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COMPANY LAW ADVISORY COMMITTEE
TO THE STANDING COMMITTEE OF
ATTORNEYS-GENERAL

Sixth Interim Report

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**SIXTH INTERIM REPORT
of the
COMPANY LAW ADVISORY COMMITTEE**

SHARE HAWKING

1. In our Fifth Report, presented to the Standing Committee in October 1970, we referred to the fact that methods had been evolved of defeating the purpose of the provisions of section 374 of the Companies Act*, and that these provisions were in our view in need of re-examination (see paragraph 58 of the report). We have now had an opportunity of reviewing these provisions, and this report deals only with this subject matter.

2. Section 374 deals with two methods of selling shares or other securities. These are logically distinct, but are sufficiently related to be the subject of legislation in the same section, and were introduced at the same time to control the activities of fraudulent salesmen whose operations were difficult to control by the ordinary sanctions of the criminal law. The first part of the section deals with share-hawking as ordinarily understood, that is to say, the activities of salesmen who go from place to place offering shares for subscription or purchase. The second part deals with the making of written offers of shares for sale. Share hawking is prohibited unless an exemption is granted by the Governor in Council on the recommendation of the Minister, but the making of written offers is permitted, subject to the requirement that the offeror must furnish certain specified information to the offeree. Shares which are quoted on a Stock Exchange are excluded from the operation of the second part of the section if this fact is stated in the offer. Exemptions from the second part are also given in relation to shares as to which the provisions of section 43 of the Act have been complied with, or those of Division 5 of Part IV, or as to which no prospectus is required by reason of the provisions as to prescribed corporations contained in section 38.

3. It will be seen from this brief description that the provisions of section 374 are complementary to those relating to prospectuses, and it is for this reason that we have thought it desirable to present a separate report in respect of them at this stage.

4. The basis of the prohibition of share hawking is that as persons who are not experienced in business matters are unlikely to be able to form a reliable judgment as to the value of shares, it is undesirable that the law should permit them to be sold by door-to-door salesmen. Not only is it extremely difficult to establish exactly what representations were made to induce a person to subscribe for them, but in many cases, without actual misrepresentation of the facts, a salesman is able to paint such a glowing picture of the profits expected that the subscriber or

buyer may find himself committed to a substantial expenditure on an investment that turns out to be worthless. The prohibition therefore represents a logical extension of the kind of protection that

** As in previous reports, the references are to the Victorian Act of 1961.*

was sought to be given by the prospectus provisions. It was thought that if a prohibition was imposed against persons going from place to place offering shares for subscription or purchase, the ignorant investor could only be persuaded to subscribe if he were sent a written communication which must either be a prospectus (or its equivalent under Division 5 of Part IV) or a written offer containing the material prescribed by the latter part of section 374.

5. It would seem that for many years the provisions relating to prospectuses and share hawking coupled with the amendments now to be found in Division 5 of Part IV, which were introduced to require prospectuses for the sale of units of various kinds (including, for example, fractions of an acre of a pine plantation, or of an oyster lease), were adequate to control the activities of salesmen. More recently, however, a new method of selling has been evolved, which does not fall within the prohibition of section 374, but which in our view is subject to the same objections as the practices prohibited by the section. The following extract from the evidence given to the Senate Select Committee on Securities and Exchange by Mr. F. J. O. Ryan, Commissioner for Corporate Affairs in New South Wales, sufficiently explains the method of operation:

'Mutual fund companies have adopted generally the same selling methods as unit trust management companies. Although I have no evidence to offer on the point I think it likely that mutual funds, in contrast to unit trust management companies, have relied more heavily on direct approaches to potential investors and less of advertising. No complaints concerning the selling methods of mutual fund companies have come to my notice, nor am I aware of any breaches of section 374 (1) by mutual funds.

I.O.S. (Australia) Pty Limited placed before me its proposed method of operation in regard to "The Australian Fund of Fund" early this year. Briefly, each week an associate, who is a salesman employed on a commission, submits to the company a list of 30 prospective clients drawn from telephone canvassing, referred leads or acquaintances. The company posts to these persons a pre-approach letter containing a written offer of shares in the Fund and which complies with sections 40 and 374 (3). The letter also includes a request for a prospectus. Seven days later the associate contacts the prospective client and arranges an appointment to discuss the offer contained in the letter. After the client has requested, in writing, and received a prospectus, the associate may discuss the prospectus and obtain an application for shares. An associate who observes the procedure laid down by the company will not, it was asserted, make an "offer" of shares to the client.

Upon review of this procedure my legal officers and I reached the conclusion that, provided the procedure was adhered to strictly,

no breach of section 374 (1) would be committed. I understand that other companies have now adopted similar selling methods. It is clear that the legislative intention of section 374 is being avoided and the section is high in priority for recommendation and amendment.'

6. We agree with Mr. Ryan's comment that it is clear that the legislative intention of the section is being avoided. The elaborate precautions taken to ensure the accuracy and completeness of prospectuses are obviously capable of being entirely nullified if a salesman can lawfully use his powers of verbal persuasion on a person who, although he will have received a prospectus, is unlikely to have read it, and may not be capable of understanding it even if he did read it. Moreover, although the method of operation described relates to the sales of mutual funds, there does not appear to be any reason why the same form of selling should not be applied to shares in the ordinary sense. The difficulty in applying the section to such a case arises from the use of the expression

'offering' in section 374 (1), and if this is met by the use of words having the same connotation as the expression 'dealing in securities', as defined in the Securities Industry Act 1970 or its equivalent in New South Wales, we think the section would afford sufficient protection.

7. As in the case of the prospectus provisions, however, a difficulty arises by reason of the use of the expression 'the public'. In this section, the expression is not used in its simple form, but in the form 'the public or any member of the public'. These words were the subject of judicial consideration in the New South Wales case of *Ex Parte Lovell; Re Buckle*, (1938) 38 S.R. (N.S.W.) 153; 55 W.N. 63. In that case it was held that the fact that the salesman had had previous business dealings with the purchaser did not prevent the purchaser from being a member of the public, although Jordan C.J. left open the question whether the expression would cover a near relative or intimate friend of the salesman. Although the phrase 'member of the public' implies that, the offeree does not have a special relationship with the salesman, it is very difficult to predict what sort of relationship would be held sufficient to prevent the offeree from falling within that description.

8. We have come to the conclusion that the expression 'the public or any member of the public' should be avoided, and that where it is necessary to do so the exemptions from a general prohibition should be spelt out in detail. In the case of the share-hawking part of the section, however, it seems unnecessary to make any specific exemption. According to Jordan C.J. in the case cited, the idea of going from house to house or from place to place (both expressions were used in the section with which he was dealing) 'connotes an element of recurrence and an element of system or of relative continuity' although he did not think the phrase was susceptible of rigid definition. Accordingly, the owner of a parcel of shares who desires to offer them to an acquaintance or a member of his family would not infringe the section by calling on the prospective offeree. In effect, the provision would only apply where the offeror was engaged in a systematic course of conduct. At the same time, there may be cases in which a person seeking to sell shares for which no ready market exists would wish to call on a number of persons whose professions would suggest that they might be able to arrange a purchase, and we would have therefore proposed that the prohibition should not apply to visits to the place of business of a banker, stockbroker, solicitor, accountant or dealer. Subject to this exception, we think the prohibition should be general, and not qualified by reference to the public or any member of the public.

9. With regard to offers in writing, the situation is somewhat different. The section makes it an offence to make an offer in

writing unless certain conditions are observed. It may be expected that on occasions a person may write a letter containing an offer to sell shares without adverting to the provisions of the section, and we think it is desirable to provide exceptions that will avoid the possibility of inadvertent breaches of the section.

10. We accordingly propose a series of exemptions that will, we think, cover transactions of a family nature, and also those commercial transactions in which the relationship of the parties is such that the buyer should be able to look after himself. These exceptions are to a large extent modelled on those provided in the case of offers of shares for subscription by the company itself.

11. The exemptions we propose will be found in sub-section (2.) of section 20G in the draft in Appendix 'A'. The following comments are made in respect of each paragraph:

(a) This is a corresponding exception with that contained in section 20F.

(b) This exempts government and local government securities, which are included within the definition of 'securities' in the Securities Industry Act 1970.

(c) This provides for cases in which a prospectus or similar document has been prepared, and corresponds with section 374 (4.) (b) and (c) (i) of the existing Act. The reference to Part VIA is to the provisions relating to takeovers in the Victorian Bill.

(d) Exempts listed securities if the offer so states and identifies the Stock Exchange, as in section 374 (4.) (a) of the existing Act.

(e) Where the person to whom the offer is made is already a share-holder in the corporation, it seems unnecessary to require that information as to the corporation should be given to him.

(f) In general, an offer made to a corporation will probably be handled by someone with business experience. Moreover it might well have been held under the existing section that a corporation was not a member of the public. However, we consider it possible that in the case of a small family company its affairs might not be in the hands of persons experienced in business, and we have therefore excluded exempt proprietary companies from the exemption.

(g) This exemption represents the exemption now embodied in the text of section 374 (3.), with the addition of references to persons whose ordinary business is to underwrite the issue of securities or to lend money, as in our proposed amendments of section 5 (6.) (see our Fifth Report, p. 35).

(h) This exemption is intended to cover the case in which a person offers shares in a company to a member of his immediate family. Such a case might well have been considered not to be within the prohibition of the existing section (see paragraph 7 above).

12. One weakness in the existing provisions requires attention. In the case of an advertisement of shares for sale which is contained in a newspaper or transmitted by radio or television or displayed in a cinema, the section requires that a statement containing the prescribed particulars shall be transmitted to the offeree if he so requests. This seems to us inadequate. If the advertisement is sufficiently persuasive to induce the offeree to write to the offeror, it still does not follow that he will ask

for the statement prescribed. However, if the section is redrafted so as to require that the acceptance of the offer must be made on a form attached to the statement, this difficulty will be largely overcome. We have considered whether there should be a total prohibition of radio, cinema and television advertising of offers to sell shares (as distinct from offers in respect of a new issue). There is perhaps much to be said for the view that the advertising of shares for sale by such ephemeral means is not likely to attract the type of buyer who should be encouraged to purchase shares, nor is it likely to be resorted to by sellers who have a product that is worth buying. But on the whole, and especially considering that the contents of the permitted advertisement are strictly limited, we do not feel that such advertising should be banned altogether. We have taken into account also the fact that the prohibition would extend

to other forms of security, such as debentures, in respect of which the case for an outright ban is not as strong, though opinions may differ as to the appropriateness of this form of advertising for the sale of such an investment. It is to be remembered that we are dealing only with securities already issued, and not with new issues, which are dealt with by section 40.

13. We have considered, amongst other suggestions that have been made, whether unsolicited telephone calls offering shares should be forbidden. On the whole we think that there is little likelihood of making a sale to a stranger by this means without the benefit of a personal interview, and a prohibition of this type would create problems for dealers or brokers who wished to make a prompt offer by telephone, either to a client, or to someone to whom the broker was sufficiently well-known to make it likely that a sale would be the consequence of such a call.

14. In the course of our work on this problem, we have had the benefit of a rough draft prepared by the office of the Commissioner of Corporate Affairs of New South Wales. Some of the suggestions made in that draft we have not thought it necessary to adopt but we have found it most valuable as a guide to our thinking, and the draft which is attached to this report is largely based on it. That draft was prepared as an amendment to the Securities Industry Act of New South Wales, and accordingly the definitions of 'security' and 'dealing in shares' contained in that Act would apply in the interpretation of its provisions. Our draft is also prepared on the basis that it would become an amendment of the Securities Industry Act and should be read accordingly. There is, however, no real significance in the choice of a vehicle in which to embody the section, and in the case of those States which have not yet adopted legislation relating to the securities industry, there is no reason why the provisions we recommend should not be enacted by amendment of section 374, but incorporating in the text the full terms of the definitions.

15. Appendix 'A' contains the draft which we propose. In Appendix 'B' we have set out some notes on the sources of the draft. It will of course be appreciated that a different form of words will be required in the different jurisdictions to deal with building societies, co-operatives and the like. Subject to such modifications, we recommend the adoption of the provisions of the draft. We should add that we have not made any alteration in the magnitude of the penalties provided for in the existing section 374. Some of the penalties provided for in the Act are difficult to reconcile with each other, and perhaps reflect a failure to take account of changes in the value of money, but we do not feel that we are specially qualified to judge whether a particular level of penalties is appropriate or not, and we would suggest that at some

stage a general revision of the scale of penalties should be undertaken.

R. M. EGGLESTON

J. M. RODD

P. C. E. Cox.

**SUGGESTED REDRAFT OF
SHARE HAWKING PROVISIONS**

Restriction on offering securities for subscription or purchase.

20F - (1.) In this section 'securities' does not include:

(a) shares in any society, association or union registered under the Cooperation Community Settlement and Credit Act 1923, the Permanent Building Societies Act 1967, or the Credit Union Act 1969; or

(b) securities of a corporation that are the subject of an exemption in force under sub-section (2.) of this section.

(2.) Where a corporation applies in the form prescribed to the Commission for the exemption of its securities from the provisions of this section, having previously advertised in the Gazette and in a daily newspaper circulated generally throughout New South Wales that it proposed so to apply, the Commission may, by order published in the Gazette, so exempt those securities on such terms and subject to such conditions as it deems fit.

(3.) The Commission shall not revoke an order made under sub-section (2.) of this section without affording the corporation to the securities of which the order relates an opportunity to show cause why the order should not be revoked.

(4.) Subject to this section, a person shall not (on his own behalf or on behalf of any other person), whether by appointment or otherwise, go from place to place for the purpose of dealing in securities.

(5.) The expression 'go from place to place' shall not include going to the place of business of a banker, stockbroker, solicitor, accountant or dealer.

Regulation of certain offers of securities for purchase.

20G (1.) In this section

(a) a reference to an offer shall be construed as including a reference to a statement, however expressed, that is not an offer but expressly or impliedly invites a person to whom it is made to offer to acquire any securities to which it is referable;

(b) a reference to purchase shall be construed as including barter or exchange.

(2.) This section has effect in relation to an offer of securities which have been brought into existence by allotment or issue or otherwise prior to the making of the offer, but does not apply to or in relation to:

(a) an offer of securities of the kind referred to in paragraph (a) of sub-section (1) of section 20F of this Act;

(b) an offer made by or on behalf of any government or local government authority of securities of that authority;

(c) an offer in respect of which the provisions of Division 1 or Division 5 of Part IV or Part VIA of the Companies Act 1961 apply and have been complied with;

(d) an offer of securities which are listed for trading on a stock exchange or on a prescribed stock exchange in another State or in a Territory of the Commonwealth, if the offer so states and specifies the stock exchange;

(e) an offer of securities allotted or issued by a corporation which is made to a person who is a shareholder in that corporation;

(f) an offer made to a corporation other than an exempt proprietary company within the meaning of the Companies Act or a corresponding provision of the legislation of another State or Territory of the Commonwealth;

(g) an offer made to a person whose ordinary business it is (whether as principal or agent) to buy or sell securities or to underwrite the issue of securities or to lend money;

(h) an offer made to the spouse child or remoter issue of the offeror.

(3.) Subject to this section, a person shall not make or cause to be made any offer in writing to any person (not being the holder of a dealer's licence) of any securities for purchase unless it is made by means of a document that:

(a) is signed by the person making the offer and dated;

(b) identifies the securities and contains in clearly legible characters the terms of the offer and the particulars set forth in the schedule to this Act; and

(c) prominently displays the words 'If you are in any doubt about this offer you should consult your professional adviser', and contains no matter other than matter referred to in paragraphs (a), (b) and (c) of this sub-section.

(4.) Notwithstanding anything in sub-section (3.) of this section, where after the exercise of reasonable diligence a person making an offer is unable to ascertain the position with regard to some part of the particulars referred to in the Schedule to this Act that are, by sub-section (3.) of this section, to be stated or specified in a document offering securities for purchase, that part of those particulars may be omitted from the document if, in the case of each omission, the offer includes a statement to that effect and identifies the type of particulars omitted.

(5.) Notwithstanding anything in sub-section (3.) of this section, an advertisement of an offer or intended offer of securities for purchase published in a newspaper or by means of broadcasting, television or cinematograph shall be deemed not to have been made in contravention of this section if the advertisement contains no information or matter other than that referred to in paragraphs (a), (b), (c), (d) or (e) of sub-section (1.) of section 40 of the Companies Act 1961 (as applied with such adaptations and modifications as may be necessary) and:

(a) a document is prepared by the person on whose behalf the offer is made which complies with sub-section (3.) of this section and contains a form of acceptance to be completed by the offeree;

(b) the advertisement states that a copy of the document will be supplied on request being made at a specified address and that the offer can only be accepted by completion of the form contained in the document.

(6.) Where an offer or intended offer of securities for purchase is made by means of a newspaper, broadcasting, television or cinematograph pursuant to the

last preceding sub-section and such offer or intended offer is accepted without the acceptor having first applied for and been forwarded a document which complies with sub-section (3.) of this section, such acceptance shall be void and the person who made the offer or on whose behalf the offer was made shall forthwith notify the acceptor in writing of that fact.

(7.) A document that is prepared in compliance with this section shall not for that reason alone be deemed to be a prospectus within the meaning of the Companies Act 1961, but nothing in this section shall be deemed to authorise a person to dispense with compliance with the provisions of Division 1 and Division 5 of Part IV of the Companies Act 1961 in relation to an offer to the public to which any of those provisions apply.

20H - (1.) A person who acts, or incites, causes or procures any person to act, in contravention of section 20F or 20G of this Act shall be guilty of an offence against this Act.

Penalty:

For a first offence, four hundred dollars or imprisonment for six months or both and in the case of a second or subsequent offence, one thousand dollars or imprisonment for twelve months or both.

(2.) Where a person convicted of an offence under this section is a corporation, every officer concerned in the management of the corporation shall be guilty of the like offence unless he proves that the act constituting the offence took place without his knowledge or consent.

(3.) Where any person is convicted of having made an offer in contravention of section 20F or 20G of this Act, the court before which he is convicted may order that any contract made as a result of the offer shall be void and may give such consequential directions as it thinks proper for the repayment of any money or the re-transfer of any shares; and an appeal against such an order and any consequential directions shall lie to the Court.

Schedule

THE SCHEDULE

The particulars referred to in paragraph (b) of sub-section (3.) of section 20G are:

(a) whether the person making the offer is acting as principal or agent and:

(i) if as principal:

(A) the name of such person; and

(B) an address in the State where he can be served with process;

(ii) if as agent:

(A) the name of his principal;

(B) an address in the State where such principal can be served with process; and

(C) particulars as to the remuneration payable to him by his principal;

(b) where any dividend interest or other income has been declared or recommended in respect of the securities or it is anticipated that there will be such a declaration or recommendation before the transfer of the securities, whether the securities are to be transferred with or without the right to that dividend interest or other income;

(c) whether any of the securities are listed for trading on a stock exchange referred to in paragraph (d) of sub-section (2.) of section 20G of this Act and, if so, the stock exchange concerned;

(d) particulars of any of the securities that are not listed for trading on a stock exchange referred to in paragraph (d) of sub-section (2.) of section 20G of this Act and:

(i) all the information that the person making the offer has as to the number of the securities that have been sold in the period of six months immediately preceding the date of the offer and the prices paid;

(ii) particulars of any restriction on the right to transfer the securities, and if there is any such restriction, the arrangements (if any) being made to enable the securities to be transferred in pursuance of the offer;

(e) whether the securities are securities of a corporation incorporated outside the Commonwealth that are listed for trading on a stock exchange in the country of incorporation and, if so, the stock exchange on which they are listed;

(f) in the case of securities that are shares or debentures of a corporation or are rights or interests therein:

(i) whether or not the securities are fully paid up and, if not, to what extent they are paid up;

(ii) the date and place where the corporation was incorporated and the address of its registered or principal office in its place of incorporation and in the State;

(iii) the authorised share capital of the corporation, its issued share capital, its paid-up share capital and the classes into which its share capital is divided and the rights of each class of shareholders in respect of capital, dividends and voting;

(iv) the dividends (if any) paid by the corporation on each class of shares during each of the five financial years immediately preceding the offer whether, in respect of shares of any particular class during any of those years, the corporation failed to pay a dividend;

(v) the names and addresses of the directors; and

(vi) the last audited accounts of the corporation;

(g) in the case of securities that are interests within the meaning of Division 5 of Part IV of the Companies Act 1961:

(i) in relation to the management company and the trustee, the particulars referred to in sub-paragraph (ii) of paragraph (f) of this Schedule and, in relation to the management company, the names and addresses of the directors;

(ii) such particulars as are sufficient to disclose the true nature of the undertaking, scheme, enterprise or investment contract to which the interests relate, and the nature of the interests and the rights of the holder;

(iii) the name and address of each person or corporation with whom or with which the holder of the interests is required, obliged or entitled in connexion with the undertaking, scheme, enterprise or investment contract by way of lease or otherwise and the names and addresses of the directors of any such corporation;

(iv) the obligations imposed on the management company or any other person to purchase the interests from any holder thereof and a statement of the method provided in the deed for the calculation of the purchase price;

(v) a summary of the provisions of the deed relating to the distribution, to the holders of the interests, of the income derived from the undertaking, scheme, enterprise or investment contract;

(vi) such information as sufficiently discloses the number of distributions (if any) to the holders of interests to which the deed relates in each of the five years immediately preceding the date of the offer during which those interests had been in existence and the date and amount of each distribution.

NOTES ON THE SOURCES OF THE DRAFT IN
APPENDIX 'A'

Section 20F

(1) (a) The existing (Victorian) Act exempts offers of shares in a co-operative company (section 374 (14)). The N.S.W. Act, with reference to which this draft has been prepared, refers to 'any society, association or union registered under the Co-operation, Community Settlement and Credit Act, 1923, as amended by subsequent Acts.'

(b) See sub-section (2) below.

(2) It is proposed that the power of exemption given to the Governor in Council by section 374 (2.) be conferred on the Commissioner for Corporate Affairs.

(3) Consequential on (2) above.

(4) Section 374 (1.), modified as indicated in the text of this report.

(5) For this exception see paragraph 8 of the report.

Section 20G

(1) (a) Inserted to cover the case in which the seller extends an invitation to make an offer.

(b) Represents part of section 374 (12.).

(2) For these exemptions see paragraph 11 of the report.

(3) Section 374 (3.) and (5.) with the addition of the requirement to insert the warning contained in paragraph (c).

(4) New. To require the information to be given in every case might cause undue hardship.

(5) Represents part of section 374 (12.), modified as indicated in paragraph 12 of the report.

(6) Consequential on sub-section (5.).

(7) Saving clause.

Section 20H

(1) Section 374 (8.).

(2) Section 374 (9.).

(3) Section 374 (10.).

The Schedule

(a) Section 374 (6.) (a), modified so as to apply both to principals and agents.

(b) New.

APPENDIX 'B'

(c) This represents part of what is at present paragraph (h) of section 374 (6.). If the listing is on an Australian Stock Exchange, particulars of sales are not required. See (d) below.

(d) (i) New. The existing section does not require particulars of sales. A corresponding provision is to be found in the provisions relating to takeovers (Companies Act, Tenth Schedule, Part B, paragraph (8.)) and in the U.K. Prevention of Fraud (Investments) Act.

(ii) New. Also modelled on the takeover provisions but applying to all classes of restriction on transfer (Companies Act, Tenth Schedule, Part B, paragraph (2.)).

(e) Part of the present paragraph (h) of section 374 (6.).

(f) (i) Section 374 (6.) (g).

(ii) Section 374 (6.) (b).

(iii) Section 374 (6.) (c).

(iv) Section 374 (6.) (d).

(v) Section 374 (6.) (f).

(vi) Section 374 (6.) (j).

(g) The existing paragraph (i) is very limited in scope. This paragraph represents a considerable extension of the requirements in respect of 'interests'.