COMPANIES
AND
SECURITIES
LAW REVIEW COMMITTEE

PRESCRIBED INTERESTS

Discussion Paper No. 6

May 1987

CONTENTS

	Page Ref.
COMPANIES AND SECURITIES LAW REVIEW COMMITTEE	i – ix
Function and Membership	i
General Aims of the Committee	ii
The Reference from the Ministerial Council	iii
Aim and Structure of this Discussion Paper	iii
Element (B): Legislative Criteria	iv
Element (A): Regulation of Prescribed Interest Schemes	iv – v
Principal Issues for Consideration	v – viii
Submissions on Other Matters	viii
Invitation for Responses	ix
Acknowledgement	ix

Chapter 1: The Coverage of the Existing Definition of Prescribed Interest

RELEVANT DEFINITIONS	1 - 6
THE FUNCTIONS OF THE DEFINITION OF "PRESCRIBED INTEREST" IN COMPANIES AND SECURITIES LEGISLATION	6 - 10
WHAT IS COVERED BY PARAGRAPH (a) OF THE DEFINITION OF PARTICIPATION INTEREST?	10 - 13
WHAT IS COVERED BY PARAGRAPH (b) OF THE DEFINITION OF PARTICIPATION INTEREST?	13 - 14
WHAT IS COVERED BY PARAGRAPH (c) OF THE DEFINITION OF PARTICIPATION INTEREST?	14 - 17
THE SIGNIFICANCE OF EXISTING REGULATORY REGIMES	17 - 20
EXCLUSIONS FROM THE DEFINITION OF PARTICIPATION INTEREST	20 – 27
Time sharing schemes	20 – 21
Shares & debentures	21 – 24
Life insurance policies	24 – 26
Partnership agreements	26 - 27

	Page Ref.
LEGISLATIVE PURPOSE AND TRENDS IN THE INTERPRETATION OF THE DEFINITION OF "PRESCRIBED INTEREST"	27 - 31
UNCERTAINTY ARISING FROM THE EXISTING DEFINITION	31 - 34
THE EXEMPTION POWERS	34 - 37
PUBLIC OFFERINGS	37 - 39
OFFERINGS OF LOAN SECURITIES ETC. CIVIL RIGHTS OF ACTION	39

Chapter 2: Definitions Elsewhere

UNITED STATES OF AMERICA	43 – 57
CANADA	57 – 62
UNITED KINGDOM	62 – 75
NEW ZEALAND	75 - 79

Chapter 3: Possible Re-Definition of the Regulatory Area's Boundary

THE CRITERIA FOR APPLICATION OF THE COMPANIES AND SECURITIES LEGISLATION	80 - 87
THE INCLUSIVE PART OF THE DEFINITION OF PRESCRIBED INTEREST	87 - 91
EXCLUSIONS FROM THE DEFINITION OF PRESCRIBED INTEREST	91 – 92
A POSSIBLE APPROACH	93
THE PLACE OF THE REFORMULATED DEFINITION IN THE REGULATORY SCHEME	93 - 94

Page Ref.

Chapter 4: Prescribed Interests having Fiduciary Elements

FIDUCIARY AND NON-FIDUCIARY PRESCRIBED INTERESTS	95 - 96
UNIT TRUSTS AND CONTRACTUAL PRESCRIBED INTERESTS CONTRASTED	96 - 98
NEED FOR INVESTMENT OPPORTUNITIES PUBLICLY OFFERED TO BE DESCRIBED AS FIDUCIARY OR NON-FIDUCIARY	98 - 101
DIVISION OF FUNCTIONS: THE POSITION OF TRUSTEE AND MANAGER OF A PUBLIC UNIT TRUST	101 - 106
REMUNERATION OF TRUSTEE OR OTHER ADMINISTERING PERSON	106
ACQUISITION OF INVESTOR'S INTEREST BY TRUSTEE OR OTHER ADMINISTERING PERSON	106 - 107
APPLICATION OF PERPETUITIES DOCTRINE TO PRESCRIBED INTEREST UNIT TRUSTS	107
APPLICATION OF CASA PRINCIPLES	107 - 108
DISCLOSURE OF SUBSTANTIAL UNIT HOLDINGS	108
RECONSTRUCTION OF SCHEMES	108
RESIDUAL DISCRETION IN THE NCSC TO RELAX RESTRICTIONS	109

Chapter 5: NCSC Rule-Making power over Prescribed Interests

THE FUNCTION OF A RULE-MAKING POWER	110 - 112
AMBIT OF NCSC RULE-MAKING POWER	112 - 116
REVIEW OF RULE-MAKING POWER	117
ABILITY OF NCSC TO DEAL WITH COLLECTIVE INVESTMENT VEHICLES AS A WHOLE	117 - 118

APPENDIX

The Evolution of the Current Definition of "prescribed interest"	(i) - (xiv)

Companies and Securities Law Review Committee

Function and Membership

The Companies and Securities Law Review Committee was established late in 1983 by the Ministerial Council for Companies and Securities pursuant to the inter-governmental agreement between the Commonwealth and the States of 22nd December, 1978.

The Committee's function is to assist the Ministerial Council by carrying out research into and advising on law reform in relation to legislation concerning companies and the regulation of the securities industry.

The Committee consists of five part-time members, namely:

Mr. Reginald I. Barrett
Mr. Geoffrey W. Charlton
Mr. David A. Crawford
Professor Harold A.J. Ford (Chairman)
Mr. Anthony B. Greenwood.

The full-time Research Director for the Committee is Mr. John B. Kluver.

The Committee's office is at Level 24, M.L.C. Centre, 19-29 Martin Place, Sydney, New South Wales, 2000.

General Aims of the Committee

To develop improvements of substance and form in such parts of companies and securities law as are referred to the Committee by the Ministerial Council and for that purpose to develop proposals for laws:

* which are practical in the field of company law and securities regulation;

* which facilitate, consistently with the public interest, the activities of persons who operate companies, invest in companies or deal with companies and of persons who have dealings in securities; and

* which do not increase regulation beyond the level needed for the proper protection of persons who have dealings with companies or in relation to securities.

In the identification of defects and the development of proposals to have regard to the need for appropriate consultation with interested persons, organisations and governments.

The Reference from the Ministerial Council

The Committee has 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.

Aim and Structure of this Discussion Paper

The Committee's purpose in preparing this Discussion Paper is to address in detail the issues arising from the Ministerial Council reference. The Committee decided that for the purpose of structuring the Discussion Paper, it was preferable to discuss element (B) in advance of element (A) of the Ministerial Council Reference.

Element (B) Legislative Criteria

The Discussion Paper seeks to identify various definitional criteria that might be adopted in determining those investment opportunities to which the prescribed interest provisions of the Companies and Securities legislation should apply. In furtherance of this task:

* Chapter 1 reviews the coverage of the existing Australian definition of prescribed interest;

* Chapter 2 examines how other common law countries (USA; Canada; UK and New Zealand) have responded to similar definitional problems;

* Chapter 3 considers a range of possible reformulations of the general criteria that might mark the outer limits of operation of the Companies and Securities legislation in terms of coverage of investment opportunities.

The principal issues arising from these Chapters and for which submissions are sought by the Committee are summarised below.

Element (A) Regulation of Prescribed Interest Schemes

The Discussion Paper raises two broad issues which the Committee believes are central to the regulation of investment opportunities falling within the prescribed interest ambit of the Companies and Securities legislation:

* Chapter 4 looks to the presence of fiduciary elements within prescribed interest schemes and

considers whether there is a need for the legislation to more adequately reflect the presence or absence of fiduciary elements in such schemes;

* Chapter 5 focuses on the problem of the diversity of investment opportunities that would fall within the definition of prescribed interests (notwithstanding any reformulation that may arise consequent to this Discussion Paper). The Chapter raises for public debate the merits of giving the NCSC a rule-making power over prescribed interests whereby the Commission could set standards appropriate to different forms of prescribed interest.

The principal issues arising from these Chapters and for which submissions are sought by the Committee are summarised below.

Principal Issues for Consideration

Comment is sought on the following issues that have been raised in this Discussion Paper.

Element (B): Legislative Criteria (Chapters 1-3)

The Definitions of Prescribed Interest and Security

* What are the basic criteria for the application of the Companies and Securities legislation, that is, what guidelines should be used in the formulation of the basic definitions of "prescribed interest" and "security"?

* Which of the nine possible methods of formulating the definition of prescribed interest outlined in Chapter 3

is the most suitable for Australian conditions or are there other possibilities not raised which are considered superior?

* Should the powers to exempt from the definition of prescribed interest by regulation or the NCSC be increased, particularly as regards the NCSC's powers under the Securities Industry Act and Codes?

* What general criteria should guide the exercise of the exemption powers (for example, the existence of alternate regulatory regimes)?

* Should there be more specific legislative exemptions from the definitions of prescribed interest and security for particular types of transactions, and if so, which transactions? (Submissions making a case for a specific legislative exemption should have regard to the matters raised in Chapters 1 and 3.)

* Should the existing specific legislative exemptions for life insurance policies and certain partnership interests be altered or removed?

The Structure of the Companies and Securities Legislation

* Should the current separate treatment in the Companies legislation as regards prospectuses for shares and debentures on the one hand and prescribed interests on the other hand be continued or should the treatment be unified so far as possible?

* Should the material concerning prospectuses and sharehawking be removed from the Companies legislation and consolidated into one statute with the current Securities Industry legislation?

* In what event should the matters currently treated in the definition of prescribed interest and associated definitions appear in a general definition of security?

Other Matters

* Should there be an addition to the Companies Act s5(4) to exclude the need for a prospectus where a prescribed interest scheme solicits loan funds from its investors?

* Should the effects of the doctrine of illegality be modified for particular situations or generally under the Companies and Securities legislation?

Element (A): Regulation of Prescribed Interest Schemes (Chapters 4-5)

Prescribed Interests having fiduciary elements

* Should use of the expression "trust" in relation to offerings of prescribed interest be limited to trusts that exhibit typical general law features of trusts?

* Should all prescribed interests be required to be described as fiduciary, partly fiduciary or non-fiduciary?

* Should special rules be provided for managers of trust or fiduciary prescribed interests such as limitations on exclusion of liability and expressly clarifying their trustee status?

* Should the rule against perpetuities be excluded for offerings of prescribed interests?

* Should acquisition of shares and substantial shareholding provisions be extended to unit trusts? Other types of prescribed interests?

* Should provisions for schemes of reconstruction be extended to unit trusts? Other types of prescribed interests?

Rule-making Power for the NCSC

* Should the NCSC have an explicit rule-making power whereby it could set standards appropriate to different types of prescribed interest?

* If so, what should be the ambit of such a power?

* Should such a power extend to collective investment vehicles as a whole, that is, include companies used for collective investment?

* If so, what should be the fate of the investment company provisions of the current Companies legislation?

Submissions on Other Matters

Comment is sought on any other matters in the general area of prescribed interests where it is felt that modification of the current legislation or administrative practice is in order.

Invitation for Responses

The Committee invites written submissions on the matters dealt with in this Paper.

The Committee will assume that it is free to publish any submission, in whole or in part, unless the respondent indicates that the submission is confidential. All respondents will, in any event, be listed in any report made by the Committee to the Ministerial Council.

Submissions should be sent to:

Mr. J. Kluver,
Research Director,
Companies and Securities Law Review Committee,
Level 24,
MLC Centre,
19-29 Martin Place,
SYDNEY. 2000

By 31st August, 1987.

Acknowledgement

In preparing this Discussion Paper, the Committee appointed as its consultant Mr. R. Vann, Associate Professor, University of Sydney Law School. Mr. Vann provided a valuable and substantial contribution arising from his expertise in this area, particularly with respect to Chapters 1-3 of this Discussion Paper, and for which the Committee expresses its appreciation.

CHAPTER 1

THE COVERAGE OF THE EXISTING DEFINITION OF PRESCRIBED INTEREST

Relevant Definitions

It is widely accepted that the existing definition of "prescribed interest" is not wholly satisfactory. Before considering how it might be improved an examination of its present coverage is needed. Given that matters of definition are involved, this chapter requires an approach in considerable detail.

The Companies Act 1981 (Cth) (as applied in the States, the New South Wales Code being quoted by way of example) in s5(1) defines[1] "prescribed interest" as follows:

(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.

That definition contains expressions defined elsewhere in s5(1). The most important of these is the definition of "participation interest" which until recent amendments was the definition of "prescribed interest" and forms the main focus of this chapter. That definition is as follows:

"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 State or elsewhere;

1. For the legislative history, see Appendix

(b) in any common enterprise, whether in the State 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.

Other defined terms of importance are as follows:

"time-sharing scheme" means a scheme, undertaking or enterprise, whether in the State or elsewhere:

(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 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;

"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 State or elsewhere, that, under, or in accordance with, the terms of 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 State or elsewhere, acquired in or under like circumstances;

"share" means share in the share capital of a corporation, and includes stock except where a distinction between stock and shares is expressed or implied;

"debenture" includes debenture stock, bonds, notes and any other document evidencing or acknowledging indebtedness of a corporation in respect of

money that is or may be deposited with or lent to the corporation, whether constituting a charge on property of the corporation or not, but does not include:

(a) a document that merely acknowledges the receipt of money by a corporation in a case where, in respect of the money, the corporation issues, in compliance with s97, a document prescribed by subsection (2) of that section and complies with the other requirements of that section;

(aa) a document issued or executed by a banking corporation in the ordinary course of its banking business, being a document that evidences or acknowledges indebtedness of the corporation arising in the ordinary course of that business;

(b) a cheque, order for the payment of money or bill of exchange;

(c) a promissory note having a face value of not less than $50,000; or

(d) for the purposes of the application of this definition to a provision of this Code in respect of which the regulations provide that the word "debenture" does not include a prescribed document or a document included in a prescribed class of documents - that document or a document included in that class of documents, as the case may be.

The Securities Industry Act 1980 (Cth) (as applied in the States, the New South Wales Code being quoted by way of example) s4(1) contains a series of similar but not identical definitions. It defines "securities" as follows:

(a) debentures, stocks or bonds issued or proposed to be issued by a government;

(b) debentures, stocks, shares, bonds or notes issued or proposed to be issued by a body corporate or unicorporate;

(c) an option contract to which this Code applies; or

(d) a prescribed interest,

but does not include:

(e) bills of exchange;

(ea) a futures contract within the meaning of Futures Industry (New South Wales) Code or of the provisions of a law in force in a

participating State or in a participating Territory that corresponds with that Code;

(f) promissory notes;

(g) or certificates of deposit issued by a banking corporation;

[NOTE: As from 1 July 1987 para. (f)-(j) of the definition of "securities" reads:]

(f) promissory notes;

(g) certificates of deposit issued by a banking corporation;

(h) in a case where:

(i) there is attached to a share or debenture a right to participate in a retirement village scheme; and

(ii) each of the other rights, and each interest (if any), attached to that share or debenture is a right or interest that is merely incidental to the right referred to in sub-paragraph (i),

that share or debenture; or

(j) a prescribed interest that is constituted by a right to participate in a retirement village scheme.

There is a definition of "share" in s4(1):

"share" means share in the share capital of a body corporate, and includes stock except where a distinction between stock and shares is expressed or implied.

The Act contains no definition of "debenture".

"Prescribed interest" is defined in s4(1) as follows:

(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.

That definition refers to other expressions that are specially defined. Again the most important is the definition of "participation interest" as follows:

"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 New South Wales or elsewhere;

(b) in any common enterprise, whether in New South Wales 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.

Other relevant definitions are:

"time-sharing scheme" means a scheme, undertaking or enterprise, whether in New South Wales or elsewhere -

(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 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;

"investment contract" means by 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 New South Wales or elsewhere, that, under, or in accordance with, the terms of 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 New South Wales or elsewhere, acquired in or under like circumstances.

Whilst the general structure and wording of the definitions of prescribed interest and participation interest in each piece of legislation are almost identical, there can be differences in their operation. The initial discussion of the inclusive parts of the definition will, however, discuss both pieces of legislation together and differences will be highlighted subsequently (especially in relation to the discussion of exclusions from the definition of participation interest).

It will be seen that the current definition of "prescribed interest" when it refers to "a right ... to participate in a time-sharing scheme" calls in aid a functional classification of specific types of opportunities but the remainder of the definition as elaborated through the definition of "participation interest" is in general terms[2]. In the

2. Recent amendments which are to operate from 1 July 1987 also adopt a functional approach to retirement village schemes.

interpretation of those general provisions it has become apparent that, although some of the words used, such as "right" and "interest", are terms of art in law, the context requires that they be read in a non-technical sense.

interpretation of those general provisions it has become apparent that, although some of the words used, such as "right" and "interest", are terms of art in law, the context requires that they be read in a non-technical sense.

It needs to be stressed that it is the surrounding language rather than any view as to underlying legislative policy that has led courts to conclude that the inclusive part in the definition employs certain words in a non-technical sense. If wide non-technical terms have to be applied without regard to consequences and without an appreciation of underlying legislative purposes - either because those purposes are not apparent or because, although apparent, they are considered irrelevant - there will on occasion be misapplications of the policy of the law. Later in this paper there will be consideration of how to reconcile the use of a broad definition in order to ensure that investors are given protection against spurious schemes while at the same time aiming to avoid misapplication of the general formula.

In order to understand how and why the courts have taken a very broad approach, it will be necessary to look in some detail at what the courts have said about the definition. Before doing that it will assist in the discussion to outline the functions that the definition of "prescribed interest" serves in the companies and securities legislative scheme.

The functions of the definition of "prescribed interest" in companies and securities legislation.

The Companies Act 1981 (Cth) represents over a century of evolution of modern company law. It is not surprising that the legislation has grown by stages to cover different situations as it appeared that some form of regulation was warranted.

Thus there have been since the turn of the century provisions requiring a prospectus to be registered for a public offering of shares or debentures and the modern descendant of these

provisions may be found in Part IV Division 1 of the Companies Act. Within that general area there have been specific legislative initiatives at various times. For example, the requirements with regard to public offerings of debentures as concerns the trustee for debenture holders and the provisions of the trust deed are now elaborated in Part IV Division 4 which dates largely from 1964, while the provisions dealing with advertisements and media comment on public offerings of shares and debentures in Part IV Division 1 were substantially revised in the 1970s.

After the prospectus provisions, the next major development was the share hawking prohibitions dating from the 1930s, now found in s552 of the Companies Act. These bolster the protection of the prospectus provisions by prohibiting or controlling various selling practices in relation to a wide range of investments. It was in these provisions that investment opportunities beyond the range of shares and debentures were first attempted to be regulated.

The major effort to regulate these other kinds of investment opportunities occurred in the 1950s when the progenitor of the current prescribed interest definitions and prohibitions was enacted (see Appendix: The Evolution of the Current Definition of Prescribed Interest for further details). In this legislation Australia broke new ground. Up to this time most Australian legislation in the area copied English models (though Victoria was noteworthy for a number of innovations). The method adopted was to enact separate provisions for the regulation of public offerings of prescribed interests rather than incorporating them in the original prospectus provisions, though the general outlines were very similar to the regime for debentures (especially regarding the need for a trustee and regulation of the contents of the trust deed). These provisions are now found in Part IV Divison 6 of the Companies Act.

Although this legislation was home grown it followed the English tradition of separately legislating for specific types of investment opportunity. The securities industry

legislation which represented the next main initiative adopted a different tradition. Here the model was clearly derived from North America where the practice has been to legislate separately from companies or corporations statutes for public offerings of and markets in securities. The main model is the New Deal legislation of the 1930s in the U.S. resulting from the Wall Street crash of 1929. Rather than dealing discretely with different types of investment opportunities, this legislation starts with a comprehensive definition of what is a security and then regulates various activities with respect to securities.

In adapting this model to Australia, the existing concepts of shares, debentures and prescribed interests were lifted from the companies legislation and used as the basis of the definitions of "securities"[3]. The securities industry legislation (now embodied in the Securities Industry Act 1980) then proceeded to require registration of dealers etc. in securities, to regulate the public securities markets and to prohibit certain market practices in relation to securities such as insider trading. The notable difference from the North American models was the omission of matters already covered by the companies legislation in relation

3. There is a definition of "securities" in the Companies Act 1981 s5(1) as follows: "securities" in relation to a corporation means:

(a) shares in, or debentures of, the corporation
(b) any unit in any such shares or debentures
(c) any prescribed interest made available by the corporation;

This definition, however, has little importance in the Act as most operative provisions refer directly to shares, debentures or prescribed interests. There is what effectively amounts to another definition of securities in s552(14) which states.

In this section, "shares" means shares in a corporation and includes:

(a) debentures and units and (without affecting the generality of the expression "debentures") all such documents (including those referred to as "bonds") as confer or purport to confer on the holder of the documents any claim against a corporation, whether the claim is present or future, certain or contingent, or ascertained or sounding only in damages; and
(b) prescribed interests.

4. This provision relates to prohibitions on share hawking.

to prospectuses for public offerings of securities and share hawking. This difference was recognised in the title of the legislation referring to the securities industry rather than generally to securities as in the case of North American statutes.

The definition of prescribed interest thus performs a number of different functions in the Australian legislative context. First, it operates in an independent fashion in the companies legislation in relation to the requirement for a prospectus where there is a public offering of prescribed interests. In this case the purpose, as with prospectus provisions generally, is to provide information to potential investors and the market in relation to the investment opportunity in question.

Secondly, it operates as part of the sharehawking provisions to control certain practices in the public marketing of investment opportunities. In this case the purpose is of a consumer protection kind to guard against overbearing selling practices. In this respect the operation of the definition is more akin to the securities industry legislation in that it is grouped together with other kinds of securities (shares, debentures, etc.) for the purpose of regulating the sale of investment opportunities. Links with the prospectus provisions are maintained with an express reference to public marketing and to information requirements.

Thirdly, in the securities industry legislation the definition of "prescribed interest" is part of a comprehensive concept of securities and serves to control dealing practices as well as regulating participants in the industry and the markets themselves. No express requirement of public offering is involved though in the nature of things the industry participants will generally be dealing with the public and the markets will be public markets. This legislation is not so much concerned with ensuring a flow of information but achieves its purpose by direct regulation and prohibitions to maintain public confidence in the markets and their participants.

The prospectus area tends to predominate in discussions of the definition of prescribed interest. However, it is not possible to isolate the different purposes that the definition of "prescribed interest" serves and so all are considered hereafter. By the same token it is impossible to discuss the definition divorced from its various contexts and it is necessary later to advert to some larger questions such as the current method of dealing with similar kinds of regulatory issues in different legislation[4].

For the present the discussion is best advanced by considering the three inclusive paragraphs of the definition of "participation interest" which form the heart of the definition of a "prescribed interest" and then to turn to the exclusions from that definition.

What is covered by paragraph (a) of the definition of participation interest?

Before para(a) is attracted there must be a "financial or business undertaking or scheme". The words are said to be of "very wide import": Australian Softwood Forests Pty Ltd. v A-G (NSW) (1981) 148 CLR 121 at 129 per Mason J who also said that "all that the word 'scheme' requires is that there should be 'some programme, or plan of action'." It must, however, be a financial or business plan of action which suggests that the plan must involve the deployment of money or money's worth.

Paragraph(a) does not require that the undertaking or scheme be presently carried on or be proposed to be carried on by the promoter of the opportunity. Nor does para(a) confine the undertaking or scheme to one which would result from an offeree taking up an opportunity offered. The undertaking or scheme could be one carried on by a third person. Recognition

4 It is to be noted that the NCSC is currently conducting its own inquiry into the law relating specifically to prospectuses. The current trend to scrutinise government regulation in many different areas provides an impetus for raising the larger issues, as the current framework of the companies and securities legislation in the field of inquiry has grown up in a haphazard fashion over time.

that para(a) is not concerned with the identity of the person or persons who carry on the undertaking or scheme was given by Mason J in the Australian Softwoods case: 148 CLR at 129.

An undertaking or scheme within para(a) may be a plan of action to be taken by one person or by several persons. It may require parallel action by several persons or it may require action of one kind from one person and action of another kind from another person. The notion of an undertaking or scheme does not imply that there must be "joint participation in everything comprised in the plan" or that there must be a pooling of effort or resources: Australian Softwoods case: 148 CLR at 129.

In the Australian Softwoods case Mason J thought that, apart from any consideration which may be derived from the general context in which the statutory definition appears, there was no very good reason for reading down the expression "financial or business undertaking or scheme". In that case the definition in question was that of "interest" appearing in the Companies Act 1961 (NSW). Therefore, the context was concerned with offerings to the public. The context differs from the context of the definition appearing in the Securities Industry Act 1980 (Cth) which is not confined to public offerings. As it was, in the Australian Softwoods case, Mason J did not proffer any general statement as to the effect of the context on the expression "financial or business undertaking or scheme" but merely concluded that the context in the Companies Act supplied no reason for denying that the particular forestry opportunity under consideration by the Court constituted a "financial or business undertaking or scheme" within the meaning of the statutory definition.

It has been part of the context of the statutory definition in the previous Companies Acts and the current Companies Act that the "financial or business undertaking or scheme" is something capable of being wound up under an order of the appropriate

Supreme Court[5]. In the cases interpreting para(a) nothing has been made of this part of the context. Probably, it supplies no basis for narrowing down the meaning of the phrase.

Given the wide interpretation of "financial or business undertaking or scheme" adopted by the High Court, para(a) could potentially apply where the opportunity offered related to practically any business enterprise of the sponsor or acceptor, regardless of its scale, regardless of whether an acceptor acquired tangible property or merely intangible property, regardless of whether the acceptor parted with value in exchange for some benefit, regardless of whether the acceptor hoped to receive back the value he parted with and regardless of whether the acceptor became passively dependent on the control of another over the value he had given up.

However, that assessment leaves out of account any narrowing down of para(a) which might be brought about by the words "any right to participate, or interest ... in any profits, assets or realisation" of any financial or business undertaking or scheme. One meaning of "interest" is a right to property. If that meaning were appropriate to para(a), there would be a narrowing down so that the paragraph would cover only those opportunities which held out the chance to acquire a proprietary interest in relation to a plan of action. That would exclude an opportunity which involved the acquisition of a merely contractual right against identified persons so that they would be personally liable but without the acceptor of that opportunity having any legal or equitable claim in respect of particular property. Opportunities in the form of a beneficial interest under a trust would be included but purely contractual opportunities would be excluded.

However in the Australian Softwoods case, it was accepted that "interest" is not confined to a proprietary interest. The association of the word "interest" with the expression "right

5. In the current Companies Act 1981 (Cth), see s175. In the earlier Uniform Companies Acts, see s87.

to participate" suggests the enlarged meaning: Australian Softwoods case 148 CLR at 133[6].

With so wide a meaning for "financial or business undertaking or scheme" and a non-technical meaning for "interest", the limits of para(a) are not apparent. There is a probability that it will apply to opportunities outside the investor protection policy sought to be implemented in Companies Act Part IV Division 6 and the securities industry legislation, a matter returned to below.

What is covered b paragraph (b) of the definition of participation interest?

Paragraph(b) became part of the definition of "interest" in the Victoria Companies Act by an amendment made by the Companies Act 1960 (Vic). Paragraph(b) was taken from an American source. It comes from the judgment of Murphy J of the United States Supreme Court in S.E.C. v W.J. Howey Co. (1946) 328 US 293 expounding the meaning of the expression "investment contract" as it appears in the statutory definition of "securities" in s2(1) of the Securities Act of 1933[7]. An investment contract was stated by Murphy J to be:

a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.

In Australia a literal reading by the courts of para(b) has produced the following propositions.

An opportunity may be an interest in a common enterprise even though it is not proprietary: Australian Softwoods case 148 CLR at 121. Similarly an opportunity may be an interest in a common enterprise not only where several persons are to act together jointly but also where there are to be two (or more)

6. Although a "right to participate or interest" need not be a proprietary right or interest not every right against another person in relation to property has been held to be covered. In Butterworth v Lezemo Pty. Ltd. (1983) 8 ACLR 737, Nicholson J of the Supreme Court of Victoria held that a licence given to a franchisee to use industrial property belonging to the franchisor was not a "right to participate or interest" in assets of the franchisor; his decision was followed in Streeter v Pacific-Seven Pty Ltd. (1985) 3 ACLC 430.

7. Reproduced in the next chapter.

closely connected operations united by an overall purpose, one operation to be carried out by one person and the other to be carried out by another person: Australian Softwoods case 148 CLR at 133 per Mason J and at 141 per Wilson J.

Courts in the United States have generally excluded from the concept "investment contract" opportunities which are for the satisfaction of some personal need such as housing (United Housing Foundation Inc. v Forman (1975) 421 US 837 at 852-3) but this approach was not thought to be open to the Victorian Full Court in A Home Away Pty Ltd. v C.A.C. (Vic) [1981] VR 475.

In the result para(b) of the definition of participation interest has been applied in a number of varied situations though not as frequently as para(a).

What is covered b paragraph (c) of the definition of participation interest?

Paragraph(c) which relies on the definition of "investment contract" quoted at the beginning of this chapter applies when the opportunity offered contemplates that other investors should acquire or may acquire rights similar to those offered to the investor in question. The rights thus acquired in parallel are to be rights in respect of property and they are to be rights used in common with the rights of the other investors.

Paragraph(c) was applied by Street CJ in Equity in C.A.C. (NSW) v M.G. Securities Australasia Ltd. (1974) CLC 27,761 and by Pape J in Waldron v M.G. Securities Australasia Ltd. [1975] VR 508 where a company invited the public to deposit money at interest on terms that each investor's contribution could be combined with the moneys of other investors to be laid out on a mortgage-secured loan with the intention of earning interest for each investor during the period that his money was so laid out either in that loan or in another loan in conjunction with the moneys of other investors. Pape J took it that the last part of para(c) was attracted because each investor's money which was channelled into a particular mortgage was used and employed in connection with the money of the other investors.

Paragraph(c) was also considered by McPherson J in Munna Beach Apartments Pty Ltd. v Kennedy [1983] 1 Qd R 151 in which purchasers of a home unit on a plan later registered under the Building Units and Group Titles Act 1980 unsuccessfully resisted proceedings by the vendor for specific performance on the ground that the sale was the sale of an "interest" and did not comply with the Companies Act 1961 (Qld). His Honour first read para(c) literally and stated the following conditions for its application:

(i) there must be a contract which provides not just for the payment of money but for investment in the sense of money being laid out with a contemplation of return;

(ii) 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;

(iii) which interest or right (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 acquired in or under like circumstances.

The last condition differs from the view of Pape J: whereas he looked to the pooling of the investors' contributions, McPherson J read para(c) as referring to commonality in the employment of each acquired right or interest as between the investors.

Applying the literal interpretation, McPherson J held that an offering for sale of a strata home unit, together with an undivided share in the common property of the apartment building was not an offer of an "interest". Element (ii) of para(c) was present but the other elements were absent. As to element (i), the contract did not provide for investing. In regard to element (iii), ownership of a share of the estate in fee simple in common property was a legal abstraction not capable of being "used or employed in common with" the similar ownership of others. Nor would contemporaneous exercise by two or more tenants in common of their several similar rights be a use in common. Even if it were, it would not be a common use "under or in accordance with the terms of the investment": it would be more a consequence of the buyer's common law rights as a tenant-in-common rather than of any terms of the investment.

In the Munna Beach Apartments case McPherson J after applying a literal interpretation felt free to go further and to test the matter on another basis because para(c) unlike paras(a) and (b) expressly invites consideration of the substance of the opportunity. In his view that fact made relevant a distinction which had been developed in some United States cases between an investment in real estate, with the hope, perhaps, of earning a profit as a result of the general increase in values concurrent with the development of the neighbourhood, and an investment in real estate as part of an enterprise whereby it is understood that the property will be developed or operated by others[8]. The former is not an "investment contract" within the United States legislation while the latter could be.

Later cases held that paras(a) and (b) of the definition of participation interest were also not attracted by the sale of home units "off the plan"[9]. This conclusion was reached even where the purchaser did not have any right to occupy the unit purchased but was required to make it available for rental under an agency agreement. The results in the latter decisions certainly do not accord with the distinction drawn by McPherson J on the basis of U.S. decisions.

Moreover it is a curious fact that little investigation occurs in these cases of the relationship of the parties during the often lengthy period between the making of the contract and the registration of the plan which creates separate titles to the home units being sold. It is understood that in many sales of home units "off the plan" the purchaser's deposit was not treated in the normal way of being held in trust or by a stakeholder pending settlement, but rather went immediately to the vendor and was used in helping to finance the construction of the home unit building in question.

8. Loss, Securities Regulation (Boston: Little Brown, 2nd ed., 1961) Vol. 1 at 491-492.

9. The main cases are Brisbane Unit Development Corp. Pry Ltd. v Deming No. 456 Pry Ltd. [1983] 2 Qd R 92, Jones v Acfold Investments Pty Ltd. (1984) 8 ACLR 488, and Maunder-HartiKan v Hamilton (1984) 8 ACLR 937.

The need for the protection of the companies and securities legislation may be doubted when the purchaser is treated in the normal way in a conveyancing transaction and is not put at any real risk until the vendor transfers title. However, when the purchaser's deposit is put at risk and is used to finance the activities of the vendor, then the transaction arguably has many of the hallmarks of the type aimed at by the definition of "prescribed interest". The purchaser has no significant interest in tangible property prior to the registration of the plan which creates the home units; his rights are contractual ones against the vendor and his money is effectively pooled and at risk with the money of other purchasers to fund construction.

The significance of existing regulatory regimes

The comments in the previous paragraph introduce an important issue of general principle as to the scope of the definition of prescribed interest. The regulatory regime for prescribed interests does not exist in isolation; the legal system has many different regulatory regimes for dealing with various activities, including financing and investment activities. Inevitably questions of overlap arise, most often at the boundary of different regulatory regimes.

In the case of real estate, there is in each State and Territory a substantial body of statute law dealing with transactions in real estate and the participants in the real estate industry. Hence the necessity for further protection under the prescribed interest legislation is not self evident. A judgment is required whether existing legislation dealing specifically with real estate provides sufficient protection for investors and others; and if not, whether the prescribed interest regime is the appropriate method of further regulation and in what areas additional protection is required.

The issue is well demonstrated by the Munna Beach Apartment case and other cases decided in Queensland at about the same time[10]. In these cases the effect of Queensland legislation dealing with home units and real estate agents was raised alongside the arguments regarding prescribed interests. It was ultimately held by the High Court of Australia that on the facts of one of the transactions, the purchasers were able to avoid the sale contract under the home units legislation[11]. The issue of whether the prescribed interest legislation should be held not to apply because there was other adequate protective legislation was not directly decided in the case as the regulatory regimes involved were generally considered to be operating in parallel. It is noteworthy, however, that in the Munna Beach Apartments case McPherson J left open the question of whether the relevant legislation dealing with real estate transactions was to be interpreted as excluding the operation of the prescribed interest legislation.

Real estate has been regarded as a difficult issue in relation to the operation of the prescribed interest definition in other areas besides sales of home units "off the plan", for example, time sharing and retirement villages, and in this regard Australia's experience is mirrored in other countries as explained in the next chapter. Other areas where similar issues arise (and which are discussed in other contexts below) are the life insurance and banking industries. Each of these is subject to separate Commonwealth regulation and as a result is subject to privileged treatment under the companies and securities legislation.

A number of problems arise in the attempt to co-ordinate other regulatory regimes with the prescribed interest procedures.

10. See Kinsella, "Real Estate Transactions as 'Prescribed Interests' under the National Companies Legislation" (1984) Australian Business Law Review 92-125 for references to the other cases.

11. Deming No. 456 Pt v Brisbane Unit Development Corporation Pty Ltd. (1983) 155 CLR 129.

First, where the other regime is a matter of State and Territory law it is very likely that there will not be uniformity of treatment under all relevant laws. As a result the exclusion of the prescribed interest rules may be judged appropriate for one jurisdiction but not another.

Secondly, both regulatory regimes will very likely undergo change over time so that an exclusion of double regulation may be thought appropriate at one stage of development of the law but not another. It does not seem possible to deal with this problem by means of some general directive in the legislation for the NCSC or the courts to weigh the relative merits of different regulatory regimes as greater uncertainty would result than exists under current law. Moreover, the resources necessary to monitor changes in other regulatory regimes in order to consider the problem on an on-going basis may well not be available to the NCSC, or other matters may be regarded as of higher priority.

An express exclusion (whether total or partial) from the prescribed interest rules may be the most appropriate method of correlating different regulatory regimes. This can be achieved by legislation or by the making of regulations or under discretionary powers vested in the NCSC or by a combination of these methods. In fact there currently exists the machinery for exclusion by regulation and exemption by the NCSC. In practice the regulation power is little exercised, while the NCSC's powers are used to modify rather than exclude the prescribed interest provisions. There is no reason, however, why attention should not be directed in future to the issue of dual systems of regulation of certain activities and the possible exclusion of the prescribed interest provisions, especially in the prevailing climate of deregulation.

The Committee has not directed its attention in detail to specific cases of dual systems of regulation except by way of illustration of the general problem. The Committee therefore seeks comment from affected parties as to cases which may

warrant total or partial exclusion from the prescribed interest definition and the mode in which such exclusion should be achieved. Such comment should set out in sufficient detail the other system of regulation in order to demonstrate why that system is considered adequate to justify total or partial exclusion from the prescribed interest regime.

Where an exclusion of a specific kind is included in the legislation it is inherently more inflexible and (unless the exclusion serves the purely technical function of co-ordinating different parts of the companies and securities legislation) the case for the exclusion needs to be carefully considered. The discussion therefore now turns to the existing legislative exclusions from the definition of prescribed interest.

Exclusions from the definition of participation interest

There are currently four exclusions from the definition, two of which (life insurance policies and partnership interests) relate to policy decisions about the coverage of the definition and two of which (time sharing schemes and shares and debentures) are explicable by the structure of the companies and securities legislation which has been outlined above. Prior to recent amendments an exemption power appeared along with the four exclusions referred to above as part of the definition of prescribed interest. Now the exemption power is still found in the definition of prescribed interest while the other four exclusions are part of the definition of participation interest. The exemption power is referred to further below.

Time Sharing Schemes

The exclusions relating to time-sharing schemes and shares and debentures are explicable in that they are dealt with elsewhere in the companies and securities legislation, that is, the exclusions are intended to operate as a technical method of reconciling the coverage of the various regulatory schemes of the legislation.

In the case of time sharing schemes, modifications were effected to the legislation in 1984 to ensure that the wider protection of the prescribed interest provisions (as compared to public offerings of shares) could not be avoided by attaching time-sharing rights to shares and relying on the exclusion of shares from the then definition of prescribed interest. Prior to the 1984 amendments an issue of shares to the public required a prospectus and a dealers licence whereas time-sharing that involved a prescribed interest added the obligation to appoint a trustee with a trust deed, the contents of which are detailed in the legislation. Now all time-sharing schemes are subject to the prescribed interest provisions through a separate definition and specific inclusion in the definition of prescribed interest.

In turn this led to an exclusion from the general definition of participation interest for time-sharing schemes. There was no complementary exclusion from the definition of a share and as a result there is the possibility of a double registration requirement for a time-sharing prospectus where rights are attached to shares, once under the prospectus provisions relating to shares and again under the prescribed interest provisions. No doubt the administrative difficulties can be resolved by a sensible administrative approach but the drafting leads to a lack of structural logic in the legislation and wider ramifications with unintended results may arise, for example, in relation to civil liabilities discussed below.

Shares & Debentures

In the case of the exclusion of shares and debentures from the definition of participation interest, the same kind of structural problems are present. Prospectus requirements for shares and debentures are found in Companies Act 1981 Part IV Divisions 1 and 5 and the exclusion is intended to prevent a doubling up of registration of prospectuses, and more importantly, to preclude the trustee and trust deed mechanisms relating to prescribed interests under Part IV Division 6 (in the case of debentures there is a special regime of a similar kind under Division 5). However, in a number of not uncommon cases, the exclusion will not be effective.

For example, units in shares and debentures are covered by many of the provisions of Part IV Division 1 by reason of the definition of "prospectus"[12] but are not excluded from Division 6 because the exclusion of shares and debentures does not cover units in shares or debentures. This leads to a double registration requirement and the need for a trustee and trust deed in cases where it may be doubted that such a result was intended[13].

Moreover, the current drafting seem to abort some intended exceptions from the legislation. The Companies Act 1981 s5(1) has a definition of debenture which has been set out above. A number of significant exceptions are made including "a cheque, order for the payment of money or bill of exchange" and "a promissory note having a face value of not less than $50,000". The intention seems to be to exclude these types of instruments from, amongst other things, the prospectus provisions[14]· However, the result of these instruments not being debentures in many cases could be thought to take them within the definition of participation interest and prescribed interest (because the debenture exclusion is not operative) and therefore to require a prospectus if a public offering is made[15].

12. The Companies Act 1981 s5(1) definition of prospectus refers in its various paragraphs to "shares in or debentures of, or units of shares in or units of debentures of, a corporation" and this carries over into the registration requirement of s103. "Unit" is defined "in relation to a share, debenture or other interest (whether a prescribed interest or not)" to mean "any right or interest, whether legal or equitable, in the share, debenture or other interest, by whatever name called, and includes any option to acquire any such right or interest in the share, debenture or other interest".

13. In the case of debentures it can lead to the obligation to comply with the differing requirements concerning trustees and trust deeds of Part IV Divisions 5 and 6.

14. Compare the exclusions from the definition of "security" in the Securities Industry Act 1981 s4(1) which refer to bills of exchange, promissory notes and certificates of deposit issued by a banking corporation.

15. A similar problem arises in relation to sharehawking. When the definition of "prescribed interest" was introduced the sharehawking provisions were amended to include prescribed interests in their coverage. The then existing extension of the provisions beyond shares and debentures was left intact so that some doubling

In the Securities Industry Act 1980 the exclusions for time-sharing schemes, shares and debentures from the definition of participation interest are effectively eliminated by adding them back through the definitions of prescribed interest and securities for the purpose of that legislation. This quixotic form of drafting arises from the grafting of companies legislation definitions which have evolved over a long period of time onto a different type of statute which seeks to regulate securities as a whole and not on a piecemeal basis.

While Australia continues to use both statutes for the purposes of general securities regulation (and does not confine the companies legislation to the regulation of companies alone) there is a case for maintaining uniformity of the drafting of definitions despite the oddities that may arise. If a decision is ever taken to move all aspects of general securities regulation to the securities legislation (as is raised for consideration elsewhere in this paper), then the drafting peculiarities can be removed. However, in the meantime the use of identical or similar definitions will continue to test the draftsman's ingenuity.

The difference in structure between the Companies Act 1981 and Securities Industry Act 1980 gives rise to frequent problems in the drafting of legislation in the prescribed interest area[16]. Moreover there are considerable difficulties in applying both pieces of legislation sensibly to entities other than natural persons and companies such as statutory

15. (cont'd) up occurs, but more importantly the exclusions from the definition of prescribed interest are effectively eliminated for the sharehawking situation, which surely cannot be intended. This oddity arises because the exclusions relate only to prescribed interests and not to the words "all such documents (including those referred to as 'bonds') as confer or purport to confer on the holder of the documents any claim against a corporation, whether the claim is present or future, certain or contingent, or ascertained or sounding only in damages" which were added to a predecessor of s552 to extend the section beyond shares and debentures before prescribed interests were included.

16. A recent example concerns the treatment of retirement village schemes. In the case of the Securities Industry Act it was possible to achieve exemption by the simple expedient of an exclusion from the definition of securities while in the Companies Act it was necessary to create a special exemption provision in s215D because an exclusion from the definitions of share debenture and prescribed interest would have been necessary if the purpose of exemption was sought to be achieved through the definition section.

corporations and bodies unincorporate. These difficulties will not be elaborated but would be solved by consolidation of the law in the area under consideration into a single statute.

Life Insurance Policies

The exclusions referred to above as being based on policy grounds relate to life insurance and partnerships. The first refers to "any interest in, or arising out of, a policy of life insurance". Life insurance companies are the subject of extensive regulation under other legislation and have been the subject of review in recent times[17]. The justification for the exclusion is based on the existence of the other regulatory procedures, an issue canvassed generally above. However, the exclusion can give rise to some competitive advantage for life companies over other similar institutions seeking to attract household savings[18]. There has moreover been in recent times a significant growth in the products offered by the life companies. Some of these products have only a nominal life insurance element and are barely distinguishable from other investment products offered in the market which are subject to regulation under the companies and securities legislation[19].

It is understood that both the life insurance industry and the Life Insurance Commissioner are hostile to the treatment of insurance bonds as investment securities. Conversely there is some resentment within the securities industry over the

17. For example, Australian Financial System Inquiry, Final Report (Canberra: AGPS, 1981)(the Campbell Report) pp. 329-341.

18. An example in recent times is the approved deposit fund, an institution created in the reform of the tax arrangements for superannuation and retirement in 1984, see Income Tax Assessment Act 1936 (Cth) s23FB. These funds which compete with life offices are required to comply with the prescribed interest provisions as to prospectus etc. and special rules have been laid down for them by the NCSC in Release 125.

19. The New Zealand Court of Appeal in Marac Life Assurance Ltd. v CIR (1986) 9 TRNZ 331; 8 NZTC 5086, held that an insurance bond was a life insurance policy. In the most recent Australian decision: Cutten and Harvey v Sun Alliance Life Assurance Ltd. (1986) 4 ANZ Insurance Cases 74461, the South Australian Supreme Court held that a "money accumulator bond" was not a life insurance policy. However the judgment turned on the wording of the insurance company's agency agreement (now obsolete) and the court was not required to interpret the meaning of the expression "life insurance policy" within the context of the Life Insurance Act (Cth) or of

licences issued to life companies. The decision is therefore of limited authority. The Life Insurance Federation of Australia has since indicated that notwithstanding this decision, its members view current insurance bonds as life insurance policies.

relaxed regime that applies to the marketing of these bonds in comparison to other investment securities and there is also considerable public disquiet expressed in numerous journals about the less favourable position of bond investors in relation both to disclosure and ongoing accountability for investment performance.

The Life Insurance Commissioner issued voluntary guidelines to the industry in 1985 on investment linked policies. These guidelines provide for a significantly lower standard of disclosure and reporting than is the case for investment securities. It is unlikely that a reasonable investor could on the basis of the material available make an intelligent choice between the merits of an investment bond and a competing unit trust.

Moreover in the event of misleading representation being made the rights of an investor under an insurance bond would be considerably less than those of an investor in securities.

There is therefore a strong case on the grounds both of appropriate investor rights and competitive neutrality of regulation of like products, for adoption of the approach similar to that of the UK in the Financial Services Act 1986, under which insurance bonds are treated as investment securities (Schedule I, Part 1 para 10). The reasoning of Professor L C B Gower in his original Review of Investor Protection upon which the legislation is founded is powerful:

(5.04) "... the most conspicuous and widely criticised example (which might equally well have been given under the foregoing heading as an example of irrationality) is the differing treatment of life assurance and other forms of investments especially in relation to property-linked and equity-linked assurance. As already pointed out, this resulted from the Report of the Scott Committee and the subsequent express exclusion of policies of insurance from the provisions of the Prevention of Fraud (Investments) Act. It is my impression that this is now generally regarded as a mistake. Certainly it produces the greatest anomalies and difficulties ...

Solicitors, as many have complained, find it very difficult to explain to their clients why it is possible to write and market an insurance linked contract with infinitely greater freedom than can be achieved by selling units directly.

(9.02) On the other hand, something clearly needs to be done to tackle the problems raised by the growing popularity of bonds linked to life policies.

The life cover is generally a negligible element in the investment package - indeed it is often described as being given away with the bond - which is generally sold for a single lump sum premium and, essentially what are being sold are units in an authorised or unauthorised unit trust. Many new, and relatively small "insurance companies" have sprung up to take advantage of the greater freedom allowed than if the units themselves were being marketed. The difference between what is permitted in the two cases is truly remarkable."

As Professor Gower concludes, the difference in treatment is difficult to justify, since insurance bonds are clearly securities within any rational concept of that term as an investment medium. The fact that the bonds are offered by companies which are regulated on prudential norms by the Life Insurance Commissioner has little to do with the rights of investors to disclosure and ongoing accountability for performance of the product.

Partnership Agreements

The second exclusion based on policy grounds relates to interests in partnership agreements. The justification for this exclusion would seem to be that entering into a partnership involves a personal relationship between a small number of people and that individuals should not be put to the considerable expense involved in registering a prospectus in seeking business partners[20]. Use of this provision to avoid the need for a prospectus was sought to be controlled by amendments in the early 1970s making clear that if the promoter is in the business of selling partnership interests then the exclusion does not apply. Promoters of this type are outside the purpose of the exclusion which is to allow persons who themselves intend to be involved in the partnership on an ongoing basis to seek out partners. A safeguard was also added in the form of a regulation-making power to deal with other cases where it is felt that the exclusion should not apply.

20. Playfair Development Corporation Pty. Ltd. v Ryan (1969) 90 WN (Pt 1) (NSW) 504 held that the exclusion as originally drafted did not require any personal link between the various partners. The maximum number of partners allowed in the usual case is twenty, see Companies Act 1981 s33(3).

The exclusion still has a weakness. It appears to permit a series of special purpose companies to be set up by a promoter with each company being used for only one partnership promotion and then allowed to wither away. The weakness arises because the company is not in a continuous business of promoting partnerships and so long as the promotion is as a legal matter done on the company's behalf and not directly for the promoter then the limitation on the exclusion does not apply. Even if this, possibly, is not currently giving rise to abuse, the weakness can easily be overcome by adding a reference to associates being in the business of directly or indirectly promoting partnerships. An amendment to this effect would seem desirable to forestall possible abuse of the current definition.

The difficulties referred to in the discussion of exclusions, are largely uncharted waters for the present, as the main focus of judicial decision and administration has been on the inclusive parts of the definition. Nonetheless the exclusions are of assistance in seeking to define the intended reach of the definition of prescribed interest.

Legislative purpose and trends in the interpretation of the definition of "prescribed interest"

It will be apparent that the courts have by and large given a very expansive interpretation to the definition of prescribed interest and their approach raises the prospect of applications of the definition in situations where it may be doubted that the protection of the companies and securities legislation is necessary. However, courts have not been disposed on grounds of legislative purpose to resile explicitly from a wide, literal reading. This is partly because they have not discerned a legislative purpose. The difficulties were described by Mason J in the Australian Softwoods case 148 CLR at 130, in relation to the Companies

Act 1961 (NSW):

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 Pty. Ltd. v Commissioner for Corporate Affairs ([1981] VR 475 at 478), 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."

In the Australian Softwoods case the High Court thus forbore to read down the wide terms of the definition so as to prevent it applying to opportunities literally covered but which on any view the legislature could not have intended to cover. Mason J noted provisions under which opportunities could be exempted from the provisions of the Companies Act. The exempting power of the NCSC is now in s215C of the Companies Act 1981 (Cth). Where a case poses questions under the Securities Industry Act 1980 (Cth) there is no similar exempting power. However, both Acts would allow an interest to be exempted by a regulation.

The words quoted from Mason J were spoken before the enactment of s5A(1) of the Companies and Securities (Interpretation and Miscellaneous Provisions) Act 1980 (Cth) which provides:

(1) 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.

Before s5A(1) can be obeyed in relation to the definition of "prescribed interest", the Court must be able to see the legislative policy from the Act (or in the case of a

legislative scheme, from Acts in the scheme) and in the present context the courts have thus far not been able to see the policy. Indeed it is equally important that the business community and others affected by the prescribed interest regime be able to see its policy underpinnings. This will assist in setting the outer limits of the application of the definition in a coherent and more certain way. Further, it should provide a basis for attracting acceptance, if not support, for the operation of the prescribed interest rules amongst those subject to their regulation.

The Companies Act 1981 (Cth) in s3(1) states the objects of the Act but the statement contains nothing to disclose the objects of Part IV Division 6 which requires the issuing of a prospectus for an offering of prescribed interests to the public. The Securities Industry Act 1980 (Cth) in s3(1) states the object of the Act as being "to regulate the securities industry in the Australian Capital Territory". However helpful that statement might be on other issues, it does not provide much assistance in the enquiry as to the limits of a "prescribed interest". At the most it might support a view that the expression "prescribed interest" is confined to securities analogous to securities in respect of which there is an established industry. There is an established industry in relation to shares, debentures and unit trusts so that what is contemplated is some security analogous to them.

Despite the difficulty experienced by judges in establishing the legislative purpose in relation to the definition of prescribed interest, it is possible to trace trends in the judicial and administrative handling of the definition. During the 1960s the definition attracted little attention, there being one judicial decision dealing with one of the exceptions to the definition[21] and few prospectuses

21. Playfair Development Corporation Pty. Ltd. (1969) 90 WN (Pt 1) (NSW) 504.

registered outside the traditional share, debenture and unit trust areas.

From the mid 1970s there was a rapid increase in litigation and in registration of prospectuses outside traditional areas. The case law gave a generally expansive interpretation to the definition of prescribed interest, reaching a high water mark in the High Court decision in the Australian Softwoods case in 1981. Thereafter, there has been a tendency in judicial decisions (such as the sale of home units "off the plan" referred to above) to hold that the definition is not applicable in particular cases[22] and it may be doubted if all the recent decisions in the area are reconcilable with the broad reading adopted in the Australian Softwoods case.

The wide interpretation in the courts has also given rise to a need in the legislative and administrative process to consider whether the legislation needs to be applied in all the various cases that literally may be thought to be covered. Hence the NCSC in its various Releases has in many areas reduced the compliance burdens produced by the application of the legislation. Similarly in a number of areas there has already been legislation or legislative proposals that reduce the ambit of application of the definition of "prescribed interest", for example, retirement village schemes and franchising.

While the difficulty of finding an underlying legislative purpose remains, it is to be expected that the courts and the

administrative agencies will continue to experience difficulty in interpreting the definition. This in turn will give rise to the need for more legislative action of a corrective kind, either limiting the scope of the definition or (more rarely) expanding it, so that the intended purpose is achieved. Although it does not seem possible to eliminate all

22. One specific decision, Brentwood Village v C.A.C. (1983) 1 ACLC 1006, which held that time-sharing rights attached to shares in a company did not give rise to a prescribed interest has been reversed by amendments to the legislation.

uncertainties at the borderline of the definition, a clearer indication of legislative purpose may assist courts and administrators in applying the legislation.

Uncertainty arising from the existing definition

The breadth of the current definition of prescribed interest and the courts' literal approach to it is bound to create uncertainty. This problem is illustrated by four cases on franchising.

In Hamilton v Casnot Pty. Ltd. (1981) 5 ACLR 279 Wallace J of the Supreme Court of Western Australia held a franchising agreement to be within paragraph (b) because, in the particular agreement, the franchisor accepted a continuing obligation to find customers for the franchisee.

By contrast in Butterworth v Lezemo Pty. Ltd. (1983) 8 ACLR 737 Nicholson J of the Supreme Court of Victoria held that a substantially similar agreement was not within any of the paragraphs. It was not within para (a) as a "right to participate or interest" in "profits" because para (a) was not referring to profits arising solely as the result of the efforts of the franchisee and there were no other profits in question. Nor did the franchisee acquire a "right to participate or interest" in any assets other than the business. Where a franchisee purchased a business from the franchisor, he did not acquire an interest in an asset of the franchisor, but in something which had ceased to be an asset of the franchisor citing Brisbane Unit Development Corporation Pty. Ltd. v Deming No. 456 Pty. Ltd. (1983) 7 ACLR 729 at 730.

In the view of Nicholson J, where the franchisee had no more than a licence to use industrial property of the franchisor he acquired no more than the ability to resist lawfully any action for passing-off or infringement of the franchisor's trade marks during the currency of the agreement. Although as stated by

Mason J in the Australian Softwoods case "interest" has a context larger than that of a proprietary interest, it did not, according to Nicolson J, extend to a mere right of user of industrial property. Nor did "right to participate" contemplate a mere right of user. The first part of para (a) was not attracted because the agreement did not show any intention that the franchisee should have the right to participate or have any interest in the realisation of any assets other than assets acquired by virtue of the purchase of the business which became the franchisee's own assets.

The agreement was not within para (b) because although the franchisor and franchisee participated in a common enterprise which was closely connected, the franchisees could not be said to have been led to expect profits from the efforts of the franchisor. Although the franchisor undertook to advertise and to make available information about new techniques these were not activities that could lead to an expectation of profit. These activities differed in this respect from the activities of promoters of a forestry and other produce schemes which represented a more significant contribution to the common enterprise by a person other than the investor.

Nicholson J held that para (c) did not catch the franchising agreement. None of the three elements of (i) investment; (ii) acquisition of a property interest; or (iii) employment of the interest in common with other like interests, was present.

Subsequently two further decisions in the franchising area reached contrasting results with respect to the application of the definition. In Hamilton v Campbell (1985) 3 ACLC 155 it was held that the franchise was caught while in Streeter v Pacific Seven Pty. Ltd. (1985) 3 ACLC 431 the franchise was held to be outside the definition[23].

23. The particular problem with regard to the application of the definition of prescribed interest to franchises will be largely overcome by current proposals to create special rules for them under separate legislation, see Franchising Review, Consultative Paper and Draft Franchise Agreement Bill, 1986.

Whether or not these results can be reconciled in view of differences in the facts of the cases, the cases illustrate a difficulty encountered by promoters in predicting whether an investment opportunity will be held to be a prescribed interest or not. The costs of complying with Part IV Division 6 on the basis that a publicly-offered investment opportunity is a prescribed interest have been estimated to be at least $30,000 not including opportunity costs. A definition which does not properly define may impede the raising of capital for new ventures which have merit. Similarly if the definition is uncertain in application, there are difficulties for the NCSC and the CACs in policing the legislation.

If prescribed interest is defined too widely there will be a danger not only of imposing unnecessary regulation but of duplicating systems of regulation. This problem has already been discussed above. An unnecessarily wide definition of prescribed interest can also lead to the imposition of penal liability on a seller for a non-fraudulent but negligent misrepresentation. That liability could be inappropriate where the subject of sale is not an intangible[24].

24. The system of investor-protection legislation in the Companies Act 1981 (Cth) Part IV Division 6, makes inroads upon the operation of the principle of caveat emptor which is appropriate when the subject matter is an intangible. Where tangible property is involved different considerations may apply. During a downturn in the market for strata title units on the Queensland Gold Coast some buyers who did not want to proceed with their contracts attempted to rely on the higher degree of protection given by Part IV Division 6. The attempts which hinged on the meaning of "prescribed interest" did not succeed. For a detailed account, see Kinsella, "Real Estate Transactions as 'Prescribed Interests' under the National Companies Legislation" (1984) Australian Business Law Review 95-125. The need to analyse the particular facts in the cases to determine whether the protection of the companies and securities legislation is appropriate particularly where there is another regulatory regime in place has already been referred to in the discussion of the Australian decisions.

Similarly in the U.S. attempts have been made to take advantage of the wide anti-fraud provisions of the Securities Exchange Act of 1934 s10(b) in order to escape liability on transactions outside the proper scope of that legislation. These attempts have been met by the Courts not only by restricting the availability of a private right of action on a penal statute but also by avoiding too liberal an interpretation of the statutory definition of "security"; see Thompson, "The Shrinking Definition of a Security: Why Purchasing all of a Company's Stock is not a Federal Security Transaction" (1982) 57' New York University Law Review 225; Grossman, "Defining

a Security" [1983] Annual Survey of American Law 711. Note, however, that these articles were written before the Supreme Court decision in Landreth Timber Company v Landreth (1985) Securities Regulation & Law Report Vol. 17 984-989 which halted the trend of holding that a sale of shares in many situations would not involve securities within the ambit of the legislation.

The exemption powers

The dangers flowing from too broad a definition of "prescribed interest" are mitigated to some degree so far as the Companies Act is concerned by the possibility of the NCSC exercising its general power to exempt from compliance with prospectus and sharehawking provisions under s215C. Section 215C was enacted in 1983 to consolidate and improve the efficacy of existing exemption provisions. It is as follows:

(1) This section applies to Divisions 1, 2, 5 and 6.

(2) The Commission may, by instrument in writing, exempt a person, as specified in the instrument and subject to such conditions (if any) as are specified in the instrument, from compliance with all or any of the provisions of:

(a) the Divisions to which this section applies;

(b) regulations made for the purposes of the provisions of those Divisions or any of them; and

(c) section 552.

(3) Without limiting the generality of sub-section (2), any exemption under that sub-section may relate to particular securities or to securities included in a class of securities.

(4) A person shall not contravene or fail to comply with a condition to which an exemption under subsection (2) is subject.

(5) Where a person has contravened or failed to comply with a condition to which an exemption under sub-section (2) is subject, the Court may, on the application of the Commission, order the person to comply with the condition.

(6) The Commission may, by instrument in writing, declare that a Division to which this section applies and regulations made for the purposes of the provisions of that Division or any of them, shall have effect in their application to or in relation to a particular person or particular persons:

(a) in a particular case; or

(b) in relation to particular securities or securities included in a particular class of securities,

as if a provision or provisions of that Division or of those regulations specified in the instrument were omitted, modified or

varied in a manner specified in the instrument and, where such a declaration is made, that Division and those regulations have effect accordingly.

(7) The Commission may, by instrument in writing, declare that section 552 shall have effect in its application to or in relation to a particular person or particular persons:

(a) in a particular case; or

(b) in relation to particular securities or securities included in a particular class of securities,

as if a provision or provisions of that section specified in the instrument were omitted, modified or varied in a manner specified in the instrument and, where such a declaration is made, section 552 has effect accordingly.

(8) The Commission shall cause a copy of an instrument executed under this section to be published in the Gazette, but failure of the Commission to do so does not affect the validity of the instrument.

(9) An instrument executed under section 109 of this Code and in force immediately before the commencement of section 47 of the Companies and Securities Legislation (Miscellaneous Amendments) Act 1983 of the Commonwealth continues to have effect, and may be revoked or varied, after that commencement as if section 109 of this Code had not been repealed.

(10) An order published in the Gazette under sub-section 172(6) of this Code and in force immediately before the commencement of section 65 of the Companies and Securities Legislation (Miscellaneous Amendments) Act 1983 of the Commonwealth continues to have effect, and may be revoked or varied, after that commencement as if sub-section 172(6) of this Code had not been omitted.

(11) An order published, or deemed to have been published, in the Gazette under sub-section 176(1) of this Code and in force immediately before the commencement of section 66 of the Companies and Securities Legislation (Miscellaneous Amendments) Act 1983 of the Commonwealth continues to have effect, and may be revoked or varied, after that commencement as if sub-section 176(1) of this Code had not been omitted.

The Securities Industry Act 1980 does not contain any provision comparable with s215C but s150(2) authorises the making of regulations under which the provisions of the Act may be deprived of effect in relation to specified transactions.

The definitions of prescribed interest in both Acts allow particular investment opportunities or a class of them to be

declared to be exempt by force of a regulation[25]. However, exemption by way of regulation is carried out by a process slower than that applicable to exemption by the NCSC.

The need to define with as much precision as possible the intended coverage of the definition of prescribed interest is not removed by the existence of an exemption power. It is not a very efficient method of securities regulation to use a broad definition of "prescribed interest" which produces numerous unintended consequences in application and then to attempt to meet those difficulties by various exemption powers.

The cost in time and money of obtaining an exemption from the NCSC in cases where it is generally agreed that the legislation should not apply is an unnecessary inhibition to business and investment. Moreover the effect that the existence of an exemption power has had in the courts' refusing to limit the coverage of the present definition on the basis of legislative intention has already been referred to and in that context its existence may be regarded as counter-productive.

Accepting that some uncertainty and over-inclusiveness is inevitable in the definition of prescribed interest, even if it is considerably refined and the courts begin to find a legislative purpose, the case for exemption powers is strong. The dual possibilities of exemption by the NCSC or by regulation as at present seem appropriate. The questions which arise are whether the securities industry legislation should have a similar power to the companies legislation and where in the legislation should the powers be located.

25. There are in fact two methods of achieving exemption through regulation for states in the co-operative scheme (though not for the A.C.T.). The method referred to in the text requires approval by the Ministerial Council and the Governor-General in Council (that is, Commonwealth regulations which are then automatically adopted in each State). Further it is possible to obtain a State-specific exemption through approval by the Ministerial Council and the Governor in Council of the State concerned, see the Companies (Application of Laws) Act 1981 of each State s16 and the Securities Industry (Application of Laws) Act 1981 of each State s15A.

The case for similar powers in both pieces of legislation is strong. At present the NCSC uses its power to attach conditions to a dealers licence to achieve a similar purpose to the exemption power in the companies legislation and often the two are used in conjunction in the prescribed interest area[26]. The extent to which conditions can be imposed in this way is a matter of doubt and the direct conferral of an exemption power is preferable.

The different structures of the Companies Act and the Securities Industry Act again create problems in finding the appropriate place for such a power. In the case of the former statute, a number of problems were experienced with the original NCSC exempting powers that were separately conferred for public offerings of shares and debentures and of prescribed interests. The difficulty was met by creating an all embracing exemption power for the NCSC by amendment to s215C. At the same time there exist separate powers to exempt by regulation in relation to debentures and prescribed interests but not shares, and consideration needs to be given to creating a single exempting power to deal with them all.

In the securities industry legislation the logical place for both types of exempting powers is in the definition of securities whereas the current power to exempt by regulation is found in the definition of prescribed interest. As mentioned above it is in the definition of securities that the exemption for retirement village schemes has been located.

Public offerings

The various operative provisions of the legislation which deal with prescribed interests (or in the case of the securities industry legislation which deal with securities

26. For example, NCSC Releases 117-121, 123-125.

which include prescribed interests) specify other conditions to be fulfilled before the legislation operates.

The prospectus provisions as regards prescribed interests are attracted only if there is an offer, invitation or issue to the public[27]. This requirement is elaborated in Companies Act 1981 s5(4) as follows:

(4) A reference in this Code to, or to the making of, an offer to the public or to, or to the issuing of, an invitation to the public shall, unless the contrary intention appears, be construed as including a reference to, or to the making of, an offer to any section of the public or to, or to the issuing of, an invitation to any section of the public, as the case may be, whether selected as clients of the person making the offer or issuing the invitation or in any other manner and notwithstanding that the offer is capable of acceptance only by each person to whom it is made or that an offer or application may be made pursuant to the invitation only by a person to whom the invitation is issued, but a bona fide offer or invitation shall not be taken to be an offer or invitation to the public if it:

(a) is an offer or invitation to enter into an underwriting agreement;

(b) is made or issued to a person whose ordinary business is to buy or sell shares, debentures or prescribed interests, whether as principal or agent;

(c) is made or issued to existing members or debenture holders of a corporation and relates to shares in, or debentures of, that corporation;

(ca) is 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; or

(d) is made or issued to existing members of a company in connection with a proposal referred to in section 409 and relates to shares in that company.

In order for the legislation to operate properly, both the concepts of "prescribed interest" and "the public" have to be adequately defined and interpreted. Over the years there have

27 Companies Act 1981 ss16g, 170.

been considerable opportunities to avoid the application of the prescribed interest legislation because of the interpretation adopted by the courts of the concept of "the public". The provision quoted was intended to reverse the interpretation adopted by the courts.

However, a recent decision of the High Court of Australia in C.A.C. (S.A.) v Australian Central Credit Union (1985) 59 ALJR 785 has stated a test for defining the public which, given its uncertainty in application, arguably opens the door to abusive practices[28]. While recommendations on this issue are not immediately germane to the possible redefinition of prescribed interest, it might be considered a futile exercise to amend that definition when its operation can be simply avoided by structuring an offer on the basis of the High Court decision to fall outside the concept of an offer to the public.

The Committee notes this problem, but considers that the possible reformulation of the statutory definition of an offer, invitation or issue to the public to be an issue beyond the ambit of this Discussion Paper.

Offerings of loan securities etc

The Companies Act sub-section 5(4) (ca) 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. However where unitholders 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 sub-section 5(4) (c). Comment is invited on whether any change is desirable.

28. For a critique of the decision, see Christie, "Investor Protection and the High Court - The A.C.C.U. Decision" (1986) Australian Business Lawyer Vol. 1 No 3; see also O'Connell "What is an Offer to the Public" Company & Securities Law Journal Vol. 4 No 3 (1986).

Civil rights of action

The definition of prescribed interest is significant not only as between the regulators and the regulated (promoters, dealers etc.), but also as between the investors and the promoter, dealer etc. in the form of civil rights of action and defence which may arise from breaches of the companies and securities legislation. If the element of civil rights of action and defence were not present, technical deficiencies in the legislation would not create as many problems and could be partly solved by enlightened administration.

If civil rights of action or defence are available then minor technical breaches of the legislation may give rise to very serious consequences. This possibility is best demonstrated by the cases referred to above of home units sold "off the plan". All but one of the cases concerned an action by the promoter/vendor for specific performance of the contract of sale and the purchasers resisted on the ground that the contracts were illegal because they breached the companies legislation through failure to register a prospectus in respect of a public offering of a prescribed interest. The defences may (or may not) be regarded as unworthy technicalities, but for the present the point is that breach of the legislation in either a major or minor respect can give rise to the defence of illegality. Courts may be tempted to give a narrow interpretation to the prescribed interest definition when it is being employed as part of a contractual defence which may appear to be technical.

The general rule is that if a contract is illegal (which it usually will be if entered into in breach of a statutory provision which can give rise to criminal penalties) neither party to the contract can rely on it in enforcement or defence of their rights. There is an exception where the parties are not "in pari delicto". A party will be regarded as not in pari delicto if it can be established that the legislation was passed for the benefit of the group of which the party is a member. In that event the party in the protected group can rely on the contract but not the other party.

In the prescribed interest context virtually every relevant provision of the companies and securities legislation creates specific criminal penalties for its breach or is subject to a general provision that imposes criminal sanctions for breaches of the legislation. Thus the illegality plea is available. If it could be shown that the prescribed interest legislation is intended to protect investors, then parties entering into contracts with promoters may be able to assert the illegality but not have it raised against them. This issue was not discussed in the cases dealing with sales of home units "off the plan" as the illegality was being raised in every case by the investor; the issue would only arise if the promoter sought to rely on illegality.

Whether the courts would accept the proposition that protection of investors is the object of the prescribed interest provisions for the purposes of the illegality rules is not susceptible of a clear answer. In view of the High Court's reluctance to find a clear policy for the prescribed interest definition in the Australian Softwoods case, it is possible that the "in pari delicto" exception would not apply.

The difficulty of establishing the exception to the illegality rule for other provisions of the companies legislation has been a problem in the past particularly in relation to the uniform Companies Act (1961) s67 prohibiting the giving of financial assistance by a company for the purchase of its shares. This problem has been overcome in relation to the current Companies Act by s130 dealing specifically with consequences of breach of this prohibition which is now found in s129. While s130 is not without its own problems,[29] it does offer a model for dealing with the problem of the effects of illegality.

The difficulty of applying this solution in the prescribed interest area is that the definition of prescribed interest performs many functions in the companies and securities legislation as outlined earlier in this chapter. It may prove

29 Carter and Hill, "Severence, Illegal Contracts and Company Law" (1986) Companies and Securities Law Journal Vol. 4 No 3.

difficult to devise a suitable provision for all occasions of its application. The question of reform of the illegality doctrine is more one of contract law than one peculiar to the companies field. Nevertheless, in view of the untoward effects of the illegality doctrine, it may be appropriate to consider a general provision in the companies and securities legislation which modifies the operation of the doctrine for the whole legislation.

The civil rights of action arising under the legislation were increased by Companies Act 1981 s574 and Securities Industry Act 1908 s149 which give the court power to award an injunction in respect of breaches of the Acts or damages in lieu to any person whose interests are affected by the conduct in breach. These provisions make it all the more important to achieve as much certainty in the definition of prescribed interest as possible as well as eliminating what may appear to be minor technical problems in the definition and associated provisions.

This task will be further considered in Chapter 3: Possible Re-Definition of the Regulatory Area's Boundary, following an analysis of relevant definitions in overseas jurisdictions, in Chapter 2.

CHAPTER 2

DEFINITIONS ELSEWHERE

In this Chapter, the experience of the US, Canada, the UK and New Zealand regarding the definition of security will be reviewed. In each case the precise details of the definition depend, in part, on the existence of other forms of regulation (especially as regards exclusions from the definition). Nevertheless the definitions will be quoted in detail to give an appreciation of the different styles of drafting used.

United States of America

The problems involved in defining the proper sphere of regulation in the interests of protecting investors are not peculiar to Australia. The U.S. has what is generally considered to be the most sophisticated and mature system of securities regulation in the world. Yet in the U.S. difficulty continues to be encountered both at a State and a Federal level in the fundamental problem of defining a security.

Taking the Federal law, the difficulties centre on the interpretation of the expression "security" as defined in the Securities Act of 1933[1] s2(1) and the similar term defined in the Securities Exchange Act of 1934[2] s3(a) (10) in similar terms. The definition in the Securities Act of 1933 is as follows:

the term "security" means any note, stock, treasury stock, bond, debenture, evidence of indebtedness, certificate of interest or participation in any profit-sharing agreement, collateral-trust certificate, preorganization

1. 15 United States Code para 77b(1).

2. 15 United States Code para 78c(a)(10)

certificate or subscription, transferable share, investment contract, voting-trust certificate, certificate of deposit for a security, fractional undivided interest in oil, gas or other mineral rights, or in general, any interest or instrument commonly known as a 'security' or any certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or purchase, any of the foregoing.

At first reading that definition appears to be a list of particular forms of investment save for the reference to "any investment commonly known as a security". When reference is made from time to time in what follows to a "list" approach to the definitional problem it is this kind of definition which is meant. Despite the amorphous nature of the list, American courts have taken the expression "investment contract" to refer to a broad category of investment opportunities both old and new. It is by reference to that heading that newly developed forms of investment have generally been considered by the courts. Because of the indeterminate nature of that term as interpreted by the courts, the U.S. definition can be regarded as an open-ended list rather than a closed list so far as the situations covered by the definition are concerned.

In addition to the inclusions in the definition of security, there is also a lengthy list of exempted securities in the Securities Act s3 and the Securities Exchange Act s3(a) (12) together with a power in the Securities and Exchange Commission to add to the list of exemptions. The most important exemptions in the case of the Securities Act can be summarised as follows:

(1) securities issued or guaranteed by a governmental body or by a national or state bank;

(2)short term notes or bills of exchange;

(3) securities of charitable, religious etc. bodies;

(4) securities of certain co-operatives;

(5) securities of certain carriers subject to other federal regulation;

(6) securities issued with court approval in bankruptcy and liquidation; and

(7) securities in the form of insurance policies and annuity contracts.

The exemptions do not operate for all purposes and there are in addition exemptions for specific transactions. The exemptions are made because of the existence of alternative regulatory mechanisms (e.g. insurance policies) or because of the nature of the securities involved (e.g. short term notes).

With regard to the inclusive part of the concept of securities, a judge-made definition of "investment contract" was provided by Murphy J in S.E.C. v W.J. Howel (1946) 328 US 293 in the following terms:

a contract, transaction or scheme whereby a person invests his money in a common enterprise and is led to expect profits solely from the efforts of the promoter or a third party.

In the same case it was said that in the process of identifying a security, "form [is] ... disregarded for substance and emphasis [is] ... placed upon economic reality.": 328 US at 298. Even with the advantage of being able to depart from a literal interpretation and to consider the substance of a transaction and even with a developed facility for ascertaining a broad legislative purpose, American courts have not been able to arrive at an agreed interpretation of "investment contract".

Later cases adopted the statement in the Howey case but made modifications to it when new forms of investment opportunities appeared on the market. For example, S.E.C. v Koscot Interplanetary Inc. (1974) 497 F 2d 473 concerned a pyramid selling operation. The promoter argued that the opportunities

offered were not "securities" as "investment contracts" because an acceptor was actively engaged in the enterprise and therefore profits would not result "solely from the efforts of the promoter or a third party". The Court rejected the argument, holding that the appropriate question was "whether the efforts made by those other than the investor are the undeniably significant ones, those essential managerial efforts which affect the failure or success of the enterprise"[3]. This approach has come to be called the "managerial efforts" test.

In United Housing Foundation Inc. v Forman (1975) 421 US 837 at 852 the Supreme Court itself modified the Howey test by defining an "investment contract" as the "presence of an investment in a common venture premised on a reasonable expectation of profits to be derived from the entrepreneurial or managerial efforts of others". The modification lay in the omission of the requirement contained in the Howey formula that the expectation of profits be derived solely from the effort of others and in the reference to the "entrepreneurial or managerial" efforts of others which suggests an activity of a business kind.

The Forman decision and the latest foray by the Supreme Court into the area in Landreth Timber Co. v Landreth[4] are illustrative of one of the problems of a definition comprised of an open-ended list of situations covered. The question posed is whether the specific items mentioned in the definition of a well-known kind such as stock (that is, in Australian parlance shares) or notes are subject to the general concept of a security developed by the courts in elaboration of the open-ended terms such as investment contract. The latest decision has sought to retract what were thought to be some of the consequences of the Forman case in this regard.

3. Adopting language used in S.E.C. v Glenn W. Turner Enterprises Inc. (1972) 348 F Supp 766

4. (1985) Securities Regulation & Law Report Vol. 17 984-989

In Forman it was held that the offer of shares in a non-profit housing co-operative which was subsidised and supervised by the state did not involve the offer of a security. The shares conferred the right to a lease on concessional terms of a specific apartment in a housing complex and in that respect were similar to company title home units in Australia. However, it was not possible to sublet the apartment and if it was desired to move out of the apartment the owner of the shares was required to sell them to the co-operative for the original purchase price, that is, the shares were not generally saleable by their owners to third parties and they could only descend on death to a surviving spouse. The shares carried no votes, could not be pledged and could only be sold by the co-operative to people with income below a very modest level. The rent on the lease was set so as to cover current operating expenses and to service the loans received from the state by the co-operative at concessional interest rates to fund the building of the complex. There were some commercial premises in the housing complex which the co-operative let out at market rentals and any surplus on these activities could be used to give a rebate on the rentals on the apartments.

The complex proved more expensive to build than anticipated and hence the rents were higher than indicated in the material issued to potential occupants during the building phase. Some of the purchasers of the shares sued the co-operative on the basis of the alleged misleading nature of the information originally provided to the purchasers. In reaching its conclusion that the shares were not a security and so dismissing the action under the federal securities laws, the court emphasised that the shares in question had none of the usual characteristics of shares and further did not meet the Howey test in relation to investment contracts. The court said:

Despite their name, they lack ... the most common feature of stock: the right to receive "dividends contingent upon an apportionment of profits" ... Nor do they possess the other characteristics traditionally associated with stock: they are not negotiable; they cannot be pledged or hypothecated; they confer no voting rights in proportion to the number of

shares owned; and they cannot appreciate in value. In short, the inducement to purchase was solely to acquire subsidized low-cost living space; it was not to invest for profit.

Following this decision a number of lower courts held that where the sale of a business was effected by the private sale of all the shares in the corporation owning the business, this did not amount to the sale of a security[5]. An extension of the reasoning in Forman was involved because the shares concerned did have all the common characteristics of shares but it was possible to read the Supreme Court decision as holding that the general concepts of a security developed in the context of the term investment contract override the specific items in the definition such as stock. The Howey test did not apply in these cases because the purchasers expected to make profits from their own efforts and not the efforts of others. This trend was brought to an abrupt halt in Landreth Timber Co. v Landreth where it was held that such sales did involve securities under the federal securities laws.

The court made clear that the specific reference to stock in the definition overrode the general concept of a security except in the rare case of which Forman was an example where the stock in question did not have the usual characteristics of stock. This result was partly intended to ensure certainty in the operation of the securities laws: when members of the public purchase stock with the usual characteristics of stock, they expect the federal securities laws to apply without investigation of the particular circumstances of the case. However, the court was not prepared to indicate how far this reasoning applied to other specific items in the definition such as notes or bonds.

It is highly unlikely that an Australian court would hold that shares were not covered by the terms of the companies and securities legislation on the grounds adopted in Forman. In

5 See the articles referred to in Chapter 1, note 24.

any event the structure of the relevant Australian definitions and the companies legislation in particular with separate Divisions dealing with shares and prescribed interests make it difficult to solve the question of what is a share for this purpose by reference to the definition of prescribed interest. It will be assumed in the remainder of this Discussion Paper that Australia will generally regulate shares and debentures as securities even though some of the usual elements of a security are absent in a particular case. Nonetheless the U.S. reasoning does find expression in NCSC Release 321 dealing with offers to the public as follows:

25. An offer of all the shares in a corporation for purchase may, in reality, be a method of purchase of the assets of the corporation. This would more likely be so where those shares have not been issued with a view to their being offered to the public (a case to which section 104 clearly would apply). In most cases, the corporation concerned is a proprietary company.

26. The Commission takes the view that it is section 552, rather than Division IV Part 1 of the legislation, which is intended to regulate such offers of purchase .... Offers for purchase of the type mentioned above, however, are not public offerings of the type covered by the concept of "offer or invitation to the public". The crucial factor which distinguishes them is that they do not involve any element of a distribution to the public which it is the purpose of the prospectus provisions to regulate.

27. Similar considerations apply to the case where the shares offered do not, in a practical sense, entitle the holder of the shares to an aliquot part or share of the whole of the assets of the company. A common example is the type of real estate development known as "company title". In those cases, particular blocks of shares carry with them a right, contained in the articles of association, to the sole use of part of the property of the company. In such cases, the form of regulation provided by section 552 is appropriate.

Whether or not this approach is justified by the current legislation,[6] the Release does raise the problem of how to deal with items like shares (which are the quintessential security) when the transaction in question does not seem to attract the underlying policy of the legislation. Whenever a

6. If the approach is not justified, then it is unwise for parties to rely on it without a specific exemption from the NCSC for the reasons outlined in Chapter 1 under the heading Civil Rights of Action.

list approach is adopted to the definitional problem this problem will be present. In the interests of certainty it does not seem appropriate to allow the general concept of a security and the purpose of the legislation to override specific well recognised categories of security contained in any definition. The way to meet the problem would seem to be by specific exceptions in the legislation or by use of an exempting power in the NCSC.

The problems raised by the Forman and Landreth decisions demonstrate the uncertainties that still exist in regard to the definition of security after more than fifty years of legislative and judicial activity at the federal level in the U.S. Both cases (at least outside the context of stock) emphasise the need to look to the economic realities of the transaction in order to judge whether a security is involved.

An influential article[7] by Professor Coffey in 1967 had criticised the Howey test as not being entirely consistent with economic realities. First, the test ignored the risk of loss of the original value furnished by the purchaser to the seller. Secondly, the words "common enterprise" were particularly ambiguous and had a wide range of possible meanings. Thirdly, emphasis was placed on the inducement of future "profits" rather than the more significant factor of risk of immediate loss of initial investment. Moreover, the word "profits" posed troublesome problems of interpretation. The writer suggested alterations of the Howey test as follows:

"A 'security' is:

(1) a transaction in which

(2) a person ("buyer") furnishes value ("initial value") to another ("seller"); and

7. Coffey, "The Economic Realities of a 'Security': Is there a More Meaningful Formula" (1967) 18 Western Reserve Law Review 367 at 374.

(3) a portion of initial value is subjected to the risks of an enterprise, it being sufficient if:

(a) part of initial value is furnished for a proprietary interest in, or debt-holder claim against, the enterprise, or

(b) any property received by the buyer is committed to use by the enterprise, even though the buyer retains specific ownership of such property, or

(c) part of initial value is furnished for property whose present value is determined by taking into account the anticipated but unrealized success of the enterprise, even though the buyer has no legal relationship with the enterprise; and

(4) at the time of the transaction, the buyer is not familiar with the operations of the enterprise or does not receive the right to participate in the management of the enterprise; and

(5) the furnishing of initial value is induced by the seller's promises or representations which give rise to a reasonable understanding that a valuable benefit of some kind, over and above initial value, will accrue to the buyer as a result of the operation of the enterprise."

That formula was adopted by the Supreme Court of Hawaii in State Commissioner of Securities v Hawaii Market Centre Inc. (1971) 485 P 2d 105 in which certain franchising arrangements were held to be investment contracts under the Securities Act of Hawaii. The Court said that the essence of a security transaction is "the public solicitation of venture capital to be subject to the risks of an enterprise over which [the investor] has no managerial control": (1971) 485 P 2d at 109.

It is interesting to speculate on the outcome that this test would have if applied to the facts of some illustrative Australian cases.

The first requirement of Coffey's definition referring to a transaction is meant to indicate that the court is not confined to the terms of particular documents and may look to all the surrounding circumstances. Further, apparently independent contracts will be linked together in deciding whether there is a security if the surrounding circumstances indicate a linkage. Although there is Australian authority in

support of a similar approach[8] some recent cases involving franchises have shown a tendency to fragment transactions and consider each portion individually;[9] nonetheless it may be doubted whether different results would follow in these cases under the Coffey test for reasons outlined below.

The heart of the definition is found in the third element which expresses the risk capital or risk to initial value test. On the basis of this test the sale of home units "off the plan" would involve securities if the purchaser's deposit was used to finance the building process and was not held in trust or by a stakeholder pending settlement[10]. Equally franchising agreements will often satisfy the risk capital test but may yet be excluded from the Coffey definition by the fourth element. They will satisfy the risk capital test, depending on the exact type of franchise agreement involved, if either all or part of the value provided by the buyer of the franchise is placed at the disposal of the seller (for example, where the buyer recommits property received in the transaction to the seller for use or dealing by the seller) or the purchase price of the franchise takes into account the anticipated but unrealised success of the enterprise conducted by the franchisor (for example, where advertising by the franchisor will have a significant impact on the franchisee's operations).

The fourth element excludes categorisation as a security only if the buyer is both familiar with the operations of the

8. See, for example, CAC v M.G. Securities Australasia Ltd. (1974) CLC 27761 at 27767, Radiata Forestry Development Co. Pty. Ltd. v Evans (1977) 3 ACLR 82, Warren v Nut Farms of Australia Pty. Ltd. [1981] WAR 134 and the Australian Softwoods case.

9. Butterworth v Lezemo Pt .y Ltd. (1983) 8 ACLR 737; Streeter v Pacific Seven Pty. Ltd. (1985) 3 ACLC 431; both these cases considered each of the elements involved in a particular franchise situation independently and did not assess the arrangement as a whole against the definition of prescribed interest.

10. See the discussion Of Silver Hills Country Club v Sobieski (1961) 361 P 2d 906 in Coffey pp. 382, 391-392. This case was applied in Australia in CAC v Lake Eildon Country Club Ltd. (1980) CLC 34359.

enterprise and has the right to participate in its management. This will cover a number of franchise situations. A difficulty arises, however, from the following qualification by Coffey:[11]

It seems highly questionable whether the joint-control theory should govern where the buyer assumes a management role after the purported security transaction but has no knowledge of the risk enterprise prior thereto.

Of the Australian franchise cases, it is possible that the results reached would remain the same under the Coffey test. In the cases where it was held that a prescribed interest was involved there was significantly greater dependence on the activities of the franchisor and more capital at risk in the franchisor's hands[12]. In the cases where it was held that no prescribed interest was involved, if there were any significant risk to initial value, the fourth element may be regarded as excluding classification as a security subject to the probability that the parties only obtained their knowledge of the enterprise after the franchise agreement was entered into[13]. The franchising example demonstrates that the Coffey definition does not overcome the problems of uncertainty in applying the test in particular cases of similar kinds.

11. Page 398.

12. In Hamilton v Casnot Pty Ltd. (1981) 5 ACLR 279 the franchisee paid a "deposit" to the franchisor in addition to purchasing cleaning equipment and was dependent on the canvassing of the franchisor for customers, while in Hamilton v Campbell (1985) 3 ACLC 155 the franchisee paid a fee to the franchisor to finance the purchase of central computer equipment to be owned by the franchisor and relied on the franchisor to get access to videos not available in the franchisee's area of operation.

13. The facts as set out in the reports of Butterworth v Lezemo Pty. Ltd. (1983) 8 ACLR 737 and Streeter v Pacific Seven Pty. Ltd. (1985) 3 ACLC 431 do not make it possible to judge the parties' precise knowledge at the time of entering into the franchise agreements though it is likely that they would not in Coffey's terms have sufficient knowledge. In these cases the reliance of the franchisee on the franchisor after obtaining initial training and equipment was considerably less than in the cases in the preceding note. The purchase price seems to have been mainly for obtaining premises, equipment, training and existing goodwill from the franchisor.

The final element involves the expectation of profits from the transaction. Here Coffey requires a broad view of what constitutes profit and so formulates his test by eliminating the word "profit" to overcome what he sees as an overly narrow approach to this issue in the U.S. The Australian cases have generally taken a broad view of the various profit formulations in the definition of participation interest[14].

In its turn the Coffey test has been criticised as being over inclusive and an alternative narrower test suggested[15]. It is argued that the security laws in the U.S. were passed to overcome perceived abuses in the public markets that undermined investor confidence and ultimately contributed to the Depression. Hence the proposed definition concentrates on the public marketability of certain instruments. A security is defined as "a financial instrument eligible to participate in a public market".

By way of elaboration of this definition, it can be broken down into a number of constituent elements. By an instrument is meant almost any bundle of rights and duties and in this respect the definition adopts a broad approach much like the transaction element in the Coffey definition. The reference

14. The relevant words in the Australian legislation are "profits, assets or realisation" in para (a), "profits, interest or rent" in para (b) of the definition of participation interest and, in relation to para (c) of that definition, the concept of investment in the related definition of investment contract. For Australian cases giving a broad reading in relation to paras (a) and (b), see for example, the M.G. Securities cases (1974) CLC 27761 (NSW Supreme Court at first instance), (1975) 1 ACLR 157 (NSW Court of Appeal), [1975] VR 508 (Victorian Supreme Court), Lake Eildon Country Club (1980) CLC 34358. The concept of investment was discussed in the Munna Beach Apartments case (see Chapter 1 under the heading "What is covered by paragraph (c) of the definition of participation interest") and it was stated that it "implies that some form of return, whether of the money itself or by way of income or profit or otherwise, is expected or in contemplation". The court was unwilling to go beyond the contract in that case and to examine the surrounding circumstances to see whether an investment was involved in which regard it should be compared with the first element in Coffey's definition discussed above.

15. Fitzgibbon, "What is a Security? - A Redefinition Based on Eligibility to Participate in the Financial Markets" (1980) 64 Minnesota Law Review 893. The author, like Coffey, is critical of the Howey test (as modified by later cases). The criticism of the test is twofold: its failure to solve many troublesome cases and its not being in accord with the results in many decided cases.

to a financial instrument indicates that it must be possible to issue and sell the instrument for the purpose of obtaining funds for investment (in the sense that the issuer is engaged in the production of goods and/or services and the proceeds of the issue are used in that process) and that the attractiveness of the instrument must relate to the success of the productive activities of the issuer so that the market can price the instrument and allocate investment funds accordingly. These limitations would eliminate for example cheques, trading in airline tickets, gambling transactions, commodity futures and advance payments for goods and services.

The most important element of this test is that the instrument be of a kind eligible to participate in a public market, that is, the instrument need not in fact be of a type currently traded but it must have certain characteristics that make it possible to contemplate trading it in public markets and do not confine it to privately negotiated contracts. Thus the instrument must not be unique, the instrument must be available for cash or something of general value and the return must be in cash or something of general value. This test excludes many loan transactions as involving securities because of their unique nature arising from detailed negotiations between the parties, personal service contracts, and co-operative arrangements (such as marketing co-operatives).

The main benefit of the test is claimed to be in the area of distinguishing debt instruments which are and which are not securities, a question which has been particularly troublesome in the U.S. On the basis of the test, sales of home units "off the plan" may well be securities (especially in view of the quite active trade that occurred in Queensland in this area) but franchises would in most cases not involve securities.

Despite the difficulties encountered in the fundamental problem of applying the current definition of a security and of an investment contract, a recent thorough review of the U.S. securities laws under the auspices of the American Law Institute decided against any attempt at a major reformulation of the definition[16]. The comment is made:

This section should be changed as little as possible, both because there is now a considerable body of jurisprudence and because it was substantially followed in the Uniform Securities Act, so that there is also a degree of uniformity' at both state and federal levels.

The second reason is not relevant to Australia since it has been found possible here to obtain uniformity at all levels. The first reason indicates that there is no easy answer to finding legislative language that at the one time creates certainty of application and produces results in particular cases that accord with the intention of the legislation. A significant contribution from the courts will be needed in any solution of the problem.

16. American Law Institute, Federal Securities Code (1980) pp. 196-198 provides so far as relevant:

(A) GENERAL - "Security" means a bond, debenture, note, evidence of indebtedness, share in a company (whether or not transferable or denominated "stock"), preorganization certificate or subscription, investment contract, certificate of interest or participation in a profit-sharing agreement, collateral trust certificate, equipment trust certificate (including a conditional sale contract or similar interest or instrument serving the same purpose), voting trust certificate, certificate of deposit for a security, or fractional undivided interest in oil, gas, or other mineral rights, or, in general, an interest or instrument commonly considered to be a "security", or a certificate of interest or participation in, temporary or interim certificate for, receipt for, guarantee of, or warrant or right to subscribe to or buy or sell, any of the foregoing.

(B) EXCLUSIONS - Notwithstanding section 202(150)(A), "security" does not include (i) currency; (ii) a check (whether or not certified), draft, bill of exchange, or bank letter of credit; (iii) (except for purposes of Part XV) a note or evidence of indebtedness issued in a primarily mercantile or consumer, rather than investment, transaction not involving a distribution (see also sections 202(25) and 302(11)); (iv) an interest in a deposit account with a bank (but not a participation in such interests); (v) (except for purposes of parts XII and XIV) a bank certificate of deposit that ranks on a parity in liquidation with an interest

in a deposit account with a bank; (vi) an insurance policy (including an endowment policy) issued by a company within section 202(76)(A); (vii) an annuity contract (including an optional annuity contract) under which a company within section 202(76)(A) promises to pay one or more sums of money that are fixed or vary in accordance with a cost-of-living index or on any other basis specified by rule; (viii) a commodity contract (whether for present or future delivery) or warrant or right to buy or sell such a contract; or (ix) the interest of a mini-account client in a mini-account under advisement if section 914(c) is effective.

Nonetheless this outline of developments in the U.S. and of the views of some of the commentators suggests possible lines of development for Australia; namely, a definition of prescribed interest of the "list" type or alternatively one couched in terms of the economic effects of a transaction and consistent with the degree of investor-protection required by the policy-maker.

It is to be noted that the U.S., unlike Australia in regard to prospectuses, has dealt with all securities as a group in its legislative framework, and not separately with shares, debentures and other securities[17]. Like Australia, however, public issues are dealt with in one statute, the Securities Act of 1933, and the regulation of markets and market participants in another, the Securities Exchange Act of 1934. The reason for this difference is largely historical but as a result problems have been experienced with slight differences in wording, needless complexity and the working out of remedies. One of the major changes proposed in the Securities Code of the American Law Institute is the consolidation of all the relevant legislation into one statute[18]. In this approach there is also a possible future direction for Australia.

Canada

The relevant legislation is found at the provincial level in Canada and is not completely uniform. Ontario has been the main innovator and the legislation of other provinces tends to

7. Thus Securities Act of 1933 dealing with prospectuses (called registration statements in the statute) provides in ss4 and 5:

4. The provisions of section 5 shall not apply to:
…
(2) transactions by an issuer not involving any public offering ...

5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly [to issue a security].

18. American Law Institute, pp. xix-xx.

follow Ontario. The Ontario Securities Act 1978 s1(1)40 contains the following definition of "security":

"security" includes,

i. any document, instrument or writing commonly known as a security,

ii. any document constituting evidence of title to or interest in the capital, assets, property, profits, earnings or royalties of any person or company,

iii. any document constituting evidence of an interest in an association of legatees or heirs,

iv. any document constituting evidence of an option, subscription or other interest in or to a security,

v. any bond, debenture, note or other evidence of indebtedness, share, stock, unit, unit certificate, participation certificate, certificate of share or interest, preorganization certificate or subscription other than a contract of insurance issued by an insurance company licensed under The Insurance Act and an evidence of deposit issued by a bank to which the Bank Act (Canada) applies or by a loan corporation or trust company registered under The Loan and Trust Corporation Act,

vi. any agreement under which the interest of the purchaser is valued for purposes of conversion or surrender by reference to the value of a proportionate interest in a specified portfolio of assets, except a contract issued by an insurance company licensed under The Insurance Act which provides for payment at maturity of an amount not less than three quarters of the premiums paid by the purchaser for a benefit payable at maturity,

vii. any agreement providing that money received will be repaid or treated as a subscription to shares, stock, units or interests at the option of the recipient or of any person or company,

viii. any certificate of share or interest in a trust, estate or association,

ix. any profit-sharing agreement or certificate,

x. any certificate of interest in an oil, natural gas or mining lease, claim or royalty voting trust certificate,

xi. any oil or natural gas royalties or leases or fractional or other interest therein,

xii. any collateral trust certificate,

xiii. any income or annuity contract not issued by an insurance company or an issuer within the meaning of The Investment Contracts Act,

xiv. any investment contract, other than an investment contract within the meaning of The Investment Contracts Act,

xv. any document constituting evidence of an interest in a scholarship or educational plan or trust, and

xvi. any commodity futures contract or any commodity futures option that is not traded on a commodity futures exchange registered with or recognized by the Commission under The Commodity Futures Act, 1978 or the form of which is not accepted by the Director under that Act,

whether any of the foregoing relate to an issuer or proposed issuer;

It will be noted that the definition is of the "list" type and, because it includes the term "investment contract" analysed above, is an open-ended list. It also incorporates a number of exclusions notably concerning banks and insurance companies. The Canadian law as a result has tended to follow developments in the U.S., including the treatment of shares, debentures and other securities together through the comprehensive definition of security. In one respect the Canadian provinces are in advance of the U.S. The provisions concerning public offerings, markets and market participants have been consolidated into one statute, for example in the case of Ontario, the Securities Act 1978.

At the federal level a draft Act was prepared as part of the Proposals for a Securities Market Law for Canada. It contains the following definition of "security" in s2.45:[19]

"Security" means a

(a)(i) bond, debenture, note or other evidence of indebtedness,

(ii) share, stock, unit, unit certificate, participation certificate or certificate of share or interest,

(iii) preorganization certificate or subscription,

(iv) agreement under which the interest of the purchaser is valued for purposes of conversion or surrender by reference to the value of a proportionate interest in a specified portfolio of assets, or

(v) interest or instrument commonly known as a security,

(b) interest or document constituting evidence of an interest or participation in:

(i) a profit-sharing agreement

(ii) a trust, estate or association, or

(iii) an oil, natural gas or mining lease, claim or royalty or other mineral right,

(c) voting trust certificate,

(d) collateral trust certificate,

(e) equipment trust certificate,

(f) investment contract, and

(g) right to acquire or sell a security specified in paragraphs (a) to (f),

whether any of the foregoing relates to a person or a proposed person but does not include

(h) currency,

(i) a cheque, bill of exchange or bank letter of credit,

19. Proposals for a Securities Market Law for Canada (1979) Vol. 1, pp.11-12; the sources listed are the Ontario Securities Act 1978 and the American Law Institute Federal Securities Code.

(j) a deposit account with

(i) a bank,

(ii) a credit union within the meaning of paragraph 137(6)(b) of the Income Tax Act, or

(iii) another deposit-taking institution that is a member institution under the Canada Deposit Insurance Corporations Act or any of the deposits with which are insured or guaranteed under a provincial enactment that provides depositors with protection against the loss of monies on deposit with financial institutions, or

(k) an insurance policy or a fixed income or fixed annuity contract issued by an insurance corporation.

It will be seen that the definition is of the list type and includes an "investment contract" which term is not defined. Again the proposed Act would deal with securities comprehensively as regards public offerings, markets and market participants in one statute. The exclusions from the definition should also be noted; they are less comprehensive than the U.S. exclusions but additional exemptions are found in s3.01 as follows:

3.01 Subject to section 3.04 and to Part 14, this Act does not apply to:

(a) a negotiable promissory note or commercial paper maturing not more than one year from the date of issue if the note or commercial paper has a denomination or principal amount of at least $50,000 or a greater amount prescribed by the Commission;

(b) a promissory note or other evidence of indebtedness issued in a mercantile or consumer transaction, including without limiting the foregoing a security evidencing indebtedness due under a conditional sales contract or other title retention contract providing for the acquisition of personal property, if the security is not sold to a person other than a financial institution;

(c) a receipt or trust certificate issued by a bank or other deposit-taking institution referred to in paragraph 2.45(j) for money received;

(d) a mortgage or other encumbrance on real or personal property, other than one contained in or secured by a bond, debenture or similar obligation or in a trust deed or other instrument to secure bonds, debentures or similar obligations, if the mortgage or other encumbrance is not sold in prescribed circumstances; or

(e) a security of an issuer, other than a reporting issuer, where the total number of security holders of the issuer, excluding employees, is less than fifty.

There is also a power in the draft Act for the Commission to exempt securities from the operation of the Act together with a power to remove the exemptions given by s3.01 quoted above (s3.03, 3.04).

Among the background papers is one by Professor Iacobucci entitled "The Definition of Security for Purposes of a Securities Act". He recommended against defining "investment contract", stating:[20]

"investment contract" has been the phrase of the definition of security which has received the most attention from the courts and securities administrators. There is no question that the phrase should appear in the definition of security. But should the words "investment contract" themselves be defined in the statute to give greater certainty and precision to the scope of the statute? Several commentators have suggested definitions of investment contract based on their analyses of the statutory objectives and the cases interpreting the phrase. The ALI Federal Securities Code does not define the term and this omission has been critisized as disappointing.

It is recommended that investment contract not be defined in the statute for several reasons. First, the general tests which have been offered are themselves capable of wide interpretation and some ambiguity, to the extent that one wonders what really is gained by trying to define investment contract. Second, the decisions of the courts and securities administrators (admittedly borrowing from U.S. experience) have shown an increasing familiarity with the term, and the results to date provide reasonable guidance to promoters and lawyers on what is or is not an investment contract. Finally, uniformity among the provincial statutes -especially in basic definitions such as that of a security - is extremely important, and so a definition of investment contract should probably await further experience and consultation among the various jurisdicitons in Canada.

With the expansive interpretation of "investment contract", it is questionable whether a number of headings found at present in the definition of "security" are really necessary. Most notable is the following heading:

"any document constituting evidence of title or interest in the capital, assets, property, profits, earning, or royalties of another person."

This heading has also been described as too broad and uncertain for inclusion in a securities act and should probably be rejected on that basis.

Although the interpretation of "investment contract" in Canada may have given reasonable guidance there, it may be doubted if the same can be said of the interpretation of "prescribed interest" in Australia. Moreover, it will be noted that the question of uniformity of provincial law is raised as one

20. Vol.3, ch.V pp.344-345.

argument for continuing with the current Canadian definition of a security; as already indicated in relation to similar views in the U.S., this is not a difficulty in Australia. Hence the main value of the Canadian proposal (as with the Americal Law Institute proposal) is in indicating a type of approach which is to list certain types of securities and then to use an open-handed term that allows the courts to fashion the definition to meet new situations.

Some care has been used in compiling the list contained in the draft Act and Iacobucci's suggestion that certain words in existing Canadian definitions be omitted is adopted in the draft definition (compare sl(1)40(ii) of the Ontario definition quoted above). This care highlights one of the dangers of the list approach. It is all too easy in developing an open-ended list to use alternative forms of expression which cover similar situations and which are very broad in their terms, leaving it to the courts to read the various parts of the definition narrowly or broadly as seems to suit the case in hand. In other words a comprehensive list may make it difficult to discern a legislative purpose in the words used, and as explained in the previous chapter, this has created difficulties for Australian courts which take a different approach to legislative interpretation as compared to their North American counterparts.

United Kingdom

The United Kingdom legislation in the area of this paper has recently undergone considerable reform. The legislation controlling investments and deposits was to be found until 1986 in the companies legislation, the Prevention of Fraud (Investments) Act 1958 and the Protection of Depositors Act 1963. The companies legislation controlled public offerings of shares and debentures while unit trusts were regulated under the Prevention of Fraud (Investments) Act 1958. The latter Act also restricted the advertising of shares, debentures, units and certain other opportunities. The

Protection of Depositors Act 1963 restricts advertising for deposits of money and regulates companies which advertise for deposits.

There is no general definition of securities in the Companies Act 1985. In s744 there are definitions, so far as relevant, only of "share" and "debenture". In the related legislation Company Securities (Insider Dealing) Act 1985 there is a definition of "securities" in s12(1) as follows:

"securities" means listed securities and [in the case of certain companies] the following securities (whether or not listed), that is to say, any shares, any debentures, or any right to subscribe for, call for or make delivery of a share or debenture.

There are related definitions of listed securities, debenture and share. This definition of securities is clearly a very narrow one but this fact can be explained by the narrow purpose of the legislation which is sufficiently described in its title.

In s26(1) of the Prevention of Fraud (Investments) Act 1958 there was a definition of "securities" but it referred to specific types of investment and contained no general words comparable with those in the definition of "participation interest". It provided as follows:-

"securities" means:

(a) shares or debentures, or rights or interests (described whether as units or otherwise) in any shares or debentures, or

(b) securities of the Government of the United Kingdom or of Northern Ireland or the Government of any country or territory outside the United Kingdom, or

(c) rights (whether actual or contingent) in respect of money lent to, or deposited with, any industrial and provident society or building society,

and includes rights or interests (described whether as units or otherwise) which may be acquired under any unit trust scheme under which all property for the time being subject to any trust created in pursuance of the scheme consists of such securities as are mentioned in paragraph (a), paragraph (b) or paragraph (c) of this definition.

That definition was supported by further definitions as follows:

"shares" means shares in the share capital of a corporation or stock of a corporation, or shares in such an unincorporated building society as is mentioned in section seven of the Building Societies Act, 1874;

"debentures" means any debentures, debenture stock or bonds of a corporation, whether constituting a charge on the assets of the corporation or not;

"unit trust scheme" means any arrangements made for the purpose, or having the effect, of providing facilities for the participation by persons, as beneficiaries under a trust, in profits or income arising from the acquisition, holding, management or disposal of securities or any other property whatsoever.

The definition of "securities" determined the ambit of many provisions in the 1958 Act. However, in ss13 and 14, it had been necessary to go beyond what was comprehended by "securities". Sections 13 and 14 (in part) were as follows:

13.-(1) Any person who, by any statement, promise or forecast which he knows to be misleading, false or deceptive, or by any dishonest concealment of material facts, or by the reckless making (dishonestly or otherwise) of any statement, promise or forecast which is misleading, false or deceptive, induces or attempts to induce another person:

(a) to enter into or offer to enter into:

(i) any agreement for, or with a view to, acquiring, disposing of, subscribing for or underwriting securities, or

(ii) any agreement the purpose or pretended purpose of which is to secure a profit to any of the parties from the yield of securities or by reference to fluctuations in the value of securities, or

(b) to take part or offer to take part in any arrangements with respect to property other than securities, being arrangements the purpose or effect, or pretended purpose or effect, of which is to enable persons taking part in the arrangements (whether by becoming owners of the property or any part of the property or otherwise) to participate in or receive profits or income alleged to arise or to be likely to arise from the acquisition, holding, management or disposal of such property, or sums to be paid or alleged to be likely to be paid out of such profits or income, or

(c) to enter into or offer to enter into an agreement the purpose or pretended purpose of which is to secure a profit to any of the parties by reference to fluctuations in the value of any property other than securities.

shall be guilty of an offence, and liable to imprisonment for a term not exceeding seven years.

14.-(1) Subject to the provisions of this section, no person shall:

(a) distribute or cause to be distributed any documents which, to his knowledge, are circulars containing:

(i) any invitation to persons to do any of the acts mentioned in paragraphs (a) to (c) of subsection (1) of the last preceding section, or

(ii) any information calculated to lead directly or indirectly to the doing of those acts by the recipient of the information, or

(b) have in his possession for the purpose of distribution any documents which, to his knowledge, are such circulars as aforesaid, being documents of such a nature as to show that the object or principal object of distributing them would be to communicate such an invitation or such information as aforesaid.

(2) The preceding subsection shall not apply:

(a) in relation to any distribution of a prospectus to which section thirty-eight of the Companies Act 1948, applies or would apply if not excluded by paragraph (b) of subsection (5) of that section or by section thirty-nine of that Act or section four hundred and seventeen of that Act applies or would apply if not excluded by paragraph (b) of subsection (5) of that section or by section four hundred and eighteen of that Act, or in relation to any distribution of a document relating to securities of a corporation incorporated in Great Britain which is not a registered company, being a document which:

(i) would, if the corporation were a registered company, be a prospectus to which the said section thirty-eight applies or would apply if not excluded as aforesaid; and

(ii) contains all the matters and is issued with the consents which by virtue of sections four hundred and seventeen and four hundred and nineteen of that Act it would have to contain and be issued with if the corporation were a company incorporated outside Great Britain and the document were a prospectus issued by that company;

(b) in relation to any issue of a form of application for shares in, or debentures of, a corporation, together with:

(i) a prospectus which complies with the requirements of section thirty-eight of the Companies Act 1948, or is not required to comply therewith because excluded by paragraph (b) of subsection (5) of that section or by section thirty-nine of that Act, or complies with the requirements of Part X of that Act relating to prospectuses

and is not issued in contravention of section four hundred and nineteen of that Act, or

(ii) in the case of a corporation incorporated in Great Britain which is not a registered company, a document containing

all the matters and issued with the consents mentioned in sub-paragraph (ii) of paragraph (a) of this subsection,

or in connection with a bona fide invitation to a person to enter into an underwriting agreement with respect to the shares or debentures, or

(c) in relation to any distribution of documents which is required or authorised by or under any Act other than this Act or by or under any enactment of the Parliament of Northern Ireland,

and shall not apply in relation to any distribution of documents which is permitted by the Board of Trade.

(3) This section shall not prohibit the distribution or possession of any document by reason only:

(a) that it contains an invitation or information:

(i) made or given with respect to any securities by or on behalf of a member of any recognised stock exchange or recognised association of dealers in securities, or by or on behalf of the holder of a principal's licence, or

(ii) made or given with respect to any securities by or on behalf of the Bank of England or any exempted dealer, or

(iii) made or given by or on behalf of a corporation to holders of securities of, or to persons employed by, or to creditors of, that corporation or any other corporation which, in relation to the first-mentioned corporation, is a subsidiary company as defined by section one hundred and fifty-four of the Companies Act 1948, with respect to securities of the first-mentioned corporation or of any such other corporation as aforesaid, or

(iv) made or given by or on behalf of the manager under an authorised unit trust scheme with respect to any securities created in pursuance of that scheme, or

(v) made or given by or on behalf of the Government of the United Kingdom or of Northern Ireland or the Government of any country or territory outside the United Kingdom or by or on behalf of any statutory corporation or municipal corporation, with respect to securities of that Government or corporation, or

(vi) made or given by or on behalf of any industrial and provident society or building society with respect to shares of the society, or loans or deposits which may be made to or with the society, or

(vii) made or given to beneficiaries under a trust by or on behalf of a person acting in the capacity of a trustee of that trust, or

(viii) made or given with respect to any securities in connection only with a sale or proposed sale of those securities by auction, or

(b) that it contains an invitaiton or information which a person whose ordinary business or part of whose ordinary business it is to buy and sell any property other than securities (whether as a principal or as an agent) may make or give in the course of the business of buying and selling such property.

Provided that nothing in paragraph (a) of this subsection shall authorise the doing of anything in respect of securities created in pursuance of any unit trust scheme which is not an authorised unit trust scheme; and nothing in paragraph (b) of this subsection shall authorise any person to do anything in pursuance of, or for the purpose of, any such arrangements as are mentioned in paragraph (b) of subsection (1) of the last preceding section.

(4) Documents shall not, for the purposes of this section, be deemed not to be circulars by reason only that they are in the form of a newspaper, journal, magazine or other periodical publication; but a person shall not be taken to contravene this section by reason only that he distributes, or causes to be distributed, to purchasers thereof, or has in his possession for the purpose of distribution to purchasers thereof, copies of any newspaper, journal, magazine or other periodical publication.

(5) A person shall not be taken to contravene this section by reason only that he distributes documents to persons whose business involves the acquisition and disposal, or the holding, of securities (whether as principal or as agent), or causes documents to be distributed to such persons, or has documents in his possession for the purpose of distribution to such persons.

The extensions beyond "securities" were in s13(1)(b) and 13(1) (c). Section 13(1)(b) was confined to arrangements under which profits or income were to arise from the acquisition, holding, management or disposal of property or at least calculated by reference to the value of property[21]. While there was uncertainty as to whose property was in question[22] s13(1) (b) by not including purely contractual schemes unrelated to property was narrower than the Australian definition of prescribed interest. Section 13(1)(c) was directed at invitations to enter difference transactions[23].

21. Pennington, The Investor and the Law (1968), p37.

22. Section 13(1)(b) was considered in Hughes v Trapnell [1963] 1 QB 737 but the Court did not have to resolve this question. Section 13(1)(b) was also considered by the House of Lords in Secretary

of State for Trade v Markus [1976] AC 35 but the question of the types of opportunities covered by the provision did not have to be decided.

23. Pennington, p37.

To this point the U.K. legislation could be described as adopting a piecemeal approach with different legislation dealing with different situations and reflecting an historical evolution. In this regard it may be compared to the Australian companies legislation, though not the securities industry legislation. The definitions in relation to securities other than shares or debentures are of the list kind but tend to be specific and add up to a closed list (as opposed to the open-ended list of the North American kind with its reference to investment contract). Again there is a marked contrast to the Australian definition of prescribed interest.

In January 1985 the United Kingdom Government in a White Paper announced[24] legislation providing a new framework for investor protection. The Government said in its White Paper:

"4.2 The definition of "investments" will set the boundaries of the regulatory area. It is therefore fundamental to the proposed system of regulation ... The definition - which will be in the primary legislation -will be specific (to provide certainty for practitioners, customers and investors) and wide (to achieve consistency of treatment between different financial services). In addition, the Secretary of State will be able to redefine the boundary by bringing in or excluding single "investments" through secondary legislation, thus giving him the flexibility needed to adjust the law speedily in the light of new practices and products.

…

4.4 Rights in various forms of tangible property like plantations or bloodstock have, when offered for participation by the public, many of the characteristics of stock in a company and accordingly need to be regulated as investments. But the Government does not intend the legislation to regulate market gardening, stud farming, franchising etc. as such.

4.5 Many life assurance policies have the characteristics of investments. The Government proposes that the marketing of long-term life assurance contracts should be treated as far as possible on the same footing as other similar investments ...

4.6 Non-life insurance policies are not commonly regarded, or sold, as investments and will not be treated as such in the legislation.

24. Financial Services in the United Kingdom. Cmnd 9532 (January, 1985)

4.7 "Investments" will be defined to exclude:

(i) property which can be inspected by (or for) the potential purchaser and which passes under his direct physical control if he buys it; and

(ii) a business, or the assets of a business, offered for sale as a single entity."

The legislation to give effect to this announcement, the Financial Services Act 1986, has now been passed. In many respects it represents the most comprehensive and coherent treatment of securities to be found in a single statute and warrants close consideration. The definition of investments in sl adopts the extensive terms of Schedule I Part 1 which covers:

Shares etc.

1. Shares and stock in the share capital of a company.

Note. In this paragraph "company" includes any body corporate and also any unincorporated body constituted under the law of a country or territory outside the United Kingdom but does not include an open-ended investment company or any body incorporated under the law of, Or any part of, the United Kingdom relating to building societies, industrial and provident societies or credit unions.

Debentures

2. Debentures, including debenture stock, loan stock, bonds, certificates of deposit and other instruments creating or acknowledging indebtedness, not being instruments falling within paragraph 3 below.

Note. This paragraph shall not be construed as applying:

(a) to any instrument acknowledging or creating indebtedness for, or money borrowed to defray, the consideration payable under a contract for the supply of goods or services;

(b) to a cheque or other bill of exchange, a banker's draft or a letter of credit; or

(c) to a banknote, a statement showing a balance in a current, deposit or savings account or (by reason of any financial obligation contained in it) to a lease or other disposition of property, a heritable security or an insurance policy.

Government and public securities

3. Loan stock, bonds and other instruments creating or acknowledging indebtedness issued by or on behalf of a government, local authority or public authority.

Notes.

(1) In this paragraph "government, local authority or public authority" means:

(a) the Government of the United Kingdom, of Northern Ireland, or of any country or territory outside the United Kingdom;

(b) a local authority in the United Kingdom or elsewhere;

(c) any international organisation the members of which include the United Kingdom or another member State.

(2) The Note to paragraph 2 above shall, so far as applicable, apply also to this paragraph.

Instruments entitling to shares or securities

4. Warrants or other instruments entitling the holder to subscribe for investments falling within paragraph 1,2 or 3 above.

Notes.

(1) It is immaterial whether the investments are for the time being in existence or identifiable.

(2) An investment falling within this paragraph shall not be regarded as falling within paragraph 7,8 or 9 below.

Certificates representing securities

5. Certificates or other instruments which confer:

(a) property rights in respect of any investment falling within paragraph 1,2,3 or 4 above;

(b) any right to acquire, dispose of, underwrite or convert an investment, being a right to which the holder would be entitled if he held any such investment to which the certificate or instrument relates; or

(c) a contractual right (other than an option) to acquire any such investment otherwise than by subscription.

Note.

This paragraph does not apply to any instrument which confers rights in respect of two or more investments issued by different persons or in respect of two or more different investments falling within paragraph 3 above and issued by the same person.

Units in collective investment scheme

6. Units in a collective investment scheme, including shares in or securities of an open-ended investment company.

Options

7. Options to acquire or dispose of:

(a) an investment falling within any other paragraph of this Part of this Schedule;

(b) currency of the United Kingdom or of any other country or territory;

(c) gold or silver; or

(d) an option to acquire or dispose of an investment falling within this paragraph by virtue of (a), (b) or (c) above.

Futures

8. Rights under a contract for the sale of a commodity or property of any other description under which delivery is to be made at a future date and at a price agreed upon when the contract is made.

Notes.

(1) This paragraph does not apply if the contract is made for commercial and not investment purposes.

(2) A contract shall be regarded as made for investment purposes if it is made or traded on a recognized investment exchange or made otherwise than on a recognised investment exchange but expressed to be as traded on such an exchange or on the same terms as those on which an equivalent contract would be made on such an exchange.

(3) A contract not falling within Note (2) above shall be regarded as made for commercial purposes if under the terms of the contract delivery is to be made within seven days.

(4) The following are indications that any other contract is made for a commercial purpose and the absence of any of them is an indication that it is made for investment purposes:

(a) either or each of the parties is a producer of the commodity or other property or uses it in his business;

(b) the seller delivers or intends to deliver the property or the purchaser takes or intends to take delivery of it.

(5) It is an indication that a contract is made for commercial purposes that the price, the lot, the delivery date or the other terms are determined by the parties for the purposes of the particular contract and not by reference to regularly published prices, to standard lots or delivery dates or to standard terms.

(6) The following are also indications that a contract is made for investment purposes:

(a) it is expressed to be as traded on a market or on an exchange;

(b) performance of the contract is ensured by an investment exchange or a clearing house;

(c) there are arrangements for the payment or provision of margin.

(7) A price shall be taken to have been agreed upon when a contract is made:

(a) notwithstanding that it is left to be determined by reference to the price at which a contract is to be

entered into on a market or exchange or could be entered into at a time and place specified in the contract; or

(b) in a case where the contract is expressed to be by reference to a standard lot and quality, notwithstanding that provision is made for a variation in the price to take account of any variation in quantity or quality on delivery.

Contracts for differences etc.

9. Rights under a contract for differences or under any other contract the purpose or pretended purpose of which is to secure a profit or avoid a loss by reference to fluctuations in the value or price of property of any description or in an index or other factor designated for that purpose in the contract.

Note. This paragraph does not apply where the parties intend that the profit is to be obtained or the loss avoided by taking delivery of any property to which the contract relates.

Long term insurance contracts

10. Rights under a contract the effecting and carrying out of which constitutes long term business within the meaning of the Insurance Companies Act 1982.

Notes.

(1) This paragraph does not apply to rights under a contract of insurance if:

(a) the benefits under the contract are payable only on death or in respect of incapacity due to injury, sickness or infirmity;

(b) no benefits are payable under the contract on a death (other than a death due to accident) unless it occurs within ten years of the date on which the life of the person in question was first insured under the contract or before that person attains a specified age not exceeding seventy years;

(c) the contract has no surrender value or the consideration consists of a single premium and the surrender value does not exceed that premium; and (d) the contract does not make provision for its conversion or extension in a manner that would result in its ceasing to comply with paragraphs (a), (b) and (c) above.

(2) Where the provisions of a contract of insurance are such that the effecting and carrying out of the contract:

(a) constitutes both long term business within the meaning of the Insurance Companies Act 1982 and general business within the meaning of that Act; or

(b) by virtue of section 1(3) of that Act constitutes long term business notwithstanding the inclusion of subsidiary general business provisions,

references in this paragraph to rights and benefits under the contract are references only to such rights and benefits as are attributable to the provisions of the contract relating to long term business.

(3) This paragraph does not apply to rights under a re-insurance contract.

(4) Rights falling within this paragraph shall not be regarded as falling within paragraph 9 above.

Rights and interests in investments

11. Rights to and interests in anything which is an investment falling within any other paragraph of this Part of this Schedule.

Notes.

(1) This paragraph does not apply to interests under the trusts of an occupational pension scheme.

(2) This paragraph does not apply to rights or interests which are investments by virtue of any other paragraph of this Part of this Schedule.

Some of the terms used are further defined elsewhere in the legislation. The power to extend the definition is found in Financial Services Act 1986 s2 as follows:

2.- (1) The Secretary of State may by order amend Schedule 1 to this Act so as:

(a) to extend or restrict the meaning of investment for the purposes of all or any provisions of this Act; or

(b) to extend or restrict for the purposes of all or any of those provisions the activities that are to constitute the carrying on of investment business or the carrying on of such business in the United Kingdom.

(2) The amendments that may be made for the purposes of subsection (1)(b) above include amendments conferring powers on the Secretary of State, whether by extending or modifying any provision of that Schedule which confers such powers or by adding further such provisions.

(3) An order under this section which extends the meaning of investment or extends the activities that are to constitute the carrying on of investment business or the carrying on of such

business in the United Kingdom shall be laid before Parliament after being made and shall cease to have effect at the end of the period of twenty-eight days beginning with the day on which it is made (but without prejudice to anything done under the order or to the making of a new order) unless before the end of that period the order is approved by a resolution of each House of Parliament.

(4) In reckoning the period mentioned in subsection (3) above no account shall be taken of any time during which Parliament is dissolved or prorogued or during which both Houses are adjourned for more than four days.

(5) Any order under this section to which subsection (3) above does not apply shall be subject to annulment in pursuance of a resolution of either House of Parliament.

(6) An order under this section may contain such transitional provisions as the Secretary of State thinks necessary or expedient.

Some of the exclusions referred to in the White Paper are effected not through the definition of investment but via exceptions to the concept of carrying on an investment business which is one of the central concepts of the Act.

There are many features of interest in the present context in the Financial Services Act. It continues the U.K. tradition of having a closed (but now comprehensive) list of investments covered by the legislation (in the interests of certainty) while it adopts the novel procedure of allowing the Executive to enlarge the list to catch any new types of transactions within the spirit of the legislation. The drafting of the Schedule set out above also reflects this "spirit of the law" approach with phraseology more reminiscent of the City Code on Takeovers[25] than a typical statute. Market participants have been consulted in the drafting of the legislation and no doubt have an understanding of the commercial significance of the terms used.

The adoption of a power to enlarge the operation of the Act is to be contrasted with the Canadian draft Act which has a power to enlarge the operation of the Act but only through the removal of exemptions. Where there is an open-ended list of situations covered by the definition of security, then the need to meet new situations can be achieved by an enlarged interpretation of terms in the definition such as investment

25. The City Code is a self regulatory mechanism of the securities industry which controls most aspects of takeovers in the U.K.

contract. Thus the power to enlarge the definition is less necessary. Where the list covered by the definition does not include open-ended terms then the case for a general enlarging power is the stronger.

The adoption of a numbered list in the U.K. also gives flexibility in the drafting of the substantive provisions of the legislation. Thus in relation to the registration of dealers etc. the full definition is used but in relation to the requirement of a prospectus for unlisted securities the relevant provisions are limited to investments covered by paras 1, 2, 4, and 5 of the definition[26]. In this way it is possible to cover a wider range of activities in one statute than even the comprehensive securities laws of North America (and thus subject them to a similar regulatory regime) whilst at the same time there can be selectivity as to the operation of particular forms of regulation in particular situations.

Use of this model would represent a departure from the current Australian tradition. Still it offers a possible guide not only in relation to the definition of securities other than shares and debentures but also for dealing with securities generally in one comprehensive statute. The list approach to the definition problem has been carried to its most refined form in this legislation and as the Financial Services Act is bound to be influential around the world when reform of securities regulation is discussed, its approach needs to be seriously considered in Australia.

New Zealand

In New Zealand the Securities Act 1978 regulates the offer of securities to the public. "Security" is defined in s2 as follows:

"any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person; and includes:

26. Financial Services Act 1986 ss3, 158. The prospectus provisions of the Companies Act 1985 are repealed by the Financial Services Act.

(a) Any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property); and

(b) Any renewal or variation of the terms or conditions of any existing security."

It is apparent from other parts of the Act that "security" comprehends three broad kinds of investment opportunities and no others. They are an "equity security", a "debt security" and a "participatory security". Those expressions are defined as follows:

"Equity security" means any interest in or right to a share in the share capital of a company; and includes:

(a) A preference share, and company stock;

(b) Any renewal or variation of the terms or conditions of any existing equity security; and

(c) Any security that is declared by the Governor-General, by Order in Council, to be an equity security for the purposes of this Act.

"Debt security" means any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property); and includes:

(a) A debenture, debenture stock, bond, note, certificate of deposit, and convertible note; and

(b) Any renewal or variation of the terms or conditions of any existing debt security; and

(c) Any security that is declared by the Governor-General, by Order in Council, to be a debt security for the purposes of this Act

but does not include an interest in a contributory mortgage;

"Participatory security" means any security other than an equity or a debt security.

The tri-partite classification of securities is mainly for the purposes of s33 and other provisions which prescribe not only disclosure requirements in respect of public offerings of securities generally but also special protective measures in

relation to debt securities and other protective measures in relation to participatory securities.

Thus far there are some noteworthy features of this statutory framework. First, the mechanism of a single statute is used to deal with securities rather than a combination of statutes. Secondly, the regulation operates on securities generally though there are special provisions dealing with particular types of securities. Comments relating to these features in other overseas legislation have already been made above.

Finally, the term "participatory security" which operates as the residual category depends on the extremely wide words of the definition of security, namely, "any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person"[27]. The quoted words are reminiscent of the words of the Ontario Securities Act 1978 sl(1)40ii which were omitted from the draft Canadian proposals on account of their breadth and uncertainty. Hence it may be unsafe to rely on the New Zealand legislation as a general guide for the inclusive part of the definition of security if particularity is to be sought in that part of the definition.

The problem of the breadth of the definition in New Zealand is addressed, however, by a number of exclusions. The Securities Act 1978 in s5(1) exempts a substantial number of specific investment opportunities from Part II. Those exemptions are as follows:

(a) Any policy of life or endowment assurance or any policy securing an annuity; or

(b) Any estate or interest in land for which a separate certificate of title can be issued under the Land Transfer Act 1952 or the Unit Titles Act 1972, other than any such estate or interest that:

(i) Forms part of contributory scheme; and

(ii) Does not entitle the holder to a right in respect of a specified part of the land for which a separate certificate of title can be so issued; or

(c) Any proprietary right to chattels (other than any such right that forms part of a contributory scheme); or

27. New Zealand's definition of "security" will thus raise the question whether the expression "interest or right to participate" extends beyond proprietary interests.

(d) Any share in the share capital of a flat or office owning company (as defined in section 2(1) of the Companies Amendment Act 1964); or

(e) Any interest or right to participate in the capital, assets, earnings, royalties, or other property of any company, partnership or other person whose sole undertaking is the practice, conduct or operation of any one or more of the professions, occupations, or businesses that may in law be practised, conducted, or operated only by persons having or possessing qualifications specified in the Second Schedule to this Act; or

(f) A mortgage of land other than a contributory mortgage; or

(g) ...

(h) A labour share or a share purchased or subscribed for by an employee of a company under an employee share purchase scheme (as defined in section 166 of the Income Tax Act 1976); or

(i) An interest in the Government Superannuation Fund.

There is a definition of a "contributory scheme" (which is referred to in paras (b) and (c) of s5(1) and operates as an exclusion from the exemption conferred by that provision) as follows:

...any scheme or arrangement that, in substance and irrespective of the form thereof, involves the investment of money in such circumstances that:

(a) The investor acquires or may acquire an interest in or right in respect of property; and

(b) Pursuant to the terms of investment that interest or right will or may be used or exercised in conjunction with any other interest in or right in respect of property acquired in like circumstances, whether at the same time or not;

but does not include such a scheme or arrangement if the number of investors therein does not exceed 5, and neither a manager of the scheme nor any associated person is a manager of any other such scheme or arrangement.

The definition of "contributory scheme" contains some of the elements of para (c) of the Australian definition of "participation interest" but they are not part of the definition of "security". It is also to be noted that there is wide discretionary exemption power in s5(5) of the New Zealand Act. Just as the existence of a dispensing power led the High Court in the Australian Softwoods

case to accept a wide literal meaning, so the wide exempting power given to the New Zealand Securities Commission could allow a similar interpretation of the New Zealand definition unless the New Zealand courts are able to discern a legislative policy and to interpret the definition in the light of it.

The New Zealand model in this area offers yet a further alternative to consider. The inclusive definition is extremely broad and open-ended without even the assistance of a detailed list to identify specific kinds of securities. Refinement in the operation of the legislation is then achieved through a long list of exemptions and exceptions from the exemptions. Although it may be doubted whether the attempt to construct a helpful inclusive definition should be abandoned as seems to have occurred in New Zealand, the reliance on a long list of refined exemptions does offer one method of achieving certainty in the (non) operation of the definition of security while retaining an inclusive part of the definition which is not a closed list of situations covered as in the U.K.

Moreover, if it should be necessary, as suggested later in this paper, for securities regulation to extend beyond shares and debentures to other analogous forms of investment opportunity already in being or yet to be developed, the New Zealand legislation provides a useful model for the integration of the regulatory laws in a measure devoted specially to securities and separate from companies legislation. In this regard it reflects the kind of approach in North America and the U.K.

CHAPTER 3

POSSIBLE RE-DEFINITION OF THE REGULATORY AREA'S BOUNDARY

The criteria for application of the companies and securities legislation

Assuming that the well recognised categories of shares and debentures are to be covered, the aim with respect to other transactions is to find criteria marking off the residual group of investment opportunities which can appropriately be regulated as securities under companies and securities legislation.

If it be accepted that improvement is needed in the existing definition of prescribed interest (which is the fundamental part of the Australian concept of securities besides shares and debentures), consideration of a new definition calls for an understanding of the proper reach of the regulatory system envisaged by the Formal Agreement of 22 December 1978. The Agreement contains the following recital that:

it is generally acknowledged in the interest of the public and of persons and authorities concerned with the administration of the laws relating to:

(a) companies; and
(b) the regulation of the securities industry,

that there should be uniformity both in those laws and in their administration in the States and Territories of Australia in order to promote commercial certainty and bring about a reduction in business costs and greater efficiency of the capital markets and that the confidence of investors in the securities market should be maintained through suitable provisions for investor protection;

Although expressed in terms of the benefits of uniformity, the recital indicates a concern for commercial certainty, a

reduction in business costs, efficiency in the raising of capital for commercial ventures and the maintenance of confidence in securities markets. These goals to a degree assume that securities are easily identified and are more concerned to provide guidelines for laws about securities rather than to define what a security is. Nonetheless, the goals do give some guidance on this more fundamental question.

The two key elements are the references to the raising of capital for commercial ventures and the maintenance of confidence in markets. Together these suggest that the core concept of a security is investment through public markets to channel capital to business. Shares and debentures spring to mind as the archetypal examples. On the other hand it seems reasonable to infer from this core concept that there is no intention to extend the companies and securities legislation generally to protect consumers of physical commodities.

Commercial certainty and reduction of business costs provide additional though subsidiary guidance. The former requires that any definition of a security should be as simple and clear as possible, given the very diverse range of transaction used to raise capital. The latter may be thought to require special justification for dual systems of regulation. Thus in relation to consumers of physical commodities the existence of other regulatory systems under trade practices and consumer affairs legislation supports the inference that they are not intended to be covered.

A possible approach is to recognise that offerings of those quintessential means of channelling capital to business, shares and debentures, are at the centre of the security concept and to extrapolate a definition of security from the essential and common characteristics of shares and debentures. Because of the wide range of transaction which may be used as close substitutes for shares or debentures, a proper system of securities regulation clearly should not be confined to shares or debentures but should extend to other transactions which exhibit similar economic features.

This extension is necessary so as to ensure the efficiency of the regulatory system in the sense of neutrality. In this context neutrality may be thought to require that the choice of the form used for a transaction is not unduly influenced by the system of regulation that applies, or to put the issue another way, the same system of regulation should apply to similar types of transactions.

Similarly the maintenance of confidence in the markets requires the appropriate regulation of the types of transactions currently used in public markets to channel capital to business and accordingly those transactions should be encompassed by any definition of a security which is adopted. Moreover because of the speed with which new types of transactions nowadays develop, some system is necessary to cope with transactions which in the future may quickly become the subject of activity in public markets in channeling capital to business.

The necessary flexibility could be achieved in a number of ways, one of which is to identify the general features exhibited by current transactions in the public markets and to apply the criteria developed to all transactions in characterising them as a security or not. This characterisation would apply whether or not the transactions currently occur in public markets, on the presumption that transactions not currently occurring in public markets that satisfy the criteria are likely to so occur in the future.

Adopting the approach suggested above and bearing in mind the goals of the Co-operative Scheme, the next step is to identify the features of a share or debenture which make them so suitable for raising capital for business. The criteria which appear to be significant in this context are as follows:

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

(ii) 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;[1]

(iv) the investor gives up value primarily in the quest for future financial gain; 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 similarity of these criteria to those identified in the U.S. discussions of the security concept will be evident. Although the six criteria are listed as separate, there is clearly a close relationship between a number of them. Thus if the person giving up value has no significant management or control over the use of the value given up, it follows almost as a matter of necessity that the person is relying primarily on the efforts of others in achieving financial gain. Nevertheless the reverse is not necessarily the case: it is possible that a person has significant control over the value given up but is still relying primarily on the efforts of others (for example, where the person has an effective veto over the use of the value given up). Similarly, criteria (ii) and (iv) are linked, while criterion (v) is likely to go hand in hand with (ii).

The criteria will be discussed in more detail in turn.

In considering whether a particular investment opportunity is analogous to a share or debenture, the first criterion should not give rise to difficulty. The second criterion is intended to identify that the value is acquired by an enterprise for

1. Outside the specific context of shares and debentures, this will be so even if the investor acquires property other than an intangible as a result of the transaction (for example, land or commodities).

profit making and productive purposes in the sense of being engaged in the production of goods and services. It would thus generally exclude betting syndicates and consumer loans.

In regard to the third criterion, the element of surrender of control over value raises questions as to the degree of control surrendered which should suffice to attract the protection provided for by the companies and securities system. It is not surrender of ownership in law that is in question. There may be a surrender of control by complete disposition of ownership of the value to a recipient so that the person giving value is left with no proprietary claim to anything in the hands of the recipient and has no more than the benefit of a personal undertaking to return value in certain events. Alternatively, the person may surrender total control over the value but retain a proprietary interest in the value surrendered. There could be a situation in which the investor surrenders control only to a limited degree so that in relation to some decisions affecting some aspects of the value given up he is to have a voice. The regulatory system should apply where the investor surrenders substantial control over the value he gives up.

The fact that the person providing the value acquires some tangible property (such as chattels or land) should not of itself take the opportunity outside the regulatory system. An acquisition of a tangible should not be outside the system where the person providing the value does not gain effective control of any property acquired in the transaction, or otherwise is unable to participate significantly in the management of the enterprise receiving the value.

This criterion would eliminate many joint ventures and franchising operations from the concept of a security (assuming that the giving up of value is not by way of archetypal securities such as shares). Conversely a forestry scheme would not be outside the regulatory system simply because as part of the scheme the investor buys the seedling trees which are then to be planted, maintained and harvested by someone else as a

small part of a large plantation. In this case the acquisition of the tangible trees is a relatively insignificant feature as against the practical lack of control over the trees. Similarly a vending machine scheme under which machines are sold to members of the public on terms that they will be leased to an operator would have to be characterised as satisfying this criterion.

The lack of control or participation in management may occur because of the nature of the property in question or because of contracts with other persons to confer control over the property on others (such as the purchase of a home unit coupled with a contract to allow a third party to lease the property to the exclusion of the purchaser[2]) or both (as in the case of the trees and vending machines).

The fourth criterion would exclude opportunities which are for personal consumption rather than investment. A decision to lay out value will not always be easily classified as an investment or a consumption decision. A person who purchases a house in which to reside is also, in a sense, an investor to the extent that he anticipates that he will gain from capital appreciation. For this reason the fourth criterion poses the question whether a particular opportunity in the circumstances is one which would normally be taken up primarily as an investment rather than for consumption.

The fifth criterion poses the question whether the acceptor of the opportunity is a passive or active party in the transaction. It is possible that the party giving value surrenders substantial control over the value, yet the prospect of financial gain depends significantly on the efforts of that person. Such cases may be rare but could arise in the franchising or joint venture situation. Marginal cases are inescapable and classification will be called for. The discussion of the second criterion of control will be of

2. Compare Maunder-Hartigan v Hamilton (1984) 9 ACLR 937.

relevance to this criterion also in view of the close link between the two.

The sixth criterion will eliminate transactions which are by their very nature inherently a matter for private negotiation between parties. Investor confidence and protection and the integrity of the markets are not affected by this type of transaction and so the need for the operation of the companies and securities legislation is arguably absent. Thus purchase of a particular farm or forestry plantation in its entirety should not involve a security as compared to participation in a farming or forestry scheme. Likewise employment contracts, bank loans, and membership of a genuine co-operative where the return is in the form of specific goods or services should be excluded on this basis.

The criteria outlined could be used in two ways in the framing of a definition of a prescribed interest or security. First, they could be included in legislation as matters to which the court and other interpreters were to have regard without being the definition in themselves, that is, as a statement of legislative purpose and an aid in interpretation of a separate definition which could itself be in specific or general terms. Secondly, the criteria could form the basis of a definition in general terms. If it is possible to agree on the relevant criteria which provide the necessary and sufficient elements of the concept of a security (and the criteria above are offered as one rather than the only possibility) then the use of the criteria in a general definition would be attractive. However, it may well be that agreement on this fundamental issue is difficult to achieve in which case the first approach has more appeal, though the use of a list of criteria in relation to a definition which itself is in general terms would be a drafting oddity.

A definition in general terms inevitably will create uncertainties, however, and so run counter to one of the goals of redrafting the definition referred to above. Fortunately it

is possible to have the best of both worlds by using exclusions or exceptions to inject certainty. And exclusions can assist in reduction of business costs where regulation under the companies and securities legislation is considered unnecessary.

Thus substantive exclusions will consist of at least two basic kinds. First, an exclusion is appropriate where it may be doubted whether or not the inclusive definition applies to a particular transaction and it is considered on balance that the transaction is not one that should be covered by the definition. (Conversely, an express inclusion can be used where it is desired to cover a particular transaction in the doubtful category). Secondly, even where a transaction is clearly within the inclusive part of the definition, there may be good reasons for not applying the definition, especially where there exists a satisfactory alternative regulatory framework.

If the exclusions are carefully handled the benefits of a general inclusive definition should be increased. It is to the fundamental question of the specific form of the inclusive part of the definition that the discussion now turns.

The Inclusive Part of the Definition of Prescribed Interest

In the light of the previous discussion a range of possibilities for reformulating the inclusive part of the definition of prescribed interest is canvassed. These can be best presented as a brief list and then expanded. The possibilities are:

1. minor modifications to the current definition which do not change its basic form;[3]

3. For example, authorising interpreters to have regard to the economic substance of any particular investment opportunity rather than being confined to consideration of its structure in legal terms as is the case in paras (a) and (b) of the existing definition of participation interest.

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 present definition with a closed list of situations covered;

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

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

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

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

These possibilities (which could be multiplied) are based on a number of distinct policy choices· Should the legislation attempt a statement of purpose directly through a specific

provision[4] or indirectly by a reformulation of the definition backed up by explanatory materials to which the courts could have regard? Or on the contrary, should the legislature not seek to be specific in the terms of the legislation and leave it to the court to sensibly interpret a general term like investment contract? Should the legislature abandon the present attempt at a general definition and adopt a closed list with or without an executive power to add to the list? Should the legislature abandon the current definition and attempt a new general definition which is clearer in its statement of purpose and general terms?

With respect to the particular possibilities, the first is not very attractive as it will simply lead to more and more detailed legislation as the legislature reacts to court decisions of which it does not approve as a matter of policy. This method has in a sense already been tried in relation to time-sharing and apparently is not regarded as satisfactory by the Ministerial Council to judge by this reference to the Companies and Securities Law Review Committee.

The second and third possibilities represent one potential direction of change with a general statement of purpose. However, if the current definition has been found unsatisfactory, it is not clear what change a statement of policy would produce. The method of treatment of the problems with the ultra vires doctrine may suggest that a statement of general policy is best introduced in the context of an entirely new definition.

The fourth and fifth possibilities are in the U.K. tradition. The achievement of certainty is improved under these approaches. The necessary flexibility to meet changing circumstances can be produced by using the model of the U.K. Financial Services Act 1986 and empowering the Ministerial Council or NCSC to declare that a particular opportunity is

4. For example, like Companies Act 1981 s.66C in relation to the ultra vires doctrine.

within the definition and stating criteria to guide the exercise of that power. Although these methods are alien to recent Australian practice, the success of this approach in the U.K. could usefully be monitored in the short term to see whether the power to add to the list needs to be used frequently (which may suggest that the system is not successful).

The sixth and seventh possibilities are based on the North American approach. In view of the Australian courts' current reluctance to acknowledge policy considerations, as compared to the North American approach generally to take legislative policy into account, it would probably be necessary to use a general statement of legislative purpose in order to produce like results to North America. This method may engender considerable uncertainty until the courts have adapted to the legislation and leaves the future development of the law in as much doubt as occurs in North America.

The last two possibilities build on the Australian tradition of having a general definition elaborated in some detail but embody a statement of purpose and new language so that the courts do not feel constrained by previous decisions on the existing definition. This approach would introduce uncertainty but the problem could be mitigated by having a relatively narrow definition and statement of purpose.

No solution is ideal. This is not surprising in view of overseas experience of attempting to cope with the problem, for no country seems yet to have found the ideal balance between certainty and flexibility and between too narrow and too broad an interpretation of the coverage of companies and securities legislation. In view of overseas experience, the current Australian definition may present no more of a problem than alternative approaches. If this point is accepted then there may be some value in an evolutionary rather than a revolutionary approach which may tilt the balance in favour of the second or third possibilities.

The problem is difficult to view in the abstract. The approach to reformulating the definition may be influenced by other changes in the structure of the legislation. For example, if the point is conceded that the area under review should be dealt with in a single statute, then the redrafting that such a view would entail may make it easier to make major changes to the definition. On the other hand, if no other changes are to be made then the evolutionary approach may be more suitable. This analysis is elaborated below.

Exclusions from the Definition of Prescribed Interest

The possibilities raised above relate to the inclusive parts of the current definition of participation interest. It is possible to attack the problem from another angle. The current problems may be thought to arise from the over broad interpretation of the inclusive parts of the definition. This could be countered by giving a wider range of exemption powers and also increasing the specific exclusions from the definition. It has been suggested in the discussion of the current exemption powers and exclusions that they are in need of review and so the opportunity is available to deal with broader problems via this route. This could be done by stating criteria to guide the exercise of powers to exempt a particular opportunity or class of opportunities from the definition.

The criteria could be framed in combination with and in the light of a statement of legislative purpose, that is, the statement of legislative purpose could equally operate on the exclusion as the inclusion side. In addition, in light of the objective of reducing costs, further criteria might well require consideration of whether the exclusion or inclusion of an opportunity or class of opportunities in the regulatory system is economically justifiable having regard to:

(a) the costs of compliance; and

(b) any detriment to the public which might be caused having regard to (inter alia) 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 consequences of fraud or inadequate disclosure of investment information.

If the exclusion powers were actively used in situations of doubt, considerably more certainty could be achieved in the operation of the system than occurs at present. Exclusions might be made subject to conditions as occurs at present as well as being outright in order to tailor the regulatory system to the multiplicity of transactions that can come within its ambit on any possible model of the definition of prescribed interest.

With regard to specific exclusions included in the legislation, it follows from the discussion in Chapter 1 that the current exclusions in relation to life insurance and partnership might be considered and modified. Further exclusions in relation say to franchising[5], joint ventures, and money market activities[6] might be considered for addition to the current list. As noted in Chapter 1, the Committee has not addressed in detail all the possible candidates for exclusion from the definition and submissions are sought on appropriate cases for consideration for exclusion.

5. Franchises are currently the subject of the Exposure Draft Franchise Agreements Bill, which if enacted, will amend the prescribed interest provisions to exclude franchises.

6. Money market exclusions are currently located in the definition of debenture in the companies legislation and (in different terms) in the definition of securities in the securities industry legislation. They should be made uniform and given a common location.

A Possible Approach

Of these numerous possibilities, in the context of little change to the basic structure of the regulatory system, a possible approach would be to adopt a broad statement of legislative purpose and to make evolutionary changes to the inclusive parts of the definition of prescribed interest. In addition the exclusions would be extended and the exemption powers would be elaborated with specific criteria for their application.

The place of the reformulated definition in the regulatory scheme

It has already been suggested at a number of points that there is substantial merit in reconsidering not only the definition of prescribed interest but also the part it plays in the legislative framework. The trend in overseas legislation is to use a single definition to define the operation of the legislation in this area, the definition generally not separating out for special treatment shares, debentures and other securities. Moreover, the legislative tendency is to consolidate the regulatory framework in one statute that is separate from the companies legislation.

If this suggestion is accepted then there is also likely to be more scope for reconsidering the definition of prescribed interest. A change could be made more easily in such a context along the lines of the fourth to the ninth possibilities discussed above. There is clearly an interest in a more fundamental reassessment of current regulatory frameworks to judge by the Campbell Report, the NCSC Consultative Document on Regulation of Public Offerings of Shares and Debentures, the current NCSC review of prospectuses and the present reference from the Ministerial Council, not to mention activity in the area overseas.

Such an approach need not entail massive disruption of existing market practices. The Securities Industry Act 1980 already provides the vehicle for reorganisation of the regulatory framework since it uses a central definition of securities for determination of its operation. The amendments that are deemed necessary to the definition of prescribed interest can be made in the context of this Act. The major change involved in this kind of reorganisation requires the removal of the prospectus and sharehawking provisions from the companies legislation to the securities industry legislation and this should be managable in view of the simplification that is likely to be attained as a result (for example, as regards duplication of definitions and exemption powers).

Whilst representing an evolutionary change to the current system in itself, this alteration of present arrangements would provide a more coherent basis for future evolution of the Australian regulation of securities.

CHAPTER 4

PRESCRIBED INTERESTS HAVING FIDUCIARY ELEMENTS

The current law involving prescribed interests and the protection of the investing public may be defective in not giving sufficient prominence to the distinction between prescribed interests that have fiduciary elements and those that lack them. This distinction raises a number of technical yet critical issues for consideration.

Fiduciary and non-fiduciary prescribed interests

The existing definition of "prescribed interest" is wide enough to cover investment opportunities in which, under general law, an investor enjoys the benefit of a fiduciary relationship with those conducting the investment, as well as other opportunities in which the relationship between the parties is non-fiduciary or at arm's length.

In a fiduciary relationship one party has duties to act for the benefit of another and is under disabilities in dealings with the other person to the relationship. A fiduciary relationship will attract duties, disabilities and liabilities which, in general are more onerous for a promoter than where the parties are at arm's length. The range of fiduciary duties, disabilities and liabilities will differ according to the legal category to which the fiduciary relationship belongs. Thus, a general trust relationship will involve the trustee being subject to a wider range of duties than would be the case in a partnership, although both a trustee and a partner are in a fiduciary position.

As a matter of general law, in a non-fiduciary relationship neither party is under any legal duty to subordinate his

interests to those of the other. In this context, the clearest contrast is between an interest under a unit trust and an interest consisting of no more than the benefit of a contractual promise.

Unit Trusts and contractual prescribed interests contrasted

A trust, by definition, must involve the trustee in holding some particular property, whether tangible or intangible, on trust. The prescribed interest trusts in respect of which public offerings are usually made are not discretionary trusts and the investor is offered a fraction of the beneficial ownership of the trust property. By contrast, a prescribed interest investment opportunity which is purely contractual[1] gives the investor no interest in specific property in the hands of the promoter.

The investor's fortunes under a trust necessarily vary with changes in the value of the trust property whereas under a pure contract the value of the investment is in law normally unrelated to any particular property.

A trustee is not in law an insurer of the trust property and if the trust property is lost, the trustee is not liable to replace it unless the beneficiary proves that the trustee failed to look after it in the way that a reasonably prudent person would have done. By contrast, in a contractual prescribed interest, a debtor's loss of property does not reduce the amount of the debtor's personal obligation in law, however careful the debtor may have been in looking after his property.

Another difference relates to the rights of an investor where the trustee or other party becomes bankrupt or goes into liquidation. The investor in the purely contractual prescribed interest opportunity has, in general, rights only

1. For example, an opportunity to make an unsecured deposit of money with a moneylender - Waldron v Auer [1977] VR 236

against the issuer of the opportunity with no recourse against other persons and in the bankruptcy or liquidation will rank only as an unsecured creditor. For example, if the opportunity offered involves a purely contractual plan to establish a plantation and the promoter undertakes to plant, maintain and harvest produce and to divide the proceeds of sale among investors, the investors will have no claim to any specific property in bankruptcy or liquidation. By contrast if the scheme involves a trust arrangement whereby each investor would acquire a proprietary interest in the land used for the plantation, the trustee in bankruptcy or the liquidator would not have total recourse to that property, if any remains. The proprietary interest of the investors would, however, be subject to any right which the trustee had to be indemnified out of the trust property for liabilities properly incurred in the administration of the trust. To the extent that trust property had been lost by the trustee in breach of trust, investors would have a right to prove along with unsecured creditors.

A further difference exists in connection with any liabilities incurred by the person conducting the prescribed interest scheme. In regard to a purely contractual scheme it is clear in law that an investor cannot be legally affected by the other party incurring liabilities in connection with the scheme unless there is a relationship of agency or partnership between the investor and the person managing the scheme. However, in relation to trusts it is possible that a beneficiary in certain circumstances may be required personally to indemnify the trustee in respect of liabilities properly incurred in the administration of the trust.[2] The extent to which this applies to public unit trusts is not clear. It is settled that the terms of a public unit trust can exclude any right of a trustee to be indemnified by a beneficiary.[3]

2. J.W. Broomhead Vic Pt Ltd. v J.W. Broomhead Pt Ltd. [1985] VR 891; (1985) 9 ACLR 593; 3 ACLC 355

3. McLean v Burns Phil Trustee Co Pt Ltd. (1985)9 ACLR 926.

Yet another difference lies in the fact that a scheme structured as a trust may attract the law of perpetuities. This is because it will involve the acquisition of interests in property. Thus the framers of a trust-type scheme will need to limit its duration so as to exclude the possibility of interests arising beyond the appropriate perpetuity period. In a purely contractual scheme there is no need for a limit on duration of the scheme as a matter of law.

Despite these differences the current legislation imposes a trust structure on all prescribed interests, including those that are essentially contractual relationships, by requiring the appointment of a trustee for all public offerings of prescribed interests (subject to any exercise of exemption powers by the NCSC).

Need for investment opportunities publicly offered to be described as fiduciary or non-fiduciary

It may be desirable for the Companies Act to reflect the difference between fiduciary and non-fiduciary prescribed interests and to authorise the NCSC to regulate the description under which an investment opportunity may be offered to the public.

The concept of a trustee as a fiduciary is appreciated by many people in the community in a general way. When investors are offered an opportunity to invest in a trust they would be justified in assuming that they are being offered the benefits of the principle that a trustee is in a fiduciary relationship. A full understanding of those benefits would comprehend the following:

* The trustee will be under a duty to avoid a conflict of interest and duty and to avoid a conflict of duties under different trusts.

* The trustee will not be entitled to derive personal profit from the administration of the trust property except to the extent permitted by provision to the contrary in the special terms of the trust or under legislation conferring that entitlement.

* The trustee will not be able to deal with the property as an absolute owner but will be confined to those dealings which under the general law or the special terms of the trust are open to a trustee.

* In general, the trustee will be required to deal with the trust property with the same care that a reasonably prudent person would exercise in the care of his own property.

However, because the duties, disabilities and liabilities of a trustee as defined in the general law of trusts may be made more or less onerous by the terms of the trust instrument governing a prescribed interest trust, what is offered to investors may lack some of the characteristics conjured up by the expression "trust". Among examples of possible provisions in the trust instrument diluting the trustee's duties, disabilities or liabilities are:

* Provisions making the trustee liable for loss of trust property only where the trustee has been dishonest rather than merely negligent.

* Provisions allowing the trustee when dealing with the trust property to follow the directions of someone other than the beneficiaries, without the trustee being liable for failure to exercise an independent discretion.

* Provisions allowing the trustee to appoint agents to act in trust matters without having a duty to take care in the appointment of the agent or a duty to supervise the agent.

* Provisions allowing the trustee or associates of the trustee to sell their property to the trust or to buy from the trust.

Where a prescribed interest offered to the public is an interest under a trust which conforms to the general law, it is appropriate that the investment arrangement be referred to as a "trust". But where the trust instrument relaxes the trustee's duties, disabilities and liabilities or the arrangement departs to a significant degree from the standards imposed by the general law, a description of the arrangement as a trust could be misleading.

One legislative response to the possibility of "soft" trusts could be to require disclosure of the terms of the arrangement which modify the usual incidents of a trust to the possible prejudice of investors. That approach would increase compliance costs and would add to administrative costs by requiring examination of each arrangement.

Another approach would be to legislate to provide that an arrangement offered to the public may be referred to as a "trust" only if the arrangement has all the standard common law attributes of a trust other than those in respect of which a dispensation has been given by the NCSC: cf the Companies Act sub-section 97(4) dealing with the conditions for calling a document a "mortgage debenture" and sub-section 97(5) on the conditions for calling a document a "debenture". Since many arrangements have already been offered under the name of "trust", such a provision could only be made to operate in respect of new arrangements formed after a certain date.

Either in combination with that approach or as an alternative to it, there could be a division of prescribed interest investment arrangements into standard categories. They could be (1) wholly fiduciary, (2) partly fiduciary and (3) non-fiduciary. It could be required that in the marketing of investment opportunities the appropriate description be given prominence. A wholly fiduciary arrangement would be one in

which the person or persons administering all aspects of the arrangement (in a unit trust the trustee and manager are subject to the duties, disabilities and liabilities of a trustee under general law (except to the extent defined by the NCSC)). A partly fiduciary arrangement would be one in which only some of the aspects of administration of the arrangement are carried out by a person or persons having the duties, disabilities and liabilities of a trustee under general law. A non-fiduciary arrangement would be one which is only promissory and does not entail administration of a fund on behalf of investors in which they have a proprietary interest. Categorisation of investment arrangements along these lines could be applied to existing arrangements.

Adoption of any of these approaches would be for the purpose of classification only and would not entitle promoters of various types of prescribed interests to circumvent regulatory prescriptions over the content of trust deeds: see further Chapter 5.

Division of functions: the position of trustee and manager of a public unit trust.

Restrictions on the use of the description "trust" and categorisation along the lines suggested would need to take into account arrangements in which, under a governing deed, some functions of administration are to be carried out by one person (the trustee) while other functions are to be performed by someone else (the manager), not as a delegate of the first but as a co-ordinate principal.

Where a trust is created the general law of trusts imposes on the trustee, simply because that person has assumed that office in relation to specific property, an original and primary responsibility to get in, hold and administer the trust property in the interest of the beneficiaries. It would be appropriate under general principles and usually the trust instrument for the trustee to appoint a manager to assist in the administration. The trustee would be under a duty to take care to make a suitable appointment, to monitor the manager's performance, to give appropriate instructions

to the manager and, if need be, to discharge the manager. If the manager defaulted, the question whether the trustee would be liable for such default would turn on whether the trustee exercised the same degree of care as a prudent person would exercise in relation to his own property. In general, if the trustee satisfied that standard, the trustee would not be liable for the manager's defaults. But the essential point is that the trustee would owe some duties to the beneficiaries as to the trustee's appointment of the manager.

The ordinary position of the trustee's responsibility for appointment of a manager may be departed from by legislation or by special provision in the trust investment so that the trustee is not responsible to the same degree.

In Queensland and Western Australia, a lessening of a trustee's responsibilities is facilitated by legislation under which they may be divided between a custodian trustee and a managing trustee. The Trusts Act 1973-1985 (Qld) s19 and the Trustees Act 1962-1978 (W.A.) s15 provide that a corporation may be appointed (where, and in the same manner, as a trustee could be appointed) to be a custodian trustee of a trust alongside a managing trustee. In general, the effect of an appointment is to allocate the functions of getting in and holding trust property, investment of funds and disposal of assets to the custodian trustee while leaving all other trustee functions to the managing trustee. Since both are trustees, it would seem that a beneficiary would be in a direct relationship to each of them and each trustee would be directly responsible to a beneficiary. The managing trustee would not be subordinate to the custodian trustee. One result would appear to be a lesser degree of responsibility of the custodian trustee for decisions made by the manager than if the custodian trustee were an ordinary trustee who had appointed the manager. The custodian trustee would not be free of all responsibility for decisions of the managing trustee, if only because under the general law of trusts a person who knowingly assists a trustee to commit a breach of trust is liable to compensate beneficiaries for loss caused by the breach. There would seem to be more scope to apply

that principle as between a custodian trustee and a managing trustee than as between a trustee and other persons.

The usual form of prescribed interest public unit trust deed contemplates something like custodian trusteeship and departs from an ordinary trust by provisions which appear to make the manager's position co-ordinate with that of the trustee. Under general trust law a manager may, in certain circumstances, be appointed by the trustee[4].

In an ordinary trust a direction of the settlor in the trust instrument that the trustee should employ a particular person as manager is liable to be read as a mere recommendation[5] which does not impede the trustee in the exercise of a discretion to appoint the most suitable manager or to dismiss a manager. By contrast under a public unit trust the initial manager is usually a promoter of the trust (or a company related to the promoter) who cannot be dismissed without the trustee showing cause.

Instead of the trustee under a prescribed interest public unit trust having the sole discretion to decide upon investment of trust funds (as would be the case under the general law of trusts), it is usual for the trustee's power of investment to be exercisable only in accordance with proposals stated by the manager.

Under some deeds a trustee may reject the manager's investment proposals but only on certain grounds and in some cases a general meeting of unitholders convened by the manager can override the trustee's objection. In an ordinary trust the trustee would be liable personally to pay a manager's remuneration and the trustee would normally have a right of exoneration out of the trust fund in respect of that liability. Under a public unit trust deed the manager

4. Parkes Management Ltd. v Perpetual Trustee Co Ltd. (1977) 3 ACLR 303, [1977] CLC par 40-354

5. See, for example, Re Will of P.R. Larkin (1913) 13 SR (NSW) 691

commonly has a right to remuneration out of the trust fund in priority to the claims of unitholders, although the manager's right may be postponed to that of the trustee.

Far from the manager being a subordinate of the trustee, public unit trust deeds frequently provide that when a new trustee is required, the manager can appoint a new trustee and that in the interim between removal of a former trustee and the appointment of a new one, the manager may act as a trustee. Further indications of the manager's non-subordinate status are sometimes found in provisions under which, in relation to building works, the manager can direct the trustee to award a contract for works to a person nominated by the manager and the manager can direct the trustee to engage a particular person as a project manager.

The fact that the manager's powers under a normal public unit trust deed are original rather than being derived from the trustee poses a question as to the relationship of the manager to the unitholders. Insofar as the manager enjoys original discretions as to investment of trust funds and other matters affecting the interests of unitholders, it is arguable that the manager owes fiduciary duties to the unitholders.[6] Although the manager is not called a managing trustee as in the Queensland and Western Australian legislation referred to above, that description would not be inappropriate.

At present the Companies Act Part IV Division 6 shows no explicit intention to treat the management company as a fiduciary. Section 168(1)(a) requires as a condition of a deed being approved under s165 that it contain:

"a covenant binding the management company that it will use its best endeavours to carry on and conduct its business in a proper and efficient manner and to ensure that any undertaking, scheme or enterprise to which the deed relates is carried on and conducted in a proper and efficient manner;"

6. Day and Harris Unit Trusts (1974) 103

That provision, though suitable to a non-trust investment opportunity, seems to fall short of a provision appropriate to a management company involved in the administration of a trust. Similarly, failure to recognize the fiduciary character of a manager with original powers seems to explain why s177, which invalidates provisions exempting a trustee from liability for breach of trust is not accompanied by a similar provision in respect of a manager.

By contrast, the New Zealand Unit Trusts Act 1960 s24(1) provides that the trustee and the manager shall each have the same duty to observe care and diligence in the performance of its duties as any other trustee, and shall be entitled to the same indemnities and relief as any other trustee. The same Act in s24(2) invalidates not only exemption clauses which would favour trustees but also those in favour of managers.

If there were legislation which allowed a public investment arrangement to be marketed under the name "trust" or with the description "wholly fiduciary" only if it conformed to the standards set by the general law, the deed governing the arrangement would either have to:

(i) unite all functions of administration in the hands of one trustee; or

(ii) divide functions of administration between a trustee and a manager as co-ordinates but only on terms which left the manager in the position of a trustee with the duties, disabilities and liabilities which would attach to a trustee having the functions of a manager.

The Companies Act requires in Part IV Division 6 that there be a manager as well as a trustee. However, under s215C the NCSC has power to approve a public offering of an interest in an arrangement in which there is only a single person having all the functions of administration.

It may be desirable for the Companies Act to provide that where a prescribed interest arrangement divides administration between a trustee and a manager in such a way that each in relation to their respective functions has the duties, disabilities and liabilities of a trustee, the manager shall be deemed to be a trustee. That would remove any doubt as to whether the manager is entitled to be treated as a trustee for the purposes of trustee legislation in the various States and Territories. For example, State legislation enables the Supreme Court to enlarge the administrative powers of a trustee. It also permits a court to excuse a trustee who has committed a breach of trust where the court is satisfied that the trustee acted honestly and reasonably and ought fairly to be excused.

Remuneration of trustee or other administering person

Under the general law of trusts the office of trustee is gratuitous except to the extent that legislation authorises particular trustees to charge remuneration and courts are empowered to allow commission. The NCSC should have power to allow a scheme to be marketed as a "trust" or "wholly fiduciary" arrangement notwithstanding that the deed provides for remuneration within limits fixed by the NCSC.

Acquisition of investor's interest by trustee or other administering person

The law of trusts allows a trustee to purchase a beneficiary's interest only under certain conditions as to disclosure appropriate to the position of the trustee as a fiduciary. However the Companies Act s168(1) (b) (iii) requires that the prescribed interest trust deed contain a covenant that the management company will, at the request of the holder of a prescribed interest, purchase or cause to be purchased, that prescribed interest from the holder and that the purchase price will be a price calculated in accordance with the provisions of the trust deed. This is necessary to enable investors to cash their investment. It follows that

the marketing of an unlisted scheme as a "trust" or a "wholly fiduciary" arrangement should be allowed in defined circumstances notwithstanding that the manager in buying back units may not be satisfying all the requirements applicable to a trustee.

As regards listed property trusts the AASE Listing Requirements Section 2F(26) provides that the management company or its nominees shall not hold any units in the trust while the units are quoted on an exchange. Section 2F(20) provides that the obligation of the management company to repurchase units from unitholders will be suspended while the units are quoted on the exchange. The policy appears to be that when a secondary market is available on the exchange, there can be no justification for the manager dealing in units.

Application of perpetuities doctrine to prescribed interest unit trusts

Under the general law of trusts if a trust is so structured that the trustee is to hold a trust fund upon trust for unitholders to be ascertained in the future, the rule against remoteness of vesting may require that no interest can vest in any person under the trust beyond an appropriate perpetuity period. Public unit trusts usually provide for an overall limit to the life of the trust. When such a trust is viewed as a form of investment alternative to a company the limit on the trust's duration imposed by the general law may appear to be anomalous.

In case it should be desired that a public unit trust should be able to last indefinitely like a company, is it desirable that a provision similar to section 578 of the Companies Act be enacted?

Application of CASA principles

Unit trusts are not regulated by the Companies (Acquisition of Shares) Act and Codes, and therefore investors do not have

the benefit of this statutory safeguard in the event of changes of control of unit holders. However unit trusts have come increasingly to resemble limited liability companies and some unit trusts have incorporated certain take-over provisions into their trust deeds e.g. that except by waiver of the trustee, no person may acquire units if, as a result, their unit entitlement would exceed 20% of the total issued units, except in compliance with procedures drawn from CASA. Various other provisions of CASA e.g. s42; s43 have also been included in some unit trust deeds.

Comment is invited on whether the principles of CASA should apply by legislation to such prescribed interests, and if so, what, if any, modifications to CASA may be necessary in this context.

Disclosure of Substantial Unit Holdings

To complement the take-over provisions, some unit trust deeds have adopted the principles of Part IV Division 4 of the Companies Act to substantial holdings of units.

Should these provisions apply to all such prescribed interests? Would it be appropriate to extend the ambit of s261; s261A of the Companies Code to unit trusts?

Reconstruction of schemes

Part VIII of the Companies Act contains provisions which facilitate the amalgamation of companies and other reconstructions by authorising the Supreme Court to make orders vesting assets and transferring property.

Should Part IV Division 6 provide a similar facility for reconstruction of schemes under which prescribed interests (unit trusts in particular) are made available?

Residual discretion in the NCSC to relax restrictions

There could be other situations where the application of the standards of the general law of trusts to a public investment arrangement is inappropriate or militates against the interests of the investors. It seems desirable that the NCSC should have a residual discretion wide enough to allow an arrangement to be marketed as a "trust" or a "wholly fiduciary" arrangement even though the duties, disabilities or liabilities of the person or persons administering the arrangement do not otherwise conform exactly to the general law of trusts.

CHAPTER 5

NCSC RULE - MAKING POWER OVER PRESCRIBED INTERESTS

The function of a rule – making power

The diversity of investment opportunities that fall within the definition of prescribed interest makes it impracticable for statute law to provide a comprehensive regime of regulation in the detail required for adequate guidance to entrepreneurs and protection for investors and with the speed needed to meet new developments. Even as regards unit trusts, it may be unwise to follow overseas precedent for separate legislation[1], given that not every investment opportunity that involves a trust relationship answers the description of a unit trust. Furthermore some existing detailed prescriptions found in Part IV Division 6 of the Companies Act, such as those on meetings of holders of prescribed interests are not appropriate to every form of prescribed interest. For instance, in a fully fiduciary scheme where the investors have the benefit of the full range of fiduciary benefits, the general law of trusts would not allow investors to meet to give directions to the trustee about the administration of the scheme. But where a scheme is not fully fiduciary, it may be desirable that provision be made for meetings of investors to be able to give directions to the persons who administer the scheme. Because of the varying degrees to which schemes may exhibit fiduciary elements, it is impossible for statute law to provide the appropriate prescription.

One means of responding to these problems is to give the NCSC a rule-making power over prescribed interests whereby it could set standards appropriate to different types of prescribed interests. Such a power would be distinct from the exemption power discussed in Chapters 1 and 3.

1. For example, the New Zealand Unit Trust Act 1960.

The NCSC does not have any express rule-making powers, but instead has utilised various of its discretionary and licensing powers to enable it to exempt from or modify, with or without conditions, certain provisions involving public offerings and dealers' licenses for specific persons: Companies Act s168(2), s215C; Securities Industry Act s51. These provisions are limited in that they do not facilitate generic or class rulings, except by way of exemption as exemplified in NCSC Policy Statements 118, 120 and 130. However, in the context of prescribed interest property trusts, the Ministerial Council was concerned that the NCSC should "exercise its discretionary powers under [Part IV Division 6] to the fullest extent for the protection of property trust investors and to encourage stability in the industry"[2]. Further to this direction, the NCSC promulgated Policy Statement 121 - Property Trusts, which, inter alia, considerably expands the obligations of trustees and managers of such trusts. The granting to the NCSC of a general rule-making power over prescribed interests may be both consistent with and a logical extension of this policy. It would also have the merit of overcoming doubts whether the expansion of obligations in particular cases can withstand legal challenge.

There is overseas precedent for placing rule-making powers of this nature in an administrative agency such as the NCSC. In the USA the SEC has an extensive rule-making function derived both from its general[3] and specific[4] rule-making

2. NCSC Release 121 para. 1.4

3. The Securities Act 1933 s19(a) provides that: "the Commission shall have authority from time to time to make, amend, and rescind such rules and regulations as may be necessary to carry out the provisions of this title [Act], including rules and regulations governing registration statements and prospectuses for various classes of securities and issuers, and defining accounting, technical, and trade terms used in this title [Act].

4. For example, the The Securities Exchange Act 1934 s10 provides that "it shall be unlawful for any person .... (b) to use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

authority. This grant of rulemaking powers was in recognition that an expert Commission may be in a better position to frame rules and adjust them as the circumstances require, compared with the normal statutory or regulation making process. In exercise of these powers, the SEC has created a large number of procedural and substantive rules including those providing the necessary definitional and implementary detail for many generally worded statutory provisions.

In Australia a form of rulemaking power is exercised by the Accounting Standards Review Board which, subject to Ministerial Council veto, may approve or revoke accounting standards[5]. It was considered that in view of the expertise of the ASRB and the need for rapid implementation of approved standards, legislative recognition of standards promulgated by the Board would be preferable to prescribing those standards directly by legislation. Similar arguments could be advanced for giving the NCSC a rule-making power over prescribed interests.

Ambit of NCSC rule-making power

A rule-making power could be formulated in various ways. One approach would be to retain existing statutory prescriptions as to the content of trust deeds but, in addition, empower the NCSC to require that any deed "shall set out such other matters as the Commission requires". A precedent for this approach is found in s98(1) (eb) of the Companies Act, which regulates the contents of prospectuses. Given this power the NCSC could, through its policy statements, stipulate those additional matters that must be included in various prescribed interest deeds. A rulemaking power of this nature would allow the NCSC to expand upon the terms of the legislation by, for example, prescribing in greater detail the duties of trustees and managers of particular types of public unit trusts.

5. Companies Act s266B

An alternative approach would be to replace the existing statutory prescriptions with a general direction to the NCSC to have regard to a statement of legislative purpose concerning prescribed interests, followed by an illustrative list of the aspects of a deed on which it is intended that the NCSC should be able to set standards. This non-exhaustive list could include:

* dispensing with the need for a trustee and/or manager in relevant cases;

* appointment of the trustee;

* functions of the trustee;

* removal of the trustee;

* appointment of new trustees;

* removal of the manager;

* appointment of new managers;

* standards of propriety, care, diligence and skill of the trustee and the manager and of the officers of the trustee and the manager;

* liability of the trustee and the manager and of the officers of the trustee and the manager;

* remuneration of the trustee and of the manager;

* expenditure of the trustee and of the manager that is to be borne by any trust fund;

* investment of funds including, where necessary, prescriptions in relation to:

** diversification of investments;

** investment in underwriting shortfalls;

** investment in other prescribed interests or in investment companies;

* accounts of the trustee and the manager;

* audit of accounts;

* reports on operations of the scheme to:

** holders of prescribed interests; and

** the regulatory authorities;

* exercise of voting power attached to securities as part of a scheme;

* borrowing powers;

* rebates on commission fees charged to investors in prescribed interests;

* entitlements of holders of prescribed interests;

* meetings of holders of prescribed interests;

* liabilities of holders of prescribed interests;

* redemption of prescribed interests;

* transfer of prescribed interests;

* registers of holders of prescribed interests;

* alteration of deeds; and

* termination of schemes.

Within this framework there may be scope for reducing compliance and administrative costs by empowering the NCSC to formulate and prescribe standard clauses on those matters in which variation as between deeds is unlikely to be needed.

Prescribed standard clauses could permit a change in the current procedure whereby CACs expend time and resources examining lengthy deeds from cover to cover to ensure compliance. The practice of detailed consideration seems to work reasonably well with a deed largely identical with previously approved deeds for the same promoters, but can give rise to frustration arising from time delays and market opportunities foregone for deeds which have no approved antecedents.

A CAC review of legal compliance tends to diffuse the responsibility for compliance from those with whom it rightfully lies, namely the promoter, the trustee and their legal advisers. In particular the CACs adopt the mantle of protectors of investors when the responsibility for adequate protection in trust deeds should be principally assumed by the particular trustee, based on satisfaction of statutory requirements and working from NCSC guidelines.

A rule-making power vested in the NCSC, setting standards for prescribed interest deeds, supplemented by NCSC guidelines, could permit the adoption of an alternative practice to that whereby trust deeds are lodged with the CACs for examination and approval. The legislative provision conferring any such rule-making power could provide that the standard clauses prescribed by the rules will prevail irrespective of whatever is contained in the Trust Deed, unless exemptions or variations are granted.

An alternative approach might be that on lodgement, the trustee and manager certify that the deed complies, other than in areas where exemptions are sought. Either approach

should enable the CACs to concentrate on applications for exemptions from or variations to the standards, so freeing up scarce resources of the CACs for other duties.

A rule-making power on standards would also introduce much needed flexibility to the existing requirements. The current provisions, supplemented by NCSC guidelines, have been drafted mainly in terms of equity and property trusts. They are often inappropriate or adapted with difficulty to trading trusts and other forms of prescribed interests. Without the current extensive use of the exemption and licensing powers, development of these alternative forms of prescribed interests would be stultified, if not still born. Regulation should enable the development of alternative investment mediums whilst ensuring a uniform and adequate protection for investors. Otherwise the emergence of innovative prescribed interest entities will be hindered to the possible detriment of the Australian economy.

Extensive use of exemption powers is a necessary but inefficient means of coping with the need to adjust existing requirements to what are now common prescribed interests such as units in trading trusts. Even if new legislation or regulations were introduced to cope with the current generation of prescribed interests, they may in time tend to be inflexible for future generations. It is suggested that a rule-making power vested in the NCSC of settling standards for the various forms of prescribed interests will permit greater certainty as well as flexibility to respond quickly to new forms of prescribed interests by the issue of appropriate additional rules. It also may reduce the demands on the NCSC and CAC resources in reviewing what have become somewhat common exemption applications for prescribed interests other than equity and property trusts.

Review of rule-making power

These powers of settling standards for prescribed interest deeds and public offerings would, of necessity, be wide and some control over their exercise would be needed. One safeguard could be a requirement for adequate public exposure of any proposed rules or standard clauses, with the right of all interested persons to make submissions prior to their implementation. In addition or alternatively, as the NCSC is subject to the control of the Ministerial Council, the powers could be granted in terms which made it clear that any rule or standard clause prescribed by the NCSC is subject to disallowance by the Ministerial Council or Federal Parliament: cf the position in relation to accounting standards drawn up by the Accounting Standards Review Board[6]. Since the setting of standards would be essentially a legislative function, it would be inappropriate for the general right of appeal to the Supreme Court given in s537 of the Companies Act to apply in respect of a standard-setting decision of the NCSC[7].

Comment on these possible changes is requested.

Ability of NCSC to deal with collective investment vehicles as a whole

If the NCSC were to be given power to prescribe standards relating to prescribed interests to be offered to the public, as suggested above, it might be desirable that the NCSC be given similar powers to prescribe standards for investment companies whose securities could be offered to the public. This would enable the NCSC to look at collective investment vehicles as a whole regardless of differences in their legal form. It may be necessary to provide a statutory definition of investment company for this purpose. If that were done,

6. Companies Act s266B. Note also Securities Industry Act s39

7. No such appeal lies from decisions of the ASRB

much statutory law now in sections 490-499 of the Companies Act could be repealed.

Comment on possible changes to sections 490-499 is solicited.

APPENDIX

THE EVOLUTION OF THE CURRENT DEFINITION OF "PRESCRIBED INTEREST"

The origins of Part IV Division 6 of the Companies Act 1981 (Cth) are to be found in recommendations made by the Statute Law Revision Committee of the Victorian Parliament in October 1954. That Committee was asked by the Attorney-General to examine "anomalies in the statute law which appear to permit (a) persons interested in the promotion and/or direction of companies; and (b) firms - to engage in fraudulent practices, with a view to reporting upon the measures deemed necessary to afford adequate protection to shareholders, creditors, and members of the public". On various dates between 4th February 1954 and 20th July 1954 the Committee heard evidence. Various investment opportunities other than shares or debentures came to the notice of the Committee. They included forestry schemes which involved the investor making a contract with a promoting company under which he was to pay money to the promoter in return for its promises to plant and maintain trees, to market the timber when the trees reached maturity and to distribute to him his share of the proceeds of sale.[1] Some schemes provided for a trustee to be

1. See, for example, the contract described in Clowes v Federal Commissioner of Taxation (1954) 91 CLR 209. See also Maddaford v De Vantee [1951] SASR 259 where it was held that the sale of units in an olive growing scheme did not constitute an offering of "shares" within the meaning of the term "shares" as defined in the Companies Act 1934-1939 (S.A.) s365

appointed to ensure on behalf of investors that the promoting company carried out its obligations. Although such an agreement might provide for the appointment of a trustee, the investor had no proprietary rights in any land or any fund: his rights were purely contractual.

The Statute Law Revision Committee also noted the existence of unit trusts which enabled investors to acquire fractional equitable interests in a portfolio of shares held by a trustee. These unit trusts were modelled on investment opportunities which had been on offer in England as early as the 1870s[2] and in which there was a renewed interest in England[3] in 1931 leading to the substantial unit trust movement which is now a significant part of the United Kingdom capital market. Under a unit trust the investor had rights which were not purely contractual: he had a fractional equitable interest in the shares held by the trustee.

In Australia unit trusts developed after the Second World War and now represent a substantial portion of invested capital[4]. Unit trusts could offer an investor diversity of investment even in the investment of a small amount of capital and the opportunity to escape the burden of making his own choices between shares if he was prepared to leave investment decisions to the promoters of the unit trust. In these fundamental respects unit trusts were like investment companies, although in terms of legal structure and in treatment under income tax law they were markedly dissimilar. Unit trusts also differed from investment

2. For an example, see the description of the Submarine Cables' Trust in Smith v Anderson (1880) 15 Ch.D. 247.

3. A committee of enquiry into unit trusts reported to the Board of Trade in 1936 (Cmd 5259) and its recommendations led to the enactment in the Prevention of Fraud (Investments) Act 1939 (U.K.) of provisions regulating unit trusts.

4. In one form of unit trust, namely, cash management trusts the total value of units on issue in September 1984 was $1586 million.

companies in not being subject to the possibility of being subjected by declaration to restrictions in the Investment Companies Act 1938 (Vic.)[5].

The Statute Law Revision Committee was concerned that the statute law was inadequate in not prohibiting the hawking of interests other than shares and debentures. Following the presentation of a progress report of the Committee,[6] the Victorian legislature enacted the Crimes Act 1954 s4[7].

That section was modelled on the Prevention of Fraud (Investments) Act 1939 (U.K.) s12[8].

The Committee was also concerned that interests other than shares and debentures were being offered to the public by proprietary companies which did not have to make the disclosures required of public companies. A further matter of concern was that a representative appointed by promoters to watch out for the interests of investors or, in those cases where property was to be held on trust for investors, a trustee appointed to hold property should be independent of the promoter and otherwise suitable.

The Committee's Report[9] contained the following paragraph 17.

17. The Committee therefore make the following recommendations which they believe will prevent or minimize future fraudulent practices and at the same time not interfere with legitimate business:

(a) That no individual, firm, or company be permitted to invite the public to subscribe to an undertaking or to an interest in the

5. See now Companies Act Part XIII Division 2.

6. Progress Report dated 7th April 1954.

7. See now Crimes Act 1958 (Vic.) s191.

8. See Prevention of Fraud (Investments) Act 1958 (U.K.) s13.

9. Report dated 14th October 1954.

anticipated profit of an undertaking unless the venture is conducted by a company and that such company whether it has more or less than 50 members shall be subject to all the obligations of a public company under the Companies Acts.

(b) That the balance sheet, profit and loss account, and directors' report of the company be sent annually to each unit certificate holder.

(c) That no interests by way of, unit certificates be offered for sale to the public unless:

(i) the company so offering complies with the provisions of the Companies Act relating to sharehawking and prospectuses; and

(ii) a trustee be appointed to act on behalf of subscribers.

(d) That no appointment of a trustee be made without the approval of the Minister who shall satisfy himself as to the integrity and financial standing of the proposed trustee.

(e) That the trust deed appointing a trustee contain, inter alia, the following provisions:

(i) That, by majority decision, the certificate holders be empowered to remove a trustee and appoint another in his stead; and

(ii) That the trustee keep proper books of account and that an audited statement of his accounts be posted annually to each certificate holder.

(f) That the trust deed be filed in the office of the Registrar-General.

(g) That the trustee be empowered to investigate the accounts of the promoting company.

(h) That the promoting company keep and file annually in the office of the Registrar-General a list showing the names and last-known addresses of all unit certificate holders and the extent of their holdings.

The Committee's Report did not contain any reference to the United Kingdom Board of Trade Committee's Report of 1936 or the provisions of the Prevention of Fraud (Investments) Act 1939 (U.K.). That Act, though not confined to regulation of unit trust schemes, contained provisions specially applicable to unit trust schemes. In

retrospect, it is worthy of note that the Victorian Committee did not keep separate the

regulation of purely contractual schemes from those, such as unit trust schemes, in which an investor acquired a proprietary interest.

In implementing the Committee's recommendations the Victoria Parliament enacted s10 of the Companies Act 1955 which provided as follows:

10.(1) The interests to which this section applies are all rights or interests, whether enforceable or not and whether actual prospective or contingent, to participate in any profits assets or realization of any financial or business undertaking or scheme, but do not include any share in or debenture of a company whether incorporated in Victoria or elsewhere.

(2) No person except a company (not being a proprietary company) or its agent authorized in that behalf under the seal of the company shall issue or offer to the public for subscription or purchase or shall invite the public to subscribe for or purchase any interest to which this section applies.

(3) Before a company (whether itself or by an agent aforesaid) issues or offers to the public for subscription or purchase or invites the public to subscribe for or purchase any interest to which this section applies the company shall issue or cause to be issued a statement in writing in connection therewith which statement shall for all purposes be deemed to be a prospectus issued by a company, and all enactments and rules of law relating to prospectuses (including, without affecting the generality of the foregoing, the provisions of sub-section (3) of section thirty-five of the Principal Act) and the provisions of section three hundred and fifty-six of the Principal Act shall with such adaptations as are necessary apply and have effect accordingly as if such interest were shares offered to the public for subscription or purchase and as if persons accepting any offer or invitation in respect of or subscribing for or purchasing any such interest were subscribers for such shares.

(4) No company or agent aforesaid shall issue or offer to the public for subscription or purchase or shall invite the public to subscribe for or purchase any interest to which this section applies unless the company has in relation to such interest made provision in a deed (which deed and any amendment thereof has been approved for the purposes of this section by the Registrar-General) for the appointment of a person or company as trustee or as representative of the holders of such interests and for other matters as prescribed by this section.

(5) (a) No appointment of such a trustee or representative shall be made without the approval of the Attorney-General.

(b) The first appointment of any such trustee or representative and all appointments to fill vacancies in the office shall be made with reasonable despatch, in default of which the company shall be deemed to have contravened the provision of this section.

(c) No such trustee or representative shall be removeable except by the Attorney-General, or by resignation or death, or by a majority decision of the holders of interests to which the deed relates.

(d) Every such trustee or representative shall exercise all due diligence and vigilance in watching the rights and interests of holders of interests to which the deed relates.

(e) Every such trustee or representative shall keep proper books of account in relation to the interests to which the deed relates and shall annually post an audited statement of such accounts to each holder of any such interests.

(6) Every such deed shall contain covenants by the company or (if it does not expressly contain such covenants) shall be deemed to contain them to the following effect, namely:

(a) that the company will use its best endeavours to carry on and conduct the business of the company in a proper and efficient manner and to ensure that any business or scheme to which the deed relates is carried on and conducted in a proper and efficient manner;

(b) that to the same extent as if the trustee or representative were a director of the company the company will:

(i) make available to the trustee or representative for inspection the whole of the books accounts and documents of the company whether kept at the registered office or elsewhere;

(ii) give to the trustee or representative such oral or written information as he requires with respect to all matters relating to the business of the company or any property (whether acquired before or after the date of the deed) of the company or otherwise relating to the affairs thereof;

(c) that the company will make available or ensure that there is made available to the trustee or representative such details as he requires with respect to all matters relating to the business or scheme to which the deed relates;

(d) that the company will from time to time on the application, forwarded to the company at its registered office, of not less than one-tenth in number of the holders of interests to which the deed relates summon:

(i) by giving notice by letter through the post addressed to each of the holders of such interests at his address as registered hereunder in the office of the Registrar-General; and

(ii) by giving notice by advertisement in a daily newspaper generally circulating throughout Victoria addressed to all holders of such interests:

a meeting of holders of such interests for the purpose of having laid before the meeting the accounts and balance-sheet which were laid before the last preceding annual meeting of the company or the last audited statement of accounts of the trustee or representative, and if the meeting thinks proper, such meeting to be held at a time and place specified in the notice and advertisement under the chairmanship of the trustee or representative or a nominee of the trustee or representative approved by the Attorney-General or of such other person as is appointed in that behalf by the holders of interests present at the meeting, and to be conducted in accordance with the provisions of the deed or, insofar as the deed makes no provision, as directed by the chairman of the meeting.

(7) Every such deed and any amendment thereof shall be lodged in the office of the Registrar-General within fourteen days after the execution of such deed or amendment.

(8) Every company shall:

(a) once at least in every calendar year file with the Registrar-General a return containing a list of all persons who on the day of the first or only ordinary general meeting of the year are holders of such interests showing their names and addresses and the extent of their holdings of such interests;

(b) not less than seven days before the first or only ordinary general meeting of the year post to each holder of any such interest a copy of the balance-sheet profit and loss account and directors' report of the company.

(9) No company or person shall by reason of any failure by the company or by any person to observe any provision of this section or by reason of the commission of any offence by any company or person be relieved from any liability to any holder of any interest to which this section applies.

(10) Any person who and any company which contravenes or fails to comply with any of the provisions of this section or of any covenant of any deed under this section and any person who is a director of such company shall be guilty of an offence and in respect of each offence be liable to imprisonment for a term of not more than twelve months or to a penalty of not more than Five hundred pounds.

Exemption

(11) This section shall not apply in the case of the sale of any interest in any business undertaking or scheme by a personal representative liquidator receiver or trustee in bankruptcy in the normal course of realization of assets.

(12) The Attorney-General may on such terms and conditions as he thinks fit exempt any company or person from the operation of this section.

(13) This section shall come into operation on a day being three months after the commencement of this Act.

Some difficulty in the operation of the prospectus deeming provision was experienced in regard to unit trusts holding shares because it was not clear whether sub-section 10(3) referred to shares in the management company or shares in the various companies whose shares constituted a trust fund. The matter was referred to the Statute Law Revision Committee which recommended amendments to the Companies Act 1955 (Vic.) to make it clear that the provision referred to shares in other companies held on trust. The Committee also recommended the insertion of a schedule.[10] That schedule set out the matters to be included in the statement which was to serve the same function as that of a prospectus. At many points it used language suggestive of unit trusts. The Committee's recommendations were implemented by the Victorian legislature in the Companies (Unit Trusts) Act 1956. In the 1958 consolidation of Victorian statutes s10 of the Companies Act 1955 became s63 of the Companies Act 1958 and the schedule listing matters to be stated and reports to be set out in the prospectus-like statement appeared as the Seventh Schedule to

10. This is the origin of what is now Schedule 6 to the Companies Regulations.

the Act of 1958. It is noteworthy that the Seventh Schedule now began with a heading "Statement of Unit Trust Company". Whether the persons preparing the consolidation included that heading because they believed that the only "interests" regulated were units under a unit trust is not known. The change may be symptomatic of a failure to distinguish between interests under trusts and interests under purely contractual schemes. That failure has complicated legislative developments in this area.

In this connection it may be noted that in the United Kingdom unit trusts in the strict sense were specifically dealt with in the Prevention of Fraud (Investments) Act 1939 (U.K.) and its successor the Prevention of Fraud (Investments) Act 1958 (U.K.). Separate treatment of unit trusts was also accorded by New Zealand in the Unit Trusts Act 1960 (N.Z).

Section 63 of the Companies Act 1958 was amended by the Companies Act 1960 by repealing sub-section (1) and substituting new sub-sections (1) and (1A). They contained an enlarged definition of the interests regulated.

(1) The interests to which this section applies are all rights or interests whether enforceable or not and whether actual prospective or contingent:

(a) to participate in any profits assets or realization of any financial or business undertaking or scheme whether in Victoria or elsewhere;

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

(c) in any investment contract:

whether or not the right or interest is evidenced by a formal document or by an interest in any physical asset but does not include:

any share in or debenture of a corporation; or

any interest in or arising out of a policy of life assurance; or

any interest in a partnership agreement.

(1A) In this section unless inconsistent' with the context or subject matter:

"Holder" means the holder of any interest.

"Investment contract" means any contract scheme or arrangement which in substance and irrespective of the form thereof 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 which 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 acquired in or under like circumstances.

It may be noted that the new definition expressly excluded any interests in a policy of life insurance and any interest in a partnership agreement. An amendment to the Seventh Schedule deleted the words "Statement of Unit Trust Company" and substituted the words "Statement by Company Offering Interests". That amendment was not accompanied by any detailed changes to the requirements of the Seventh Schedule in its application to other than unit trusts but s63(3) was amended so that if the interests offered were not units under a unit trust the statement was to set out in addition such of the matters and reports specified in the Fifth Schedule relating to prospectuses as were required by the Registrar.

In December 1960 the Statute Law Revision Committee of the Victorian Parliament published its report on certain aspects of s63 of the Companies Act 1958 which had been referred to it by the Attorney-General. The Committee recommended[11] that s63 should be strengthened to provide for more "statutory details to be included in a deed and to provide for more duties to be imposed on a trustee to watch the interests of

11. Report para. 13.

unit holders". On the first of those matters the Committee noted the requirements in the First Schedule to the Prevention of Fraud (Investments) Act 1958 (U.K.) and it drew upon that Schedule to some extent when formulating its recommendations as to the changes that should be made in the Seventh Schedule.

The Committee's other recommendations included recommendations:

(i) that it should be mandatory for management companies to transmit subscriptions to the trustee within 30 days of receipt;[12]

(ii) that trust deeds should contain a provision allowing a trust which was subject to a fixed date for termination to be continued in operation if necessary, in the interests of the unit holders;[13]

(iii) that trust deeds should provide that no more than 10 per cent of trust funds be invested in any one organization;[14]

(iv) that trust deeds should provide that funds held pending final investment be subject to (iii) and that the period of investment be approved by the trustee;[15]

(v) that the trustee be given statutory power to call meetings of unit holders; [16]

(vi) that the trustee, or a meeting of unit holders, upon the removal of the management company, have statutory, powers either to appoint another manager or to wind up the trust;[17]

(vii) that where the management company goes out of business, the power of the trustee to remove the management company should be subject to the consent of the Court;[18]

12. Report para. 26.

13. Report para. 28.

14. Report para. 29.

15. Report para. 30.

16. Report para. 33.

17. Report para. 33.

18. Report para. 34.

(viii) that the management company should be prohibited from investing trust funds in its "subsidiaries, etc."[19]

(ix) that certain advertisements or statements be not issued by the management company without the consent of the trustee;[20]

(x) that certain types of organization (the Public Trustee, a statutory trustee company, a bank, a life assurance company) be automatically given approval to act as trustees;[21] and

(xi) that legislation be enacted to provide for the registration of names adopted for unit trust schemes.[22]

When in the period 1961-1962 uniform companies legislation was enacted the provisions relating to interests were placed in Part IV Division 5 of the Uniform Companies Act. The provisions in Part IV Division 5 included new provisions which implemented some of the recommendations of the Victorian Statute Law Revision Committee. Of the recommendations listed above the following were adopted:

(i)	was adopted in s80(1) (b) (i);
(ii)	" " " s80(3);
(v)	" " " s 87;
(vii)	" " " s87;
(viii)	" " " s80(1)(d);
(ix)	" " " s80(1) (b) (iv).

The Seventh Schedule to the 1961 legislation differed from the earlier Seventh Schedule in that it could no longer be confined to unit trust schemes. It now referred to an "undertaking, scheme, enterprise or investment contract" and its requirements were re-framed so as to refer more appropriately to all types of "interests". The new Seventh

19. Report para. 37.

20. Report para. 30.

21. Report para. 33.

22. Report para. 33.

Schedule also implemented a number of recommendations of the Statute Law Revision Committee as to items that should appear in the statutory statement.

By the Companies Act 1971 (Vic.) the definition of "interest" in sub-section 76(1) was amended so that the exclusion of an interest in a partnership agreement was narrowed down. Under the new provision the exclusion would relate to an interest in a partnership agreement that was a "prescribed interest".

The 1971 Act also gave the Minister power to dispense with the need for the approved deed to include covenants as required by s80 and to dispense with certain of the requirements of s84 relating to the keeping of a register of interest holders.

The Companies (Interstate Corporate Affairs Commission) Act 1974 (Vic.) s12 amended Part IV Division 5 so as to apply in relation to "interests" the principles of reciprocity as provided by the Interstate Corporate Affairs agreement of 18 February 1974.

The Companies Act 1975 (Vic.) s12 amended the definition of "interest" in sub-section 76(1) of the Companies Act 1961 by again altering the terms of the exclusion of an interest in a partnership agreement. The exclusion was not to extend to a partnership agreement as part of a scheme promoted by a person in the business of promoting similar schemes or to an agreement within a prescribed class of agreements.

The definition was also amended by the exclusion of a prescribed right or interest declared by the regulations to be an exempt right or interest.

The 1975 Act also amended the provisions about the mode of exercise of the Minister's power to dispense with statutory covenants under section 80.

The next major development was the coming into operation of the co-operative Commonwealth/State legislation on companies and securities so as to apply the provisions of the Companies Act 1981 (Cth) and the Securities Industry Act 1980 (Cth) as part of the law of the States as well as being operative in the A.C.T. The provisions of Part IV Division 5 of the Companies Act 1961 were substantially reproduced as Part IV Division 6 of the Companies Act 1981 (Cth) but using the expression "prescribed interest" in place of "interest".

Since then the Companies and Securities Legislation (Miscellaneous Amendments) Act 1984 (Cth) amended the definition of "prescribed interest" so as to make it include expressly any right to participate in a time-sharing scheme.

This survey of the history of the definition discloses that a form of regulation appropriate to an interest in the form of units under a unit trust was made to serve other forms of investment opportunity which were purely contractual.

The survey also discloses that it became necessary to have a dispensing power at two levels. The first, in relation to the ambit of the definition of the central term "interest" and its successor "prescribed interest" was made necessary because the definition could extend to a very wide range of opportunities. The second, in relation to exemption from the obligation to include statutory covenants, arose partly because of the wide application of the definition and partly because a set of requirements designed primarily for a type of unit trust needed to be modified to meet other types of legal structure.

Suite 2407,
Level 24,
MLC Centre,
19-29 Martin Place,
Sydney. 2000.

Telephone: (02) 223 1433

Chairman:
Professor H.A.J. Ford

Members:
Mr. R.I. Barrett
Mr. G.W. Charlton
Mr. D.A. Crawford
Mr. A.B. Greenwood

Research Director:

Mr. J.B. Kluver