PROSPECTUSES AND NATURAL RESOURCES

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The approach to a topic like this is like the approach of Dickens to Chinese Metaphysics — that is one reads an article on China and an article on Metaphysics and puts them together. The volume of writings on the prospectus provisions will ensure that part of the duo will be paramount. There has been in the last two decades a particular natural resources slant to prospectuses in the growth of the mining and oil boards, giving rise to forms of fund raising and distribution of interests in resources devised from time to time and arranged principally with a view to taxation benefits, liability of investors, negotiability of interests, and ease and attraction of investment.

The central concept of all prospectus provisions however is the concept of 'the public' with the consequential compliance and penalty requirements of the 1981 Companies legislation (Code) and its predecessor the Uniform Companies Act (UCA), the Securities Industry Act (SIA) and the Australian Associated Stock Exchanges Listing Requirements (LR), to which may be added in many cases the curious form and even more curious operation of the no liability company.

Investment methods most commonly used for natural resources include the issue of shares and rights to shares (including partly paid shares), the issue of options, resources trusts, drilling funds, limited and other partnerships, and joint ventures and other unincorporated associations. These may generally, from the point of view of statute, be seen to be governed in the case of shares (and units in shares) by the provisions of Part IV Division 1 of the Code and by the prescribed interest provisions (Part IV Division 6) in respect of the other items. Another way of classification is indirect access to assets (shares and options), limited indirect access (resources trusts and limited partnerships) and direct access (more or less) in the case of the direct participation provisions of drilling funds and joint ventures.

A full examination of the foregoing is clearly beyond the scope of this paper. Accordingly a number of selected issues will be dealt with under the following headings:

- Australian Central Credit Union and section 5(4) generally
- further anomalies in issue to the public — options and other interests
- second board variations and section 104
- experts and misrepresentations in prospectuses
- variations during the course of a prospectus
- no liability companies
- vendor consideration and aspects of listing requirement 3M(1)

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PROSPECTUS

The most important strand in all of the foregoing is the concept of issue to the public and the regulation thereof, the central provisions of which are, in the Code, sections 96 (distribution of application forms), 98 (contents of prospectuses), 99 and 100 (notices and advertising), 103 (requirement to register a prospectus), 104 (offers for sale), 107 and 108 (civil and criminal penalties).

This is reflected in the definition of prospectus itself in section 5 of the Code. Section 5 of the UCA defined prospectus in terms of an offer to the public. Section 5(6) of the UCA defined offer to the public in terms, *inter alia*, of 'the person issuing a prospectus'. The new definition avoids the circularity but it is not easy to find the purpose served by it. The substance of the provisions of sections 96 and 97 which refer to 'prospectus' would not require a definition of that term — both refer to a prospectus that has been registered by the Commission. Section 98 prescribes the contents of a prospectus and section 103(2) prescribes the preconditions to registration of a prospectus by the Commission. It appears however that section 103(1) has independent substantive effect in respect of the prohibition of offers or invitations to the public in respect of 'shares' and 'debentures', apart from sections 96 and 97, if there is a registered prospectus.

There are some anomalies in relation to the issue of prescribed interests and some other anomalies. For example, the prohibitions of section 96 would not appear to extend to the issue of the form of application for options over shares. As 'prospectus' is defined in terms of written instrument, neither section 103 nor section 96 would appear to prohibit oral offers or invitations in respect of options to subscribe for shares and oral offers to the public of shares for subscription or purchase would only be prohibited if falling within the 'share hawking' prohibitions of section 552(1). Again, there is nothing to prevent material circulating with a registered prospectus, provided it is not untrue or misleading[1] and provided it does not fall foul of the 'advertising' provisions.[2] If section 100 applies, section 99 does not as in section 99(1). What if further drilling results are published in an 'inspired' report in a stock exchange or general meeting report of a listed company making the issue (or perhaps another listed company)?[3] Or in the annual report of any issuing corporation?[4]

There is also the long standing question (not resolved by the 1981 provisions) as to the application of the prospectus provisions to purchase of shares as opposed to subscription. The definition of prospectus covers both but its application to particular sections gives rise to doubts.

Be that as it may, if there is not an issue to the public then the prospectus provisions do not apply. By their nature natural resources prospectuses require a number of things not required by industrial issues. The Listing Requirements require a number of reports.[5] In addition,

1 Ss. 107 & 108.
2 Ss. 99 & 100.
3 S. 100(a), (b).
4 S. 100(4)(c)(i).
5 LR 2B (6), (7), (8), (10), (11) & (11A).

although streamlined provisions of prospectus checking by the Commission involving full checklists and verifying declarations by solicitors and experts has been of considerable assistance, and although it is noted that there is continuing review of the prospectus provisions taking place, the additional requirements of the Code and penalty provisions in relation to issue to the public in section 108 and elsewhere make it desirable for issues not to be by way of offer or invitation to the public, which concept is governed principally by section 5(4) of the Code.

AUSTRALIAN CENTRAL CREDIT UNION AND SECTION 5(4)

Section 5(4) of the Code is not an exclusive definition. Like the UCA, it defines 'public' in terms of 'any section of the public' and therefore does not avoid the difficulties of this approach as referred to in the Company Law Advisory Committee Report on the Control of Fund Raising, Share Capital and Debentures (the 'Eggleston Report') and by Professor Loss.[6]

The principal difficulty of course is to determine just what does constitute 'any section of the public' in any given case. The concept of 'public' is easier of definition and application than the concept of 'any section of the public'. Whether a particular offer or invitation will be deemed an offer or invitation to a 'section of the public' and, therefore, an offer or invitation to the public must be determined by the general law as applied to the particular facts of the case.

In order to avoid such uncertainties, both the Eggleston Report and Professor Loss recommended a numerical test as an alternative. This was rejected by the Commonwealth Government in formulating the Corporations and Securities Industry Bill 1974 (the 1974 model). The reason set out in the explanatory memorandum for this rejection appears sound. In the event section 5(4) went on to deal with two other interpretations which were set out by the majority and minority judgments in *Lee v. Evans.*[7] In that case the majority of the High Court thought that the words 'invitation to the public' in the South Australian Registration of Business Names Act meant an invitation made generally and therefore capable of being acted on by any member of the public not merely the original hearer. If this is the case then in that test an invitation or offer to a section of the public within section 5(4) occurs if the offer is general within the section designated by the maker, so that any member of that section may accept it. However that interpretation is precluded by the new wording of section 5(4) in that a section of the public is still the public 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.

Windeyer J. suggested a different test namely whether the recipient of the invitation is selected at random or by virtue of a prior special relationship. This test also now seems to be excluded. Section 5(4) speaks

6 Loss L. *Proposals for Australian Companies & Securities Legislation* (1974).
7 (1964) 112 C.L.R. 276.

of a section of the public 'whether selected as clients of the person making the offer or issuing the invitation or in any other manner'.

Accordingly, at the time of implementation of the new section 5(4) the only coherent solution was that perhaps there was an offer to a section of the public if the class to whom the offer was directed or the persons who received individual offers formed a sufficiently substantial group numerically. But this test had already been rejected.[8]

There still remained other anomalies in relation to the section. For instance section 5(4)(b) exempts all invitations made or issued to a person whose ordinary business it is to buy or sell shares whether as principal or agent. An offer to a stock broker is within the exclusion but it is not clear whether or not it applies to institutional investors such as life insurance companies. A life insurance company has been held to be conducting a business of investing funds for certain taxation purposes.[9] It certainly would be if it buys and sells securities regularly with the intention of making gains. Why should it not also be if it merely rearranges its portfolio from time to time to maximize the yield of the securities?[10]

The Code not only retains the exemption from 'offer to the public' of bona fide offers or invitations made to existing members or debenture holders of a corporation which relate to shares in or debentures of that corporation (unlike the 1974 model which was to abolish this exemption) but extends this exemption to offers or invitations of 'prescribed interests'. It is curious that a holder of debentures is seen to be better informed than the general public, and the exemption still leaves open the question of renouncable issues. It is by no means clear that a renouncable offer is not an offer to the public although the prevailing view seems to be that it is not, on the basis that the test in the Code relates to the identity of the offeree and the fact that there are renounceable rights does not alter the identity of the person to whom the actual offer or invitation is made. If this is the case then it is possible for a company (listed or unlisted), to make a renounceable rights issue and (assuming this is not caught by section 104) for any potential shortfall to be renounced in favour of *e.g.* selected clients of an underwriter of the issue.

The prevailing view seems wrong. Perhaps there is some substance in the view if the company were already listed if one took the line of the Eggleston Committee that where shares are listed there is no need for a prospectus since the third party may purchase the existing shares on the Stock Exchange without a prospectus although perhaps the third party should get the benefit of a 'directors proposal'.[11] But what of unlisted companies?

The suggestion in *Australian Central Credit Union* case that the exclusion in section 5(4)(c) is designed to facilitate takeover offers is too narrow.[12] The temptation to apply the exclusion to a situation where an

8 Corporations and Securities Industry Bill 1974.
9 *Colonial Mutual Life Assurance Society Ltd. v FCT* (1946) 73 C.L.R. 604.
10 *London Australia Investment Co. Ltd. v. FCT* (1977) 138 C.L.R. 106.
11 5th Interim Report (1970) para 16.
12 (1984) 9 A.C.L.R. 132, 138.

offeror offers its shares to shareholders of another corporation by way of a takeover offer or a tender offer has been removed *BHP v. Bell.*[13]

The exception may exist in any case without the statute,[14] and a growing line of cases suggested that no offer to the public could be involved if there were a limitation on the persons who could accept the offer by reference to some quality of the recipient.[15] Section 5(4) may in any case not apply to the share hawking provisions of section 552, which uses the term 'member of the public'.[16]

The 1981 provisions did not clarify the position other than generally to cut down the width of the exclusions.

The situation has been improved (on one view) or thrown into further confusion (in my view) by the decision of the High Court in *Australian Central Credit Union.*[17] In that case there was a proposed offer, restricted to members of a credit union numbering about 23,000 persons, of units in the unit trust holding the union's proposed premises. It was held to be a non public offering. Mason ACJ Wilson Deane and Dawson JJ said that the question whether there would be an offer to a section of the public must be determined 'by reference to the nature content and general circumstances' of the offer and to 'the significance of any particular characteristic which identifies the member of the group' and 'any connection between that characteristic and the offer'.[18] Brennan J looked to whether the offerees were members of a group who, by reason of an antecedent relationship with the offeror, had a greater or different interest in the offer than persons not related to the offeror.[19] All concluded, however, that the offer was made to the members in their domestic and private capacity.

The majority admitted that ordinarily the most important factors determining whether an offer is to a 'section of the public' would be the number of persons comprising the group, the subsisting relationship between the offeror and the members of the group, the nature and content of the offer, and the significance of any particular characteristic which identifies the members of the group and any connection between the characteristic and the offer. Another factor emerges towards the end of the judgment, where the majority states: 'It is legitimate to consider, in addition to the matters already mentioned, whether the relevant group of persons is one which parliament could reasonably be expected to have had in mind as part of the investing public to be protected by the disclosure requirements'.[20]

Given these factors, it is submitted that the ACCU should have failed. In terms of the numerical test, the magnitude of the proposed number of offerees, some 23,000, was clearly large enough to weigh as a

13 (1984) 8 A.C.L.R. 609, 617.
14 *Burrows v. Matabele Gold Reefs and Estates Co. Ltd.* [1901] 2 Ch 23.
15 See *e.g. Comm'r for Corp. Affairs v. Australian Softwood Forests* (1981) 148 C.L.R. 121.
16 S. 552 (1) to (3).
17 *Australian Central Credit Union v. CAC (S.A.)* (1985) 59 A.L.J.R. 785.
18 *Ibid.* 787.
19 *Ibid.*
20 *Ibid.*

factor 'militating in favour of a conclusion that [the members of ACCU] would constitute a section of the public in relation to an offer made to them'.[21]

The majority judgment's examination of the facts with respect to 'subsisting relationship' leaves something to be desired. The majority said:

> The characteristic which sets the proposed offerees apart as a group is both restricted and well-defined. It is a membership of ACCU. The rules of ACCU restrict eligibility for membership by reference to employment and/or residence and prescribe clear procedures for applications for membership and their rejection or acceptance.[22]

Membership of the ACCU was indeed 'well-defined'. But to say that it was 'restricted' is not entirely accurate. Restricted to whom? The eligibility requirements, set out in the Court below,[23] indicate that anybody in South Australia or the Northern Territory could join the ACCU so long as that person was nominated by an existing member. In a sense, this requirement is a 'restriction', but in practice it would appear to be nominal only — somewhat like the restrictions placed on membership for most N.S.W. licensed clubs. Twenty years ago it would have been difficult to find a credit union with the characteristics of ACCU — traditionally the typical credit union was a small body whose membership was not open to the public at large. But with the significant changes that have occurred in Australia's financial system in recent times, large credit unions such as the ACCU have taken a new prominence. The public perceives such credit unions to be open to all — which in the case of the ACCU would appear to be a correct perception, in the light of its eligibility rules.

The High Court's observation that membership of the ACCU was restricted led to a conclusion that the eligibility to accept the proposed offer of securities was also restricted. This conclusion may facilitate the avoidance of the public offering provisions of the Code in future cases, for the High Court appears to indicate that the courts will be bound by the form of the offer notwithstanding the substantive nature of the offer and its surrounding circumstances.

The High Court's judgment can be questioned for its treatment of the intention of Parliament in relation to section 5(4). As noted above, the majority said that 'it is legitimate to consider ... whether the relevant group of persons is one which parliament could reasonably be expected to have had in mind as part of the investing public to be protected by the disclosure requirements'.[24] One might ask — if it is so legitimate, why did the majority fail to do so? Nowhere in the judgment is there any indication that the High Court considered the legislative policy underlying section 5(4). Furthermore, the majority's attempt to distinguish the United States principle, stated in the Supreme Court decision, *SEC v Ralston Purina Co.*[25] is questionable. In that case, the Court 'construed the language of

21 *Ibid.* 788.
22 *Ibid.*
23 (1985) 9 A.C.L.R. 718 (Full Court of S.A. Supreme Court).
24 (1985) 59 A.L.J.R. 785, 788.
25 346 U.S. 119 (1953).

[section 4(1) Securities Act 1933] by reference to the purpose which the Statute sought to promote, holding that the applicability of the exemption should therefore turn on whether the particular class of persons affected needs the protection of the Act'.[26] The relevant phrase in section 4(1) is 'public offering'. This is not to suggest that the High Court should have necessarily followed the test laid down by the U.S. Supreme Court, the so called 'reliance' test. It may be that the legislative purpose underlying section 5(4) of the Code is different. Yet, rather than identifying the Australian legislative policy, the majority distinguished *Ralston Purina* decision in these terms:

> The generality of the statutory provision in the Ralston Purina Case made it susceptible to the interpretation placed upon it by the Supreme Court. Here, however, the statutory provisions are comprehensive and detailed and are couched in language reflecting earlier statutory provisions which have been the subject of judicial interpretation. Perhaps more importantly for present purposes, s.5(4) is specifically expressed with a view to displacing to some extent the preceding judicial interpretation.[27]

However, section 5(4) is not 'comprehensive and detailed' at all — indeed earlier in the judgment the majority stated that '[p]lainly enough, s.5(4) is not intended to provide a comprehensive definition of what constitutes, for the purposes of the Code, an offer . . . "to the public"'.[28] And what of the last part of the foregoing quotation? It is true that over the years the predecessors of section 5(4), both in Australia and the United Kingdom have been amended in order to displace preceding judicial interpretation. But the fundamental notion of 'public' according to ordinary usage remains largely intact. Indeed, the majority itself acknowledges that it would be 'wrong' to use the contents of the specific statutory amendments in section 5(4) to attribute to the substantive words of section 5(4) a different scope than that which they bear as a matter of ordinary language.[29] In any event, the statutory amendments to section 5(4) referred to do not bear on the facts in the *ACCU* case.

It is submitted that the notion of 'public', which is a 'cornerstone of regulation of corporate securities',[30] called for a purposive interpretation by the High Court. Indeed, section 5A of the Companies & Securities (Interpretation & Miscellaneous Provisions) Act contemplates this, though of nine judges who considered the *ACCU* case through the proceedings, only one judge took this approach, and was in the court below.

In addition and perhaps more importantly the Court did not accept the view that the section should be interpreted in the light of the exclusions from it.' This is a respectable means of statutory interpretation and the failure by the High Court to adopt it casts some doubts upon its decision.

In the result, the majority of the High Court found against the existence of a public offering on the ground that the 'proposed offer would

26 (1985) 59 A.L.J.R. 785, 788.
27 *Ibid.*
28 *Ibid.* 787.
29 *Ibid.* 789.
30 NCSC Practice Note, cited in *ACCU v. CAC (SA)* (1985) 9 A.C.L.R. 719, 725.

have a perceptive and rational connexion' with the proposed offerees' membership of the ACCU.[31] But the majority failed to give much elaboration on this, let alone enunciate clear principles upon which lower courts can develop and upon which legal advisers can rely. One would hope that the High Court will reconsider the principles discussed in the *ACCU* case before the draftsman feels compelled to rewrite section 5(4) (to overcome the decision) in a manner typical of tax amendments of recent years.

The issuer of securities, in particular those relating to natural resources, could still be forgiven for being confused. The law has been developing from case to case in an *ad hoc* manner. An offer of its assets by a company to its shareholders and a major creditor was (rightly) held not to be an offer to the public.[32] Although members of the public were sought out or had been introduced to a director of a company, and given a pamphlet publicizing investment in the company's unit trust (with an application form for investment) it was held that there was 'no public action of any kind on the part of the respondent company, no offer being made to the public on the facts of each case'.[33] A company's offer to convert options over its shares was not an offer to the public.[34] Offers to 163 persons of interests in a film scheme were held not to be offers to the public on the basis, *inter alia*, that there was a common characteristic of tax avoidance and/or some possible previous tax avoidance activities.[35] The *ACCU* case also leaves the NCSC guidelines in parts inappropriate.[36]

Presumably there is not a sufficient particular characteristic between investors whose only association is that of membership of a club for investment in natural resources shares, or being clients of a broker or investment adviser where the only nexus is their status as clients. Presumably a new float of areas already held by a company, with an offer to existing shareholders, would fall within the ACCU exemption. But it may make a difference if the new float had new areas. If so how many? Why should there be a presumption that there is sufficient knowledge by a shareholder of existing areas? What of offers of shares to farmees or royalty holders in respect of areas held by a company? Does it make any difference if these areas are being acquired as a result of or in connection with the issue? What of an offer of royalty or other interests to existing shareholders which does not seem to fall within section 5(4)(c)? Would it generally make any difference if the offer of interests relates to existing or to future property of the company? If this is the case does it make any difference how many areas?

An offer only to employees may be clear (notwithstanding NCSC practice note 321). What of short term prospecting staff? Why should this be different from long term consultants (if it is)? Why should there be any

31 (1985) 59 A.L.J.R. 785, 788.

32 *Eastern Petroleum Australia Limited & Anor. v. Horseshoe Lights (Gold) Pty. Ltd.* (1985) 3 A.C.L.C. 594.

33 *Comm'r for Corp. Affairs v. Austcan Property Investments Pty. Ltd.* (1981) C.L.C. 40722.

34 *Venture Acceptance Corporation Limited v. Kirton & Ors.* (1985) 3 A.C.L.C. 3.

35 *Hurst v. Filmco Limited* (1985) 3 A.C.L.C. 63.

36 *E.g.* Practice Note 321.

difference (if there is) to any of those categories if the only common characteristic is the holding of, *e.g.*, one share? Or even a debenture?

One of the difficulties is that the facts in the *ACCU* case (including the very large number of persons and the ease of membership) seem to be at odds with the morality of the test laid down in the conclusion. It is submitted that the situation is no clearer after *ACCU* than before *ACCU* and that the whole of the provisions in relation to issue to the public require amendment on an analysis of to whom the protection should be directed and in respect of what.

Even if there is a particular characteristic and a relevant connection with the offer, and even a relevant antecedent relationship, this seems to be the wrong test.

Prospectus provisions were or should be intended to safeguard investors who need to know certain information in order to be able to evaluate an investment or otherwise rely on advice in respect thereof. Examples from section 5(4) all relate to situations where the investors need to know material information which can usually be satisfied by means other than a formal prospectus. The United States and Ontario have set out guidelines for exemption for those persons who fend for themselves and who do not need the protection of the legislation, on the basis that such a person could fend for himself if, *inter alia*, he knew or had access to prospectus quality information.[37] Guidelines have been set out at length with procedures for exemption in any particular case where it is not prejudicial to the public interest.[38]

As the whole capital market is changing rapidly, there is a need to change prospectus procedures so as to balance an adequate supply of information against subscription of funds as simply and cheaply as possible.

To begin with, there should be a distinction between new ventures and subsequent ventures. Assuming for the sake of this paper that the prospectus requirements contained in the Code (including its regulations and Schedule 4), the NCSC guidelines, and LR 2B(5)–(13), are reasonable, then it is submitted that the registration of a prospectus, certified as containing the relevant information by an appropriately licensed issuing house (and the issue being dealt with only by dealers appropriately licensed under the SIA) should be sufficient for new ventures to achieve the balance between knowledge and efficiency, and incidentally relieve the burden, far heavier than UCA section 42(2)(d), on the Commission to ensure under section 103(2) compliance of a prospectus with the Code and to be of the opinion that the prospectus does not contain any statement or matter that is false in a material particular or is materially misleading in the form and context in which it appears. After all:

1. a prospectus must state that the Commission takes no responsibility as to its contents.[39] (It is interesting to speculate whether this means the Commission in fact has no liability — the Code does not expressly say so);

37 (US) Securities Act 1933 s. 4(2) and Rule 146; Securities Act 1974 (Ontario).
38 SEC Securities Act Release No. 5487.
39 S. 98(1)(c).

2. there are heavy penalties for non-compliance *e.g.* under sections 98(7), 107, 108 of the Code and sections 126, 127 and 130 of the SIA;
3. other provisions of the Code require the lodgement and publication of significant public documents without similar scrutiny.

As to subsequent issues there are only minor differences in the requirements relating to the contents of a prospectus issued by a well-established company as against one issued by a new company.[40] There seem to be some inefficiencies here, notably in the case of a later public issue of shares by a company whose shares are already listed for quotation on a stock exchange.

Shares quoted on a stock exchange are freely available to the public for purchase. There are no requirements under the Code for information to be supplied by a company to a potential purchaser. As long as a company has complied with stock exchange reporting requirements particularly in relation to mining companies[41] and the various provisions of the Code requiring regular reporting there seems no reason (with certain exceptions) to require additional information to be given to the public in relation to a new issue. The exceptions may include how much money is being raised, the purpose of the issue, expenses of the issue, and material information not already disclosed.

The exception under section 5(4)(c) has been based on the assumption that existing shareholders and debenture holders have or have available to them sufficient knowledge of the company's affairs to make a proper decision as to whether or not to accept the offer. One may question the continuing validity of this assumption as:

— the shareholder may have only just purchased his shares on the exchange; and
— it is unrealistic to think that the average shareholder, especially in relation to mining companies, really reads and understands the complex reports periodically forwarded to him.

In the result, it seems unnecessary and therefore inefficient to impose upon a listed company making a new public issue virtually all the prospectus requirements which are designed to regulate public issues by new companies. The only requirements that should be imposed are those which relate to the additional information required by an investor taking up shares in a new issue by a listed company as against the information already publicly available to an investor wishing to buy existing shares on the stock exchange, certified as suggested above in relation to new ventures.

One might go further and say that in neither case need the prospectus or abridged prospectus be given to the investor, provided the issue is dealt with (and recommended by) issuing houses appropriately licensed, with copies being made available if requested. The statutory sanctions would, if necessary, be altered to reflect this position. Given the esoteric nature of many natural resources issues the class of 'knowledgeable' investors is probably quite small. The penalties will be

40 S. 98(5).
41 LR 3M(4)-(12).

there, as will the statements, in the form of registered and abridged prospectuses. Doubtless there may be collateral representations, but this is the case under the existing regime.

FURTHER ANOMALIES IN ISSUE TO THE PUBLIC – OPTIONS AND OTHER INTERESTS

Any interest in Australia in the issue of prescribed interests in connection with natural resources ventures has been principally brought about by taxation considerations and in particular making available to investors directly the deductions and losses under the mining and petroleum divisions of the Income Tax Assessment Act (ITAA). For reasons set out at length elsewhere[42] partnerships, limited partnerships and unit trust structures *simpliciter* are not appropriate, leaving generally the approaches of direct farm-out (by way of an unincorporated joint venture or otherwise) and a variation of the unit trust structure involving some direct relationship between investor and exploration. In the main the direct approach has ignored the prospectus provisions, perhaps seeking to rely upon an *ACCU* special relationship like the common purpose of tax avoidance in *Hurst v. Filmco.*[43] An unincorporated joint venture of course, suffers from the problems of section 33(3) of the Code and in both cases the question of limitation of liability by statute does not apply.[44]

The problems associated with the foregoing have led to the application of the unit trust arrangements and direct relationship involving the prescribed interest provisions. The terms of the prescribed interest provisions seem to discourage such schemes rather than to regulate them by requiring that the prescribed interests be offered by a public company, that there be an approved trust deed and an approved trustee, and that there be a registered statement similar to a prospectus.[45] The drafting of the sections has been the subject of adverse judicial comment such as 'the fearsome combinations that can be put together from such a collocation of alternatives'[46] and 'barbarous'.[47] The expense of wending through the requirements of the Code and its schedules and regulations is extraordinary in an industry such as the exploration industry which must rely upon speed and ease of capital raising. Accordingly the temptation to utilize other means so as not to make an issue to the public is even more pronounced. The temptation is sharpened by the anomalies which arise in relation to the prescribed interest provisions. For example, section 5(4)(ae) excludes from 'offer to the public' an offer or invitation made by a corporation to holders of prescribed interests issued by that corporation under an approved deed where the offer or invitation related to prescribed interests pursuant to the same approved deed. If the management

42 Sharwood M. 'Drilling Funds' [1983] *AMPLA Yearbook* 136, 154–158.
43 *Op. cit.*
44 Sharwood *op. cit.*
45 Code: Part IV Div. 6.
46 *Comm'r for Corp. Affairs v. Australian Softwood Forest Pty. Limited* 3 A.C.L.R. 502, 506.
47 *W.A. Pines Pty. Limited v. Hamilton* (C.L.C. 34369, 34350).

company has changed or if the deed has been altered, the exemption would not apply. There seems to be no reason for this consequence.

The definition of 'prescribed interest' in section 5 perpetuates the anomaly that a person promoting a scheme by way of partnership has at least one 'free go' (without being within the definition) and may have more if his 'ordinary business' is not or does not include the promotion of similar schemes.

Section 170(2) provides that for all purposes a statement shall be deemed to be a prospectus issued by a company. This sits strangely with the other prospectus provisions. For example section 107 applies in the share context to written instruments which are prospectuses but have not been registered. The deeming of section 170(2) would seem only to operate in respect of the registered statement and accordingly would not seem to be effective of itself to attract section 107 to a statement which should have been registered but was not.

Section 170(3)(a) attempts to attract the general prospectus provisions of the Code by way of reference and *mutatis mutandis* application of certain of the general prospectus provisions. If the section is interpreted literally then it may be said then whenever a prescribed interest is in question (whether or not it is issued to the public) the assumption of section 170(3) will bring into play a sufficient public element to bring the prospectus provisions generally into effect. In addition, if an individual makes an oral offer of a prescribed interest to the public the application provisions do not seem to catch this. Again, if a statement is being prepared for registration and there is an 'inspired' article written in a newspaper, as there is yet no prescribed interest there may be some doubt whether section 100 applies.

It is also difficult to apply the distinction between subscription and purchase to prescribed interests. For instance an acquisition of an explorer's unit in an exploration trust seems to be an acquisition of rather than a subscription for, contractual rights. On the other hand the acquisition of a capital unit in the same trust may involve a subscription. If the other provisions of the Code are only brought in through section 170(3) then it would appear that in many instances with prescribed units the same problems as to limited application of those provisions relating to purchases as opposed to subscriptions would apply.

The difficulty in determining whether provisions apply in any one case is illustrated by an issue whereby, for example, there is a share issue but the issue of each share obligates the investor to lodge moneys which will be used by the company for the purpose of exploration. If the investor is entitled to production or entitled to interests in areas then there will presumably need to be a registered statement as well as a prospectus for the shares. If he is entitled only through his shares and the Articles of Association, then perhaps only a share prospectus will be required.

The difficulties of the provisions are further exemplified by the treatment of options over shares. By virtue of the definition provisions an option is a 'unit' of a share and accordingly falls within the definition of 'prospectus'. On the other hand an option is not excluded in the definition of 'prescribed interests', whereas a share is.

Is there then a double registration requirement in the case of many exploration natural resources companies where there is the issue of an option together with a share? Suppose however options are issued for no consideration, as is often the case with mineral exploration prospectuses. Leaving aside questions of the power of the company to do this (which it probably has) and whether the issue is or should be supported by a simultaneous issue by the company of its shares, are they 'subscribed'? They are not 'purchased' and there is some suggestion that a 'subscription' only takes place for consideration.[48] If so, an issue to the public may freely take place without a statement. On the other hand, the 'existing member' exemption in section 5(4)(c) does not apply to option holders, who would seem to have a better case to put forward than the holders of debentures. The whole thing is made harder by the fact that an offer or invitation in relation to an option over shares has been held prior to the 1981 Code to be an offer or invitation in relation to shares.[49]

My own thought of the present system is that the creation and public issue of prescribed interests should not be regulated by the Code. After the investor has subscribed his money there is virtually no statutory regulation. The principal continuing obligations are:

1. to maintain a register pursuant to section 172;
2. to lodge a return showing the unit holders and such other particulars as are prescribed pursuant to section 173;
3. to comply with the terms of the deed;
4. to register transfers and issue certificates pursuant to sections 182–188.

These rights are particularly meagre considering the many ways in which a shareholder is given statutory rights and privileges.[50] Prescribed interests are not interests in a company and their basic nature is quite different from shares in a company. They require special consideration and special regulation. They are normally equitable interests in a trust and, as such, are subject to an entire body of existing law outside company law. Authorities in Australia have seen fit to deal with mining companies by way of special provisions and Listing Requirements, and also by way of the creation of the no liability company. This is not the case with prescribed interests. There is no commonality of interest between a pizza franchise, the renting of time sharing units, and a holder of explorer or capital units or direct interests in a farmin.

In addition the requirement to have an 'approved deed' may well have been appropriate for traditional forms of syndicated investment, such as unit trusts and listed shares, but produces inefficiencies in the wider range of investments particularly in relation to natural resources. It is quite inappropriate where the assets of the trust consist of mineral interests which do not have a ready market and the nature of which investors will be aware at the time they invested. Even worse it may be contrary to the

48 *Government Stock and Other Securities Investment Co. Ltd. v. Christopher* [1956] 1 All E.R. 490, 492. *BHP v. Bell op. cit.*

49 *Mutual Home Loans Fund of Aust. v. A-G* (1973) 130 C.L.R. 193.

50 *E.g.* directors duties and interests, annual and extraordinary meetings, auditors duties, annual accounts, oppression of minority, schemes of arrangement, winding up *etc.*

interests of other unit holders if funds have to be generated to buy back units by selling off certain areas.

After all an investor in shares in a company has no guaranteed right to sell his shares back to the company.

SECOND BOARD VARIATIONS AND SECTION 104

The second board is now established in the major stock exchanges with the object of providing a market for companies which are not eligible for admission to the official lists of the Australian Associated Stock Exchanges because, in the main, of their lack of an established business record. The second board requirements are similar in each case, are complementary to statutory obligations, and impose requirements on companies which, if not complied with, render them liable for removal from the second board list. The 'industrial' restriction on the second board has previously prevented the listing of natural resource companies but with the introduction of eligibility of 'mining companies' on the Brisbane second board opportunities for listing, and consideration of issues for the public, have now arisen.

'Mining Company' is defined as being a company which is principally engaged in the extraction of any mineral oil or natural gas. Accordingly exploration companies *per se* would not be suitable. In addition listing requirement 1(5)(e) states that the vendors and/or the company must have commenced production.

The prospectus requirements of the second board are in the main similar to the first board, but the lowered capital structure requirement brings forth the argument that the prospectus requirements as to issue to the public are too cumbersome for the obviously restrictive nature of a second board mining company. A mining company must have at least $200,000 paid up capital and at least 50 holders of shares, with a 20 per cent holding in members of the public of at least $50,000.

The second board (like the first board) recognizes this in that it does contemplate compliance prospectuses under requirement 1(6) — in particular in requirement 1(6)(b) which requires a listing application including accounts and all information which would be required in a prospectus under the Code.

The same rules as to issue to the public would appear to apply to issues in relation to the second board but, given the perception that there needs be a lesser spread of shareholdings and the view that the compliance prospectus obviously gives rise to considerable savings of time and money, there has been developing a practice (at least amongst industrial second board companies) relating to the issue of existing securities either directly or through an agent or other intermediary. This practice (which to a lesser extent has always existed amongst backdoor listings) brings into consideration the provisions of sections 104 and 552 of the Code.

The no liability structure once again lends itself to the issue of securities where it is possible to issue a large number of securities at a very considerable discount either directly or to a promoter. He may then offer these securities as a gift or to exempt persons in order to obtain the spread required by the listing requirements. If this does not raise sufficient capital, he may then arrange for a rights issue to be made and underwritten. The underwriter will then take up and place any shortfall.

These issues proceed on the assumption that if they were not caught by sections 104 ('offers for sale') and 552 ('share hawking') then they are not caught by the prospectus provisions at all, arguing that those are the only sections relating to offers of existing securities rather than offers or invitations for subscription. For the purposes of this discussion no reference will be made to sections 125 and 126 of the SIA and section 52 of the Trade Practices Act (TPA) which may or may not be applicable depending on the practices adopted in the offers of the securities in question.

It was widely argued under the UCA as to whether the predecessors of the present sections[51] constituted a code as to existing securities. On the whole the arguments were inconclusive although the prevailing view appeared to be that they did.

The definition of 'prospectus', modelled on the 1974 model, has been substantially rewritten and still refers to 'purchase' as well as 'subscription'. Reading this definition in conjunction with section 103(1) on a literal view any offer to purchase still required a prospectus. It is submitted that the correct approach however is that by virtue of the later subsections of section 103 it is clear that the section deals with subscription. Alternatively an argument may be made for implying the words 'by or on behalf of the corporation' after the word 'person' in section 103(1). In addition section 103 imposes certain duties on the company (with criminal penalties) and on the directors of the company which would be unworkable and without purpose if this section applied to a sale of the shares by offer to the public by an existing shareholder who is otherwise unrelated to the corporation. An analysis of sections 96 and 98 and the regulations and schedule 4 thereto also point to the view that these provisions deal only with subscription.

At least it has become clear since *BHP v. Bell*[52] that both terms, where used in the prospectus, prescribed interest and share hawking provisions refer, unless there is a clear indication to the contrary, to both cash and security exchange notwithstanding some authorities to the contrary.[53]

Section 552 deals principally with the placement of securities by intermediaries. Unlike the United Kingdom Australia has retained the share hawking provisions as well as prohibiting unlicensed dealings in securities under the SIA section 43(1). It would seem that the authorities would in future proceed under the SIA.

The first prohibition is directed to share hawking or going from place to place offering for subscription or purchase, including barter.[54]

However it is the second share hawking prohibition which is more interesting. Section 552(3) prohibits an offer in writing to any member of

51 Ss. 43 & 374.
52 *Op. cit.*
53 *Christoper op. cit.*
54 S. 552(15)

the public of any shares for purchase, subject to certain exceptions. The provisions may be avoided by not submitting an offer in writing or perhaps merely submitting an invitation rather than an offer (but see *ex parte Lovell*).[55] The prohibition only applies to purchases and as it applies only to any member of the public (rather than to the public or a section of the public) the exceptions in section 5(4) may not apply (although the reasoning in *ACCU* may well).

There are provisions as to civil penalties pursuant to section 552(10). Accordingly perhaps there is no action for breach of statutory duty in relation to section 552.

If securities are offered for purchase under section 552(3), then only an abridged statement is required. If the shares are listed, nothing is required under section 552(4)(a).

Section 104 provides that where a corporation allots or agrees to allot securities with a view to all or any of them being offered for sale to the public any document by which the offer for sale to the public is made is for all purposes deemed to be a prospectus issued by the corporation and the person accepting the offer shall be regarded as a subscriber for the securities. The person actually making the offer is also liable under section 104(3).

The section has its genesis in the 1926 Green Committee report though the Committee seemed rather to have overlooked the situation that in many cases securities were placed to the dealers as agents of the issuing company, and accordingly clearly caught up by the normal prospectus provisions.[56]

There are problems of interpretation. Does the phrase 'with a view to' mean that it must be shown either that the allotting corporation actually intended the securities to be offered to the public or that the allotment would not have been made but for the knowledge that there would be a subsequent offer of the securities to the public?

Would it be enough to show the corporation should have realized that the securities would be offered to the public? Does it matter whether or not the securities were allotted by the corporation to A with a view to A selling them to B so that B could offer them to the public (which will usually be the case in relation to sub-underwriting)? There is a presumption in section 104(2) that it shall be evidence (unless the contrary be proved) that an allotment was made with a view to the securities being offered to the public if it is shown that the offer for sale to the public was made within six months after the allotment or that at the date of the offer the whole consideration to be received by the corporation in respect of the securities had not been so received. The provision is ambiguous because it is not clear whether unrebutted or unexplained evidence of the type suggested would automatically be enough to establish that the corporation had the necessary intention.

Presumably there is a rebuttable presumption that an allotment was made with a view to the securities being offered for sale to the public if either of the two 'evidentiary' factors are established. The problem with the

55 (1938) 38 S.R. (NSW) 153.
56 *E.g. Clark v. Urquart and Stacey* [1930] A.C. 28.

'view to distribution' test is that it depends primarily on the subjective state of mind of the private placee at the time of the allotment from the issuing company. Special regulation in the United States[57] places much more onerous restrictions and, given the general views expressed above in relation to a prospectus overview there may well be adopted provisions to this effect.

There seems to be a view (not shared by the writer) that the provisions of section 104(2)(a) are always satisfied if the shares are listed in six months period, that is to say that if there is a sale by any person (including the ultimate placees) of those shares within six months even on the market, then the provisions are satisfied. In addition, section 104(6) contains an express reference to invitations as well as offers.

It would not appear that section 104 compliance affects the operation of section 552, or vice versa, section 104 being directed only at remedying the mischief of indirect placements.

EXPERTS AND MISREPRESENTATIONS IN PROSPECTUSES

The law has gathered a rich array of sanctions in both legislation and common law against a wide variety of persons in relation to prospectus inadequacies. In addition the Stock Exchanges have imposed (with statutory effect through SIA section 42) a variety of information requirements on companies. One way or another directors, promoters, experts and other persons are variously caught up in the legislative (both civil and criminal) remedies of sections 107, 108 and 574 of the Code, sections 125, 126 and 130 of SIA, TPA section 52, Crimes Act section 176 (N.S.W.) (and its equivalent in other places), and misrepresentation legislation (S.A. and A.C.T.). Again there are the common law remedies of rescission or damages for fraudulent and innocent misrepresentation, deceit, and negligent misstatement.

This section of the paper will deal with two matters, namely to what extent are experts liable for untrue or misleading statements or omissions in a prospectus, and to what extent may directors or others rely upon experts and their statements, and in each case in relation to negligent misstatement, sections 125 and 126 SIA, section 107 of the Code, and breach of statutory duty. Contractual misrepresentation and section 52 of the Trade Practices Act are mentioned later in this paper.

By section 5 of the Code an expert means any person whose professional reputation gives authority to a statement made by him in relation to a matter. Presumably an expert will be deemed to have made a statement in relation to a matter if he gives the consent required by section 106.

A mining company seeking listing will require reports from a geologist or a mining engineer[58], an inspection by a qualified engineer, a title report from a solicitor and reports from an accountant, and may include a report on expenditure of moneys, on the purchase price of interests from vendors, and an analysis of that purchase price. In relation

57 U.S. Securities and Exchange Commission Rule 144.
58 LR 2B (6) & (7); engineer 2 B (8); solicitor 2 B (1)(d); accountant S. 98(1)(e).

to vendors consideration the Stock Exchange may also require a valuation of areas. Some solicitors have also boldly undertaken the mining tenement details required by LR. 2B(10)(a)–(d) and the Corporate Affairs Commission.[59]

An expert will be liable for negligent misstatement in respect of his report in the prospectus as he has special knowledge, has undertaken to impart it and (presumably reasonably) is aware that investors will act thereon. The fact of lending his name to the prospectus is probably not sufficient *e.g.* if he does not do a report but is named as 'solicitor' or any of the other divers persons whose consent to be named is required under the Code. At some stage an enterprising and damaged investor may well decide to put the matter to the test, especially in the case of solicitors or consulting geologists who, even though not giving a report, might possibly (depending upon the circumstances) be not unreasonably assumed to have read the prospectus or relevant parts thereof, particularly if the expert is also a director. Directors of course are also liable in the same way.

A disclaimer is effective in relation to such a misstatement made negligently (but not made dishonestly).[60] Section 98(6) invalidates any provision aimed at waiving compliance with section 98 while a general disclaimer in damages for negligent misstatement in the prospectus may be effective for negligence but would not prevent an action for compensation based on section 107 of the Code.

Comfort letters given by an expert to the board will not directly involve the expert in a negligent statement but of course would indirectly do so in proceedings by directors.

An expert or a director cannot escape an action for negligence on the ground that the plaintiff could himself have found out or confirmed information provided, but as much of advice given by geologists in a natural resources prospectus is unavoidably speculative, it will be harder for a plaintiff to establish a breach of duty in respect of such speculative advice.[61]

Section 125 of the SIA is wider than the Code in its terms, catching both negligent and dishonest behaviour in respect of both written and oral statements, but only applies to purchases rather then subscriptions for securities.

Section 126 of the SIA also applies to, *inter alia*, experts but only if the expert knows or is reckless in relation to misleading false or deceptive statements, whether they are in the prospectus or not. The expert must 'induce or attempt to induce' another person to deal in securities, which sits strangely with the phrase 'reckless making or publishing' in section 126(1)(c). It would seem that omissions are not caught unless they make the statement misleading. As to the question of inducement it may be enough not to show intent but to show that the statement was made in

59 *E.g.* Release C1 — 'Prospectuses — Material Misleading in Form or Context'. 18.

60 *Hedley Byrne & Co. Ltd. v. Heller & Partners Ltd.* [1964] A.C. 465, 540 *Shaddock's case* (1981) 55 A.L.J.R. 716. There have been some suggestions that a professional may not be able to disclaim for advice given for reward. (Richmond J. in *Scott Group Ltd. v. McFarlane* [1978] 1 N.Z.L.R. 569–70 — but *cf.* Cooke J. 581). This seems against the weight of authority.

61 *Stafford v. Conti Commodity Service Limited* [1981] 1 All E.R. 691.

circumstances suggesting an interest on the part of the maker in influencing investment decisions by ascertained or unascertained persons.[62] Perhaps it means 'cause' although this has been denied in other contexts.[63]

In normal circumstances a statement would not be deliberately misleading but would be negligent. This is similarly caught by section 126(1)(c) by virtue of the words 'dishonestly or otherwise', but would appear to apply only to negligence of a gross nature.[64] Accordingly it would not be a breach by a solicitor if, having title searches from a reputable firm of mining title searchers, he draws conclusions that may reasonably be drawn without verification of the data.

Under section 107 an expert is liable for any untrue statement in the prospectus purporting to be made by him as an expert or a non-disclosure in the prospectus of any material matter for which he is responsible in his capacity or purported capacity as an expert. Presumably the latter would catch up previous exploration upon areas where the reporting geologist was responsible for such research and matters he not only knew but should have known. Under LR.2B(11) a geologist might well be responsible for such report in the prospectus of a mining company seeking listing.

A statement is deemed to be untrue if it is misleading in the form and context in which it is included. The statement will be deemed to be included in a prospectus if it is contained in any report or memorandum that appears on the face of or is issued with the prospectus or is incorporated by reference in the prospectus whether the reference occurs in the prospectus or in any other document.

Presumably, then, brokers' and underwriters' letters should not be circulated with the prospectus but some time after — assuming of course that they are 'experts' for the purposes of the Code.

A statement incorporated by reference still needs a consent under section 106 if a report purports to be based upon a statement made by that expert. If such a statement is referred to in the context of a larger report it may well be that the contents of the larger report are incorporated by reference in the prospectus, and the geologist in that case would have to give thought as to whether there was any non-disclosure of any material matter in that report.

The defences available under section 107(5) are not available to an expert but there are statutory defences under section 107(7) including that the expert was competent to make the statement and had reasonable grounds to believe, and did believe until the time of the allotment, issue or sale of the shares or debentures that the statement was true. As 'true' is not deemed to be not misleading, presumably the defence is still available even if the expert knew the statement was misleading. The defence does not seem to be available in respect of omissions, but may be in respect of half-truths.

The elements of section 107(1) are that there was a subscription or purchase on the faith of the prospectus, and that the investors sustained loss or damage by reason of any untrue statement in the prospectus or by

62 *R. v. De Berenger* (1814) 105 E.R. 536.
63 *Ryan v. Triguboff* [1976] 1 N.S.W.L.R. 588.
64 *R. v. Grunwald* [1963] 1 Q.B. 935.

reason of the non-disclosure of any matter of which the person responsible had knowledge and which he knew to be material.

The requirement for actual knowledge perhaps may tempt the person responsible not to enquire too widely or read the other parts of the prospectus although in that case he would not avoid section 107.

It does not seem to be possible to read the expert's statement (or any statement) in isolation — 'if by a number of statements you intentionally give a false impression and induce a person to act on it, is not the less false although if one takes each statement by itself there may be difficulty proving that any specific statement is untrue'[65].

What if a geologist's report set out the amount of recoverable gold but the mining engineer's report stated that the gold was recoverable only at an uneconomic price? What if there is a statement of opinion *e.g.* 'drilling results have been encouraging'? Does this differ from the statement 'there are valuable gold reserves' or the old standard formula 'results to date warrant further exploration'? The better view would seem to be that these are statements and fall to be measured by section 94(1).

The investment must be made on the face of the prospectus. This raises the whole question of reliance which is particularly appropriate in the case of a mining company. For instance a prospectus may state that there is a net profit interest in respect of an area whereas in fact there is an overriding royalty. If the statement is not read it seems that section 107 is not applicable, being the common law situation.[66] There have been suggestions that the line of cases in the United Kingdom that give rise to this general conclusion are not appropriate because of the different background of the United Kingdom legislation. Section 107 refers to 'the prospectus' and not the particular statement and subscription on the faith of that prospectus. Be that as it may, there still has to be a nexus between the untrue statement and the damage.

What if the prospectus was written in Swahili, (ignoring for the moment the provisions of section 98) *i.e.* the investor *could* not rely upon it. Is this very different from the situation in relation to a geological report which does not contain a summary for the layman? Perhaps experts should make their reports as complicated as possible for the purposes of section 107 although this may still be caught up by SIA. It may be better not to draw conclusions in the report but let the directors do this provided that they do not say they have relied upon the expert.

The provisions of section 107 at least overcome some of the shortcomings of the action for deceit.[67]

An expert may have a wider liability if he is a promoter (or even a 'director' under the expanded definition in section 5 of the Code). Promoter is defined in section 5 as meaning 'a promoter . . . who was a party to the preparation of the prospectus or of any relevant portion of the

65 *Aaron's Reefs Limited v. Twiss* [1896] A.C. 273, 281.

66 See *e.g. Edgington v. Fitzmaurice* (1885) 29 Ch.D 459; *Re Northumberland & Durham District Banking Company* (1858) 28 L.J. Ch. 50; *Smith v. Chadwick* (1884) App. Cas. 187.

67 Ford H.A.J. *Principles of Company Law* (4th ed.) 1136.

prospectus, but does not include a person by reason only of his acting in the proper performance of the functions attaching to his professional capacity or to his business relationship with a promoter of the corporation'. The common law definition remains — 'the term also covers persons who are less active but agree to form a company on the understanding that they will also profit from the operation'.[68] Assuming that an underwriter is a promoter, he can be liable under section 107 unless he can rely successfully on the defences in section 107(5). With respect to criminal liability under section 108 (as well as possible civil liability under sections 108 and 574), the question is whether he 'authorised or caused the issue of the prospectus'. A typical underwriter of a natural resources float may fall within these words (*cf.* section 98 — 'any . . . persons responsible for the prospectus'). A solicitor who reports or advises upon a title report is within his professional capacity. A review of the director's statement from the point of view of directors' liability therefor would be in the same category. What of the solicitor who drafted the director's statement *ab initio* or advises on the number of shares to be issued? What of the expert who has two qualifications *e.g.* the solicitor commenting on geological reports?

The defence for non-experts — *e.g.* directors or officers or underwriters — exists in the United Kingdom and the U.S.A., under section 11 Securities Act 1933, as well as in Australia. The mere fact that a director is misled — in the same way as investors — by other directors or officers of the company is not enough. It is well established that a director cannot rely on the uncorroborated statements of a vendor to a promoter of the company or a fellow director.[69] This might be thought to impose an unrealistic obligation on an 'outside' director who will in practice rely upon the executive directors and other officers of the company. Is he obliged to make detailed enquiries himself into the geological records and proceedings of the company and its titles? Obtaining a report/opinion from competent people regarding material facts might save the directors, in that 'a reasonable man might reasonably believe that the truth of the statement is verified by competent and independent agents instructed . . . by or on behalf of the board of directors of whom he was one'.[70]

Traditionally, it has been thought that, in the absence of special circumstances which might place him on inquiry (such as a basic error in report on titles which would be apparent to a director who is not a mining consultant or a solicitor) a director is entitled to rely on the company's professional advisers. This is the case in the United Kingdom and has been followed in the American and New Zealand jurisdictions.[71] A director cannot protest that he was not a man of business and was misled by others whom he reasonably expected to be reliable[72] and there is authority that where material contracts are not disclosed in the prospectus, a mistaken belief that the contracts are not material and therefore need not be

68 *Tracey v. Mandalay* (1953) 88 C.L.R. 215.
69 *Adams v. Thrift* [1915] 2 Ch. 24; *Bundle v. Davies* [1932] N.Z.L.R. 1097, 1099.
70 *Adams v. Thrift op. cit.*
71 *Ibid; Bundle v. Davies op. cit.; Lanza v. Drexell* 479 F. 2d 1277 (1973).
72 *Fouche v. Superannuation Fund Board* (1952) 88 C.L.R. 609, 641.

disclosed even though based on professional advice will not be a defence.[73]

However, in the United States the SEC will not permit the central data in the registration statement — the description of the business, the promotional history and underwriting agreements — to be 'expertised'.[74] The SEC has indicated that even where an expert may be properly employed, management may not rely on the expert's work as an excuse for not discharging its fundamental and primary responsibility for accuracy.[75] This has been supported in the United Kingdom.[76] Accordingly it may throw doubt upon a common law defence that statements in a prospectus were phrased or omitted under legal advice.

It is a defence to civil liability under section 107(5)(d)(i) 'as regards every untrue statement not purporting to be made on the authority of an expert . . . [that] he had reasonable grounds to believe, and did until the time of the allotment believe that the statement was true.' There seems to be no defence however where there is an omission. The same defence exists in relation to criminal liability under section 108 (which does extend to non-disclosures) but the defence is not as wide as that in section 98(8).

The defence under section 107(5)(d)(11) relating to experts appears to extend to statements of opinion by experts but does not extend to a statement made by directors in the directors' statement even though it was based on a statement by an expert unless the statement 'purports' to be made by an expert or to be based on a statement made by the expert.

The expert's defence is not available under sections 125 and 126 of the SIA but presumably the existence of a report will go to the question of negligence in these respects.

Provided that action for breach of statutory duty arises under the Code, then a director may be vulnerable to an action under sections 108 and 574. He would then have to prove that 'he had reasonable grounds to believe that the statement was true', to bring him back to the position at common law.

It had previously been held that there could be no action for breach of statutory duty in respect of specific provisions of the UCA.[77] However, the argument that a provision such as section 107 is a code is overcome by reason of section 574 of the Code. Subject only to the fact that relief under this section is discretionary it amounts in effect to the creation of an action for breach of statutory duty in respect of every criminal offence created by the legislation. It is possible that as the courts have a discretion under section 574 as to whether they grant a remedy by way of damages or not, they will adopt the practice of not granting damages for a breach where the legislation specifically provides for corresponding civil liability, *e.g.* section 107. However, in general section 574 will take away the comfort of those promoters who may have obtained previously an informal

73 *Twycross v. Grant* (1877) 2 C.P.D. 469; *Watts v. Bucknall* [1903] 1 Ch. 766; *Shepheard v. Broome* [1904] A.C. 342.
74 *Excott v. Barchris* 283 F. Suppl. 643, 683.
75 See Loss *Fundamentals of Securities Regulations* (Little Brown) 1983.
76 *Adams v. Thrift; Shepheard v. Broome op. cit.*
77 *Lloyds v. NSW Mutual Real Estate Fund* (1977) 2 A.C.L.R. 569.

indication from the Commission that it would regard an action as not warranting prosecution.

An example of a misleading (even untrue) statement invariably in prospectuses is 'this page has been intentionally left blank.'

VARIATIONS DURING THE COURSE OF A PROSPECTUS

Section 112 of the Code states:

> A company shall not, before the statutory meeting, vary the terms of the contract referred to in the prospectus unless the variation is made subject to the approval of the statutory meeting.

The statutory meeting is required by section 239 to be held not less than one month and not more than three months after the date on which the company allots shares pursuant to the prospectus, and section 239(3)(e) contemplates modification of contracts for approval by the meeting.

Perhaps one may suggest that if there be an allotment of some shares as soon as the minimum subscription is reached then, by implication from section 112, the company is free to vary contracts as it wishes, even though the prospectus is still current.

This interpretation is too wide but the point is put forward as an introduction to the problem of variations to information in a prospectus during the course of that prospectus. These may of course be variations of contracts but the variations will very often be wider and will constitute either additional information or variation of existing information in the prospectus, and natural resources prospectuses are particularly prone to alterations. In the case of a trading company it is contemplated that there will be continuing trading and sales and variations as a result. The Code expressly contemplates accounts which may be up to six months old at the date of the prospectus although it is submitted that material variations should still be brought to the attention of investors in these companies.

Resources prospectuses do not in general have the comfort of these provisions of the Code. There may be substantial variations of information, *e.g.* in titles (either by way of change, loss of or further titles), in the interests of third parties (by way of change, loss of or further parties), further exploration and development (in both cases either adding to or varying the information in the prospectus), and execution or variation of material contracts, *e.g.* by working out the terms thereof or by agreement.

The question of disclosure of new or changed material depends on the nature thereof.

For instance the acquisition of new areas outside Schedule 4(8) to the Regulations would usually not require disclosure (provided the prospectus made it clear that the activities were not restricted to the areas disclosed in the company's prospectus) unless *e.g.* the acquisition used moneys otherwise set aside for exploration or development in a prospectus budget. The sale of a major area may or may not require disclosure depending on how important it is in the prospectus. If the new information does not contradict existing information but is only additional, *e.g.* a further discovery on existing tenements, there would not seem to be a requirement for further disclosure, and the same applies to new information which bears on existing information but does not adversely change it, *e.g.* upgrading of reserves. If there is a working out of an executory material contract *e.g.* a farm-out in accordance with its terms, then once again the matter is relevant but does not seem to require disclosure except perhaps for the purposes of section 126 of SIA.

It is where the information is adverse (and material) that problems arise, for example, the discovery of a defective title, down-grading of reserves, or the withdrawal of an important joint venturer.

The main question is the time from which a prospectus speaks. The prospectus is dated[78], there is a director's report fourteen days before, and it is current only for six months. The Code does not address the 'updating' problem except in a negative sense of preventing updating other than in accordance with sections 99 and 100. The prospectus cases address misleading statements in the prospectuses themselves rather than arising out of subsequent events, but compare *Allan & Ors. v. Gotch.*[78a]

There are some small clues in the legislation as to extension of time, *e.g.* in sections 107(5)(c) and (d) which relate to untrue statements at the time of issue or allotment and belief as to experts' statements at the time of the issue of the prospectus respectively. Section 107(7)(c) also refers to the date of allotment issue and sale of the shares. On the other hand, perhaps these constitute a code as to time (at least in relation to the Code).

Unless the misstatement is a condition of the contract to allot (*cf.* of a collateral contract) to be entitled to rescission there must be a material misrepresentation of an existing fact. Mere statements of intention or of opinion are not enough (and these will be common in the case of natural resources prospectuses, especially for exploration), unless they are really representations of fact[79], or if the intention was not held[80] or unrealistic.[81] Mere non-disclosure is not sufficient and additionally the investor must rely on the misrepresentation referred to above.

A damaged investor may be more tempted to take proceedings in contract, to obtain the difference between what the shares are actually worth and what they would have been worth had the contract been performed.

The application form in a prospectus will refer to the application being made on the terms and conditions of the prospectus, and accordingly it is a question of construction for the court as to whether a statement in the prospectus amounts to a term and accordingly will be brought in as a warranty (the usual situation) or a condition.

However, it is difficult to imply a term that there will not be a material variation to the prospectus during its term, particularly if a discerning promoter expressly states that the prospectus speaks from its date. The disappearance of the subject matter of the prospectus will of course give a total failure of consideration but in the absence of this, or

78 Ss. 98(1)(b) & (1)(g).
78a (1883) 9 VLR 371.
79 *Brown v. Raphael* [1958] Ch. 636.
80 *Edgington v. Fitzmaurice op. cit.*
81 *Re New Brighton Recreation Ground Co.* (1889) 10 L.R. (NSW) Eq. 66.

some doctrine of promoters or directors' fidicuiary duty the investor may have difficulty.

In practice the investor will overcome these problems by turning to the legislation, namely sections 125 and 126 of the SIA, sections 107 and 108 of the Code, and section 52 of the TPA together with (in S.A. and A.C.T.) the misrepresentation legislation.

Section 107(5)(d)(i) relates liability for untrue statements to the time of allotment or sale. Section 107(5)(d)(ii) relates liability of a director for untrue statements purporting to be by or based on an expert *etc.* to the date of the prospectus. If section 574 does not operate with section 108 to form a separate head of breach of statutory duty then it seems a material adverse change to *e.g.* drilling results in a consulting geologist's report, while clearly known to the directors, will not give rise to director's liability although the expert may be liable under section 107(7)(c). Even under sections 107(5)(d)(i) and (7)(c), *when* must the 'statement [be] true'? Is it sufficient for it to have been true at the time of making it? This would not seem to be borne out by legislative purpose.

In general a material adverse change to the information in a prospectus would be caught by SIA sections 125 and 126[82] and would leave the promoter in the position of having to vary his prospectus.

Three further points arise. In the first case, section 111 of the Code requires subscription moneys to be placed in a trust account pending allotment, and the section prevents allotment until the minimum subscription has been reached. It may be that the directors in this case are then placed in a fiduciary position towards those applicants along the lines contemplated by the High Court in *Brian v. UDC*[83] have a duty of disclosure to the applicants, and the applicants may therefore be in a position to withdraw their applications. Even if this applies to subscribers it would seem not to apply to potential applicants, the duty of disclosure contemplated by the decision in *Deveraux*[84] not applying outside existing shareholders. Still, perhaps these are straws in the wind.

Second, there is the application of section 52(1) of the Trade Practices Act. The *Guava* case[85] has made it clear that section 52(1) applies to securities. In the context of securities the conduct most likely to infringe section 52(1) is the making of a misleading or deceptive statement. The concealment of a material fact which made a statement of half-truth would probably make the statement misleading or deceptive. This view is reinforced by the terms of section 4(2) under which the expression 'to engage in conduct' is defined as including to refuse to do any act or refrain from doing any act. Whether failure to reveal any material fact (where there would otherwise not be a half-truth) would be a breach is not clear. Although refraining from acting can amount to engaging in conduct it may be doubted whether a provision in terms so general as those of section 52(1) is intended to impose a general duty of disclosure. It is to be noted, however, that section 52(1) is concerned with conduct and not merely

82 See especially s. 126(b)(i) in relation to 'dishonest concealment of material facts'.
83 *Brian Pty. Ltd. v. United Dominions Corporations Limited* (1985) 59 A.L.J.R. 676.
84 *Deveraux Holdings Pty. Ltd. v. Pelsart Holdings Pty. Ltd.* (1986) 4 A.C.L.C. 12.
85 *Milner v. Delita Pty. Ltd.* (1985) 61 A.L.R. 557.

statements. The investor may recover the amounts of the loss or damage[86] and an injunction or orders in relation to the contract or setting of it aside or varying it.

In relation to section 52 it is pointed out that the provisions of sections 75B and 76(1) of the TPA dealing with 'aiding and abetting' may well catch up the professional adviser, depending on how far that adviser has gone in relation to the prospectus. Presumably he would not necessarily be caught up with the question of subsequent variations.

In relation to section 52(1) generally, if the *Guava* case sheeted home liability to the company in relation to the dissemination of information in the brochures in question by husbands to their wives, and reliance by the latter on such dissemination, *a fortiori* the section should catch up subsequent material adverse variations to the information in the prospectus.

The third point is the distinction which may arise between applicants at different times. If the minimum subscription has been reached then those applicants who become shareholders before the variation will remain with their shares and, it would seem, have no remedy. The position of shareholders in limbo is discussed above.

If there does require to be a variation to the prospectus, the procedure is now clearer. Under section 5(3) of the UCA, it was not possible to circulate a variation without such variation itself becoming a prospectus and accordingly requiring to be registered in the form required by the UCA. The absence of this section now means that the promoter may take the course of issuing, with the approval of the Commission, a notice of variation under section 100.

However this may not be appropriate where there is, for instance, a required variation of a material contract. This will in practice most often arise where there is a triggering of one of the provisions of an underwriting agreement, most commonly being that notorious escape clause the 'Gold Index' provision. In this case a notice as such will not suffice because of the conditions of section 112 and there will need to be an application to the Commission pursuant to the provisions of section 215C of the Code.

Finally it may be noted that a prospectus may, in certain circumstances, live on after it has reached its six months expiry, if it was also to stimulate market dealings, and give a purchaser of shares thereon some grounds[87], although this is not usually the case.

NO LIABILITY COMPANIES

The no liability company is the archetypal vehicle for natural resources issues — it may only be incorporated for 'mining purposes'.

The Victorian Mining Companies Act 1871 produced the no liability company to correct the dishonest practice of investors in taking up shares in dummy names, so as to avoid liabilities for calls. The legislation set about abolishing this practice by abolishing the obligation to pay the

86 Damage s. 82; injunction s. 80 and orders re the contract under s. 87.
87 *Andrews v. Mockford* [1896] 1 Q.B. 372.

calls either while the company was a going concern or on its winding up by virtue of Code sections 476, 479 and 37(1)(g).

The principal characteristics of the no liability company which make it immediately useful in natural resources prospectuses, are that the company is exempted from the requirement that at least 5 per cent of the nominal amount of the share be payable on application for shares offered to the public[88], that shares may be issued at a discount without resort to the court[89], and that there is no liability upon members to pay calls, the shares being forfeited without personal liability on the shareholder.

In relation to discount it has been quite common for promoters to be issued a large number of shares at a very considerable discount in order to maintain control. This issue will be canvassed below in relation to a vendor's shares, but the matter of discount also becomes appropriate in relation to the question of whether a prospectus is needed at all. That is to say, the issue of shares at a discount will facilitate procedures whereby an issue is not to the public.

It is less expensive for promoters to take up the shares needed by them to distribute to the public so as to enable a spread of shareholders. Distribution would of course be made by way of gift otherwise the 'purchase or subscription' provisions of sections 96, 103 and 104 may apply. If one is able to issue shares at such a discount, then there is no logical difference between this and issuing shares for nothing. Quaere, however, if 'subscription' applies otherwise than for cash.[90]

There is nothing to prevent a condition of the prospectus being that the applicant promises to pay the full par value of shares to be allotted. This is so even though section 476 provides that the acceptance of a share in a no liability company shall not constitute a contract to pay calls or to contribute to the company's debts.[91]

In the absence of such a contract then failure to pay calls made by a no liability company will lead to forfeiture without the need for a new resolution of directors under section 479. Sections 479–483 govern forfeiture of the shares which are to be offered for sale by public auction within six weeks after the date on which the call was payable. They may be redeemed at the latest on the day previous to the day appointed for the sale. If they are sold, the proceeds are used to pay the auction expenses, the expenses incurred in respect of the forfeiture, and calls due and unpaid. The shares which are not sold are held by the directors in trust for the company and are at the disposal of the company. The company can dispose of them by re-issue or sale but they must first be offered to shareholders and although on forfeiture the holder loses his proprietary rights, the share is treated as still existing.[92]

An enterprising promoter may issue a very large number of shares, partly paid, to himself, and not pay a call thereon for the appropriate amount. The shares will then go to auction in accordance with the Code

88 S. 110(4) but see LR 1(1) as to a minimum 20c share.
89 S. 118(1).
90 *Christopher op. cit.* but *cf. Bell v. BHP op. cit.*
91 *Theseus Exploration NL v. Foyster* (1972) A.L.J.R. 448.
92 *McLachlan v. Cooper's Creek Mining and Exploration NL* [1973] VR 517.

and this will be a public auction, in respect of which advertisements may be issued pursuant to section 479(1). Presumably these notices may be issued to the public and there appears to be no restriction upon who may attend and bid at the auction. If sufficient publicity is given to the auction presumably the shares will be sold at an appropriate reserve price and it is not beyond the realms of possibility for there to be an underwriting of the sale of the forfeited shares. This may lead to a sufficient spread and sufficient raising of moneys to satisfy the listing requirements and accordingly obtain a listing without the need for a prospectus. Will the provisions of section 100 (as to advertising) apply? Presumably there is no prospectus in existence, unless the definition of prospectus in section 5 catches up the sale notices or other documents associated therewith. Section 99 appears to apply in its terms but should be displaced by the provisions of Part XIII Division 1 operating as a code in relation to no liability companies.

A curious question arises as to the status of the forfeited shares. It would appear that the shares are still in existence in some sort of capital purgatory. Accordingly, if the agrument that only sections 104 and 552 apply to the placements of existing shares then it seems the shares may be issued directly by the company to the public (or perhaps by its agents the directors as trustees) without contravening sections 104 (as the shares are already 'placed') or 552 (either by virtue of section 552(4), if the company is listed, or by virtue of having the abridged statement required by section 552(3), or by arguing Part XIII Division 1 is a code excluding the section).

VENDOR CONSIDERATION AND ASPECTS OF LISTING REQUIREMENT 3M(1)

3M(1) precludes certain securities of a 'mining company' or interests or rights in respect of them, from being sold, assigned or transferred until at least 12 months after listing or allotment. The scrip for the securities is endorsed as vendors securities and held by an appropriate bank or trustee company. Options are also included.

3M(1) appears to cover shares, options and units, but curiously enough does not apply to convertible loans (see definition of 'loan securities' item (d)). It is also sufficient to attract the provisions of the requirement if the company holds only one tenement.

While there is a prohibition on dealing in the securities there may be an argument from the use of the words 'or any interest or right in respect of them' that there may be a transfer of, for example voting or dividend rights *in* the shares. In addition, the prohibition is on them being 'sold, assigned or transferred'. Presumably this catches a mortgage but would not appear to cover a charge. In addition it would not appear to catch the grant of an option in respect of the securities in question.

Given the sanctions of suspension of or removal from listing, and the view of the Exchanges that requirements must be read in accordance with their spirit perhaps a literal interpretation as above will not serve. For instance the Exchanges will not countenance the avoidance of 3M(1) by the transfer of shares in a vendor company holding the vendor shares.

Perhaps one may hope, however, in view of the fact that the provisions of the listing requirements have now entered the legislation effectively through the SIA section 42 (*cf.* the ineffective provisions of the former section 31) there may be a tendency to a more literal interpretation of the provisions of the requirements.

3M(1)(a)(ii) stipulates an agreement between the vendor and the company providing for breach of the escrow provisions being enforceable by the company. Similar problems were encountered with UCA section 124 and amendments were required thereto.

SIA section 42 provides that:

> where any person who is under an obligation to comply with, observe, enforce or give effect to the . . . listing rules of a Securities Exchange fails to comply with, observe, enforce or give effect to any of those . . . listing rules the court may, on the application of the NCSC, the Securities Exchange or the person aggrieved by the failure . . . make an order giving directions to the last mentioned person concerning the compliance with, observance or enforcement of or the giving effect to, those . . . listing rules.

To have standing to seek an order under section 42, a person must be a 'person aggrieved by the failure'. Whether in seeking an order against a listed company for breach of a vendor's agreement it is enough to be a shareholder remains to be seen. The section also envisages a direction to do some act or to refrain from acting, failure to comply with which would give rise to a penalty under section 141. The extent of section 42 has been affected by the majority of Appeal Court (NSW) in *Pioneer Concrete Services v. FAI Insurances Ltd.* (July 1986).

The reasons set out earlier in this paper in relation to breach of statutory duty and section 574 of the Code also apply to breach of statutory duty in relation to the SIA by virtue of section 149. Perhaps the practical effect of this is that the creation of a general civil remedy once in respect of breaches of the SIA means that a company is now at risk in respect of any breach even though the Exchange does not intend to take action.

Apart from section 42 it is difficult to find any other provision which obliges the Exchange to enforce the listing requirements. Moreover, although a company is contractually bound to comply with listing requirements as a result of the granting of the application for listing, it does not seem so to be bound when removed[93] (although suspension does not seem to be sufficient) and an unlisted company is amenable neither to the listing requirements nor to orders under section 42.[94]

'Vendor' is widely defined by the listing requirements and includes promoters. It is not uncommon for promoters to attempt to obtain as much control as possible of their companies and this is expressly contemplated by the second board requirements. It is also commonly achieved in the case of resources companies which are no liability companies by issuing shares to promoters for cash at a very considerable discount. These shares (and indeed often other shares offered at a discount to those ultimately issued to the public) are held by the Exchanges to be subject to the vendor requirements under 3M(1), even though the

93 *Kwikasair Industries Ltd. v. The Sydney Stock Exchange Limited* (1968) A.S.L.R. 30, 701.

94 *Repco Ltd. v. Bartdon Pty. Ltd.* [1981] VR 1.

consideration for the issue of those securities is cash and accordingly does not appear to fall under 3M(1) or 3M(3). Suppose there is an issue to vendors who are also promoters of shares at a discount with a cash payment equivalent to the cost to the vendors of the areas. Leaving aside the difficulties of assessment under the ITAA section 177C, the securities still do not appear to fall within 3M although they are treated by the Stock Exchange as vendor securities and have even attracted the requirements of the Exchange for a valuation to be published.[95]

It would appear that while listed a company is contractually bound to observe the listing requirements.[96] By SIA section 42 it is also under an obligation to comply therewith, as is any person associated with it[97] *e.g.* the directors of the Company or of its related companies.

95 LR 2B (11)(e).
96 *Kwikasair, ibid.; Ampol Petroleum Ltd. v. R.W. Miller (Holdings) Ltd.* [1972] 2 N.S.W.L.R. 850, 881.
97 S. 6.