extent to which an investor will not have the benefit of fiduciary administration of the standard required by the model provisions.

[87] The Committee recommends that it should be a requirement that any departure from the model provisions, insofar as they relate to fiduciary standards, should be explained in the prospectus. For example, the model provisions for a unit trust deed would be consistent with the law of trusts which imposes fiduciary duties on persons who administer trusts. To the extent that the trust deed

excludes any of the rules of the law of trusts or makes other departures from desirable standards embodied in the model provisions there should be disclosure to intending investors. The disclosure should be couched in language understandable by a person of average intelligence with no legal training. It would then be for intending investors to judge whether they wish to invest in a scheme in which, for example, the manager has been empowered to act at arm's length from unit holders so as not to be chargeable with conflict of interest and duty or conflict of duties.

[88] The preparation of model provisions for various categories of prescribed interest calls for co-operation between the regulatory authorities and representatives of the relevant associations of issuers of prescribed interests or representatives of the relevant industry associations. The regulatory authority charged with this responsibility needs to be both watchful of the interests of investors and appreciative of the problems facing entrepreneurs. The NCSC has demonstrated its ability to do the kind of work envisaged by the Committee. The NCSC's capacity to accommodate the regulatory requirements to the special characteristics of various types of schemes appears from its various Releases relevant to prescribed interests. See its Releases, No. 117 on time-sharing, No. 120 on film investment, No. 121 on property trusts, No. 123 on money market and mortgage trusts, No. 124 on horse racing and breeding syndicates, No. 125 on approved deposit funds and No. 140 on trustee company common funds. The formulation of model provisions would be a further development of the work which led to the preparation of those Releases.

[89] In paragraph [67] the Committee has drawn attention to the problem of applying section 5(4)(ca) where the deed has been amended. The Committee recommends that model provisions as to amendment should be drawn with that problem in mind. The Committee also recommends that the model provisions as to amendment should not be modified without the approval of the National Companies and Securities Commission and that any future amendments of the power to amend should require the approval of the National Companies and Securities Commission.

Effect of non-compliance with regulatory requirements on civil rights of action

[90] The Discussion Paper at page 40 noted that the definition of prescribed interest is significant not only as between the regulated (promoters, dealers etc.), but also as between the investors and the promoter, dealer etc. in relation to civil rights of action and defence which may arise from breaches of the companies and securities legislation.

[91] Even though the regulators may not take the point that a particular transaction is a prescribed interest, that may be alleged by a party to the transaction who seeks to avoid having to perform his obligations on the ground that the transaction involves the public offering of a prescribed interest without the requirements of the legislation having been complied with. A downturn in the market for home units produced a rash of cases of this kind.

[92] These cases cause litigants and courts to expend effort in trying to decide whether the transaction falls within the necessarily wide definition of prescribed interest. Moreover, unless the parties advert to the question whether their transaction involves a prescribed interest before they enter it, there is no scope for exempting powers to be used.

[93] In some other parts of companies legislation, such as the Companies (Acquisition of Shares) Act, it is accepted that non-compliance does not invalidate a transaction. See also Companies Act section 110(13). It is accepted that penal consequences only should flow from a contravention of the legislation. For the reasons stated in the Discussion Paper - which did not provoke any opposing view in the submissions - the Committee is of the view that non-compliance with the statutory system of regulation of prescribed interests should not have automatic consequences on the civil aspects of a transaction.

[94] The Committee recommends that the system of regulation of prescribed interests, whether the prospectus provisions or the approved deed requirements, should not provide a basis for a

transaction being affected by the defence of illegality. On the other hand, there could be situations where the courts should have power to undo a transaction in which there is non-compliance, if in the circumstances that is practicable. A precedent for that is in section 552(12).

Application of perpetuities doctrine to prescribed interest unit trusts

[95] The form of scheme of prescribed interests known as a unit trust can be affected under the general law by the doctrine about perpetuities. That doctrine may require the duration of the trust to be limited. Trust deeds contain a clause limiting the duration of the trust. The maximum permitted period, which differs as between States and Territories, is of the order of eighty years. By contrast, a company may be incorporated without any provision limiting the length of its life. Insofar as units are perceived by the investing public to be similar to shares in companies the application of perpetuities doctrine to public unit trusts produces an anomalous result.

[96] Perpetuities doctrine can serve a useful purpose in private trusts in preventing the dead hand of the past from unduly restricting the enjoyment of full ownership by living persons. But if the community can tolerate the indefinite duration of trading and investment corporations, there seems to be no good reason for applying perpetuities doctrine to public unit trusts and other participatory investment schemes that might attract the doctrine.

[97] The submission of The Trustee Companies Association of Australia pointed to a need to bring public prescribed interest trusts into line with companies in terms of not being subjected to perpetuities doctrine. There was no strong opposing view in other submissions.

[98] So far as trusts are concerned, if there is to be relaxation it should not be in respect of trusts generally but only those that involve prescribed interests and then only those in which the public is interested or could be interested.

[99] The Committee recommends that a provision comparable with section 578 of the Companies Act be enacted to apply for the benefit of schemes of prescribed interests in respect of which a deed has been approved under Part IV Division 6. To meet the possibility that an ingenious conveyancer setting up a private property arrangement might seek the benefit of the proposed measure by having the deed approved, the Commission should have a discretion to refuse approval of a deed where it is not satisfied that interests governed by the deed are to be offered to the public.

Secondary market in "prescribed interests"

[100] At present the Companies Act Part IV Division 6 does not allow for an individual holder of a prescribed interest to make a general offer of that prescribed interest to the public free from regulation under that Division. Section 552(4) allows sales of prescribed interests that are listed for quotation on the stock market of a securities exchange in a State or Territory without having to comply with the disclosure requirements of section 552(3).

[101] There are prescribed interests that an individual holder who is not a promoter should be able to offer to the public by general advertisement without having to comply with Part IV Division 6. An example, is an interest in a time-sharing arrangement. A similar question arises in relation to an owner of shares in a home unit scheme organised as a company. In his case Part 4 Division 1 of the Companies Act, rather than Part 4 Division 6, is relevant.

[102] Suitable limits of an exemption are suggested by the limits that apply to an offer of a partnership interest as stated in the definition of 'prescribed interest' in section 5(1).

[103] The Committee recommends that Part IV Division 6 should be subject to an exception so that it does not apply to:

(a) an offer or invitation relating to a disposition, in whole or in part, of, or creation of an interest in, an existing prescribed interest where the offer or invitation is made by

a person other than one whose ordinary business is, or includes:

(i) the promotion of undertakings, schemes, enterprises or investment contracts of the kind that comprehend the particular prescribed interest; or

(ii) the disposition, or creation of interests in, prescribed interests of the type to which the offer or invitation relates

and the disposition or creation of interest is not part of a profit-making scheme; or

(b) an offer, or invitation made on the stock market of a securities exchange in a State or Territory.

[104] The exception should allow an offer or invitation to be made through an agent even though the agent may be in the business of promoting the particular kind of prescribed interest offered, so long as the agent's interest in the outcome of the offer or invitation is not so extensive as to make the agent a substantial joint participant in the transaction. That will involve a question of degree. It may be necessary to have machinery for specifying the maximum commission that an agent may charge without being liable to be considered a substantial joint participant for this purpose.

Take-overs of prescribed interest schemes

[105] There is a question whether any special legal rules are called for in relation to a take-over of a scheme for prescribed interests. Theoretically, in this context 'take-over' could refer to:

* acquisition of the office of trustee or representative;

* acquisition of the office of manager of the scheme; or

* acquisition of power to change the fundamental character of a scheme or to wind it up.

[106] Even if acquisition of the office of trustee or representative were possible, any take-over aimed to make such an acquisition does not call for special rules. The role of the trustee or representative is not entrepreneurial. There are statutory limitations Confining eligibility to be a trustee or representative of a publicly-offered scheme to a small group. In State law there are statutory limitations on the acquisition of shares in public trustee companies. There is little scope for take-over activity of the kind that causes concern in relation to companies generally.

[107] But a take-over of the position of manager is different. When a company aims to have itself substituted for an existing manager -instances having occurred in recent years - there is a need to consider whether any special rules are called for. Some commercial incentive to make a bid to replace an existing manager lies in the remuneration that can flow to the manager of a scheme. There could also be cases where a company seeks to become manager so as to control some trust activity cognate to activity already carried on by the bidder in its own interest. In those cases a successful bid could introduce problems of conflict of interest. There could be cases where a manager of one scheme seeks to become manager of another scheme. If the two schemes are similar a successful bid could lead to a conflict of duties.

[108] Not every scheme for prescribed interests will raise the problem. The schemes affected are schemes involving ongoing management over a long period such as unit trusts. Other types of scheme formed for a single venture, such as film production syndicates, would not ordinarily raise the problem.

[109] Theoretically, there could be a change in the way a scheme is managed without a change of manager. This could occur where shares in a management company are acquired by a new controlling shareholder. Any such acquisition may or may not be subject to the regulation of take-overs in the Companies (Acquisition of Shares) Act depending on the number of members in the management company. The system of regulation in that Act is for protection of the directors

and shareholders in the management company. It does not purport to extend any protection to investors in any schemes administered by the management company. The capacity for new controllers of a management company to change the way in which a scheme will be managed will depend on the provisions of the deed governing the scheme and they in turn will depend on requirements under Part IV Division 6 of the Companies Act.

[110] Whether a bid aimed at gaining power to change the character of a scheme or to wind it up is legally possible will depend on the terms of the scheme in relation to the powers of investors under the scheme.

[111] Whatever may be the aim of a bidder, - to supplant an existing manager or to alter or wind up the scheme - the bidder will normally seek to acquire the interests of investors, usually units under a unit trust, so as to have the necessary number of votes to exercise control at meetings of interest holders on critical questions.

[112] In whose interests should there be any regulation of take-overs of prescribed interest schemes?

[113] Does the manager have an interest that should be protected? The management company will normally have an interest in the continuance of its income as manager. It may have done all the preparatory work involved in the flotation of a scheme and it may have had a lot of front-end expenditure which it intended to recoup over a period of years.

[114] One possible view is that managers are participants in a market for control of collective investment schemes and market forces should be free to operate. It may be said that any manager will be alive to the possibility of suddenly being supplanted and, accordingly, will be more efficient. Legislation should not provide security of tenure or impede contenders for management; no one manager has a monopoly of expertise for the management of collective investment ventures.

[115] A contrary view would point out that in relation to take-overs of companies section 59 of the Companies (Acquisition of Shares) Act 1980 (Cth) appears to indicate that the incumbent directors have an interest worthy of legislative protection. In section 59 it is accepted that they have an interest in at least knowing the identity of a bidder. It is also accepted that they have an interest in having reasonable time in which to consider the bid. Furthermore, it is acknowledged that they have an interest in having enough information to enable them to assess the merits of the bid. What is not clear from section 59 is whether they have that interest in their own right or whether they enjoy it so that they can be in a position to advise shareholders. The principles in section 59 stem from recommendations of the Eggleston Committee in their Report to the Standing Committee of Attorneys-General on Disclosure of Substantial Shareholdings and Takeovers (1969). The Eggleston Committee expressed agreement with measures to ensure:

(i) that an offeror's identity is known to the shareholders and directors; and

(ii) that the shareholders and directors have a reasonable time in which to consider the bid.

[116] They also considered that it was necessary to ensure that the offeror is required to give such information as is necessary to enable the shareholders to form a judgment on the merits of the bid. It is noteworthy that they did not refer to directors in this third desideratum.

[117] In company take-overs regulation the true position may be that the directors have no independent interest to be protected and that any information about the identity of the offeror and the terms of the offer comes to them incidentally in the process of the law protecting the interests of shareholders. A similar view could be taken that any protection for managers of schemes for prescribed interests who have promoted the scheme should come only incidentally from whatever protection is afforded to interestholders. Managers acting as promoters are in a fiduciary position: Elders Executor and

Trustee Co Ltd. v E G Reeves Pty Ltd. (1987) 78 ALR 193. Fed Ct No. G419 of 1986, Gummow J 29 Sep 1987). The extent to which they owe fiduciary duties during the conduct of a scheme remains uncertain. But it is enough that in the succeeding paragraphs of this report the Committee sees a need for some protection of interestholders and that protection would also accrue incidentally to a manager.

[118] The interests of investors. Investors in prescribed interests will often be concerned as to the skills of the manager. This gives them an interest in the identity of the manager. If there is a possibility of change of manager, the unitholder who has a vote on the question of appointing a new manager of a unit trust and other schemes would seem to need:

* information as to the identity of a possible new manager;

* time to consider any offer made that might lead to change of manager; and

* information as to the terms of the offer.

[119] There is a question whether all unitholders should have a fourth right to an equal opportunity to share in the benefits, as is the case in regulated company take-overs. The answer would seem to depend on whether the terms of the scheme allow the unitholder to require the manager to buy out the unitholder. If they do, there is no call for any legal requirement of equal opportunity to share in the benefits. But in the few unit trusts that are listed on the stock exchange the compulsory buy-back provisions are suspended while the trust is listed.

[120] Some unit trusts have trust deeds containing provisions similar to those in the Companies (Acquisition of Shares) Act in order to meet the possibility of a take-over. The reproduction of CASA's provisions in that way cannot produce the same result as if CASA applied directly because part of the control under CASA depends upon discretion’s vested in the NCSC.

[121] It may not be satisfactory to leave it to the framers of trust deeds to decide whether there should be controls over take-overs by writing in provisions based on CASA. The presence or absence of controls should be of importance to buyers of units on the stock exchange and it is not practical for a buyer to distinguish on the stock market those schemes which have the controls from those that do not. In a market setting in which investors may not distinguish between listed companies and listed trusts it will be anomalous that there is regulation of take-overs of companies but no regulation of take-overs of trusts.

[122] In the submissions received by the Committee there was some support for the enactment of legislation regulating take-overs of prescribed interest schemes. However, that support was expressed in general terms. To provide interestholders with the kind of protection given to shareholders would call for legislation as complicated and lengthy as the Companies (Acquisition of Shares) Act 1980. It would also be necessary to have provisions for notifying substantial acquisitions. The Committee is not satisfied that protection comparable to that given shareholders is needed.

[123] The Committee believes that there should be controls to deal only with the case where a company seeks to supplant the existing manager of a scheme which is subject to Part IV Division 6. The Committee envisages legislation designed to ensure that interest-holders receive relevant information on the basis of which they can decide whether they wish to sell out or retire from the trust. Legislation limited to that aim would not be as lengthy as CASA but it would still need the concepts of 'entitlement', 'relevant interest' and 'associate'.

[124] The central provision could be to the effect that any person who intends to acquire prescribed interests by purchase from existing holders of those interests, in circumstances where the acquisition could institute or increase the entitlement to interests of any company that would be eligible to be manager of the scheme to which the interests relate, should be required to give written notice in prescribed form to the trustee at least 14 days before acquiring. The notice should show the maximum number of interests to which that person is entitled, the number of interests that that person proposes

to acquire and the period over which it is proposed to make acquisitions. The trustee should then be obliged to use reasonable efforts to find out the intentions of the possible new manager and, if the information elicited suggests that a bid to supplant the manager will be made, the trustee should tell the incumbent manager and all interestholders the information it has sought and the information it has obtained. The trustee should be empowered to obtain advice from a competent merchant bank to report on what looks like a bid for supplanting the manager. The trustee should be indemnified out of the trust fund in respect of the reasonable costs of obtaining advice.

[125] The legislation should provide that the trustee is to enjoy qualified privilege in respect of any statement that it publishes.

[126] Since a bidder for control is unlikely to be able to obtain control without circularising interestholders it may be enough to apply the central requirement only where there is to be an off-market approach to interestholders.

[127] The type of provision suggested leaves out of account a take-over where the bidder is not aiming for control so as to become manager. Nor does it ensure equality of opportunity to all interestholders in listed trusts. The problem of an investor not knowing the assets value of his interests and selling out to a better informed person who takes advantage of a disparity between assets value and market value can be met in other ways than setting up complicated controls on acquisition of interests both on and off the stock exchange. After recent taxation changes most, if not all, unit trusts will be investment trusts rather than trading trusts. The regular ascertainment of the net assets value of interests and the notification of that value to interestholders by managers on a monthly, or even weekly, basis ought to be relatively easy. Regular advertising of net assets value of interests should be required.

[128] In paragraphs [12] - [19] the Committee has referred to the question whether investment opportunities now comprehended by the term 'prescribed interests' that are to be offered to the public should be required to assume the form of shares or debentures. If that could be done, there would be no need for additional legislation controlling take-overs of prescribed interest schemes.

Reconstruction of schemes

[129] Part VIII of the Companies Act contains provisions which facilitate the amalgamation of companies and other reconstruction's by providing for schemes of arrangement and authorising the Supreme Court to make orders transferring assets and liabilities from one company to another.

[130] Insofar as schemes of prescribed interest (in particular, unit trusts) offer investors something comparable with shares the justification for Part VIII would also warrant the provision of similar facilities for schemes of prescribed interests.

[131] Legislation similar to Part VIII for schemes of prescribed interests might also provide a procedure by way of scheme arrangement under which a public unit trust could be converted to a company.

[132] Elsewhere in this report the Committee has stated that it would be advantageous to the community to channel collective investment schemes into the company structure. Consistently with that, there should be encouragement for existing schemes to convert themselves to companies. The Committee notes that the Queensland Coal Trust's plans for conversion to a company will require the enactment of a Queensland Act which would enable unit holders to enter into a scheme of arrangement whereby their units in the Queensland Coal Trust would be cancelled, the Queensland Coal Trust would become wholly owned by a new corporation and all shares of that new corporation would then be allotted to unit holders in the same proportion as their unit holdings.

[133] The Committee recommends the enactment of provisions comparable with those in sections 314 to 317 of the Companies Act to apply in respect of schemes of prescribed interests.

Control or winding up of schemes offered to the public that do not comply

[134] The Corporate Affairs Department of Western Australia in its submission referred to a need to control schemes which are set up

initially in breach of the legislation. It said that there is a need to empower the Court to appoint someone to administer such schemes or to wind them up. Section 573 (1) of the Companies Code may already provide that power. The power is necessary and the legislation should clearly confer it.

Disqualification of offenders from further functions in relation to corporations and schemes of prescribed interests

[135] In its submission the Corporate Affairs Department of Western Australia pointed out that whereas under section 227 of the Companies Act a person convicted on indictment of any offence in connection with the promotion, formation or management of a corporation may not, within a period of 5 years after conviction, without leave of the court, take part in the management of a corporation, a breach of the legislation on prescribed interests under section 174 does not carry disqualification from managing a corporation.

[136] The promotion, formation and management of schemes of prescribed interests are sufficiently similar to the like activities in relation to a corporation as to make it anomalous that a conviction on indictment under section 174 does not lead to disqualification.

[137] It seems to the Committee appropriate that a conviction on indictment under section 174 should betoken unfitness to take part in the management of a corporation. It should also disqualify, at least for a period, from participation in the promotion, formation or management of any scheme of prescribed interests to which the public is invited to subscribe. The limitation to cases of public offering seems necessary in view of the very wide definition of prescribed interest. Moreover, whereas the legislation about companies is for the protection of creditors as well as investors, the legislation on prescribed interests is for the protection of only the investing public, since the trustee or the manager is the person liable for debts of the enterprise. Similarly, conviction on indictment of any offence in connection with the promotion, formation or management of a corporation should also disqualify from participation in promotion, formation or management of any scheme of prescribed interests to which the public is invited to subscribe.

Should there be a separate Act regulating prescribed interests?

[138] Two respondents to the Discussion Paper supported the idea that the legislation about prescribed interests should be the subject of an Act separate from the Companies Act.

[139] The arguments in favour of a separate Act.

(a) A separate Act is more likely to contain a statement of the regulatory requirements and not rely on legislation by reference as is the case with the prospectus provisions applicable to public offerings of prescribed interests: Part IV Division 6 incorporates by reference provisions from Part IV Division 1. A separate Act would provide an opportunity to make the legislation more readily comprehensible than the existing legislation.

(b) The Companies Act is a very bulky measure and needs shortening.

[140] Arguments against a separate Act.

(a) Some prescribed interests are company securities: namely, interests in unlimited corporations other than shares. However, if as suggested in paragraph [50] these company securities were regulated with shares and debentures, this argument would lose its force.

(b) The business world and professional advisers are accustomed to the present arrangement which should not be disturbed.

[141] The Committee gives considerable weight to the last argument and recommends that the enactment of a separate Act be not given a high priority. But if there were to be substantial changes in the legislation, the opportunity might then be taken to introduce a separate Act. The Committee does not regard the changes recommended in this report as providing that occasion.

[142] It may be that the recommendations to be made by the Australian Law Reform Commission on reforms of companies legislation relevant to corporate insolvency will lead to major changes. At the time of those changes opportunity might be taken to consider having separate legislation for prescribed interests. A different approach would be to locate the legislation about prescribed interests in the Securities Industry Act 1980 along with the provisions about prospectuses and share-hawking that are now in the Companies Act (see Discussion Paper pages 93-4). This would bring Australia into line with other common law countries which distinguish between, on the one hand, the incorporation, management and winding up of corporations and, on the other hand, the issue of securities and dealings in securities.

[143] In paragraphs [12] - [19] the Committee referred to the question whether at a suitable time consideration might be given to requiring all investment opportunities comprehended by the term prescribed interests to take the form of company securities before they could be offered to the public. If there were any prospect of that suggestion being adopted, the need for separate legislation relating to prescribed interests would disappear.

H A J FORD (Chairman)

G W CHARLTON

D A CRAWFORD

A B GREENWOOD

D R MAGAREY

August 1988

APPENDIX A

LIST OF RESPONDENTS

Australian Stock Exchange Limited

Corke & Co, Solicitors, Perth

Corporate Affairs Department, Western Australia

Law Council of Australia

Mortgage Bankers' Association of Australia

Trustee Companies Association of Australia