The concept of "public offering" under the Securities Act 1978

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The Securities Act 1978 deals with the law relating to the offering of securities to the public. This article explores the question of when an offering will be regarded as being made to the public. An examination is made of New Zealand law and this is compared with the law in the United States and Ontario. The writer argues that the question should be determined not on factors such as the number or class of offerees but on whether the offerees need the protections provided in the Act.

I. INTRODUCTION

The Securities Act 1978 was passed in the dying stages of the 1978 Parliamentary session. Aside from providing for the establishment of the Securities Commission, the other principal aim of the Act is, according to the statute's title, "to consolidate and amend the law relating to the offering of securities to the public, and to extend the application thereof".[1]

The principal purpose of this article is to examine and discuss the circumstances in which an offer of securities by a company[2] will be considered as being made to "the public" for the purpose of the Securities Act, when the relevant sections of the Act come into force.[3] The question of whether a particular offering of securities is to the public is clearly of the utmost importance since the Act applies only to securities which are publicly offered.

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1 For a general discussion of the provisions of the Securities Act 1978, see Darvell "The Securities Act 1978: A New Direction to Investor Protection" [1979] N.Z.L.J. 53.

2 It is to be noted that the Act also regulates the offering of securities (as defined) to the public by entities other than companies such as syndicates, and by individuals. In this article, however, attention will be focussed primarily on the offering of securities to the public by companies although the comments herein are of general application to any offering of securities which is subject to the Act.

3 The provisions of the Act relating to the establishment of the Securities Commission came into force on 1 May 1979: The Securities Act Commencement Order 1979 (S.R. 1979/94). The remaining provisions of the Act are expected to come into force next year.

This article is divided into three principal parts: Part II discusses when an offer of securities will be regarded as being made to the public under the provisions of the Companies Act 1955; Part III examines the concept of public offering under the Securities Act 1978, and discusses several significant differences between the definition of "offer to the public" under that Act and under the counterpart provisions of the Companies Act 1955; Part IV suggests some possible guidelines which might be adopted to provide a more objective standard for determining whether an offer of securities in a particular case is made to the public for the purpose of the Securities Act.

II. THE DEFINITION OF "OFFER TO THE PUBLIC" UNDER THE COMPANIES ACT 1955

The prospectus provisions of the Companies Act 1955 apply only where the invitation or offer to subscribe for or purchase securities of a company is made to the public.[4]

Section 63 of the Act is designed to assist in determining whether an offering is to "the public" for the purposes of the Act.

The section provides in subsection (1) that any reference in the Act to offering shares or debentures to the public shall be construed as including a reference to offers "to any section of the public, whether selected as members or debenture holders of the company concerned or as clients of the person issuing the prospectus or in any other manner . . ."

This provision makes it clear that a circular addressed by the company to its security holders in the case of a rights (whether renounceable or non-renounceable) bonus or conversion issue is, in principle, a "prospectus", as too may be an offer by a sharebroker to place shares and debentures with clients. Indeed, as Professor Gower points out, the definition of "the public" in section 63(1) is so wide that, unless some limitation were imposed, it would be impossible for any company ever to issue any securities without making a public issue.[5]

Subsection (2) of section 63,[6] however, restricts the scope of section 63(1) by providing as follows:

> This section shall not be taken as requiring any offer or invitation to be treated as made to the public if it can properly be regarded, in all the circumstances, as not being calculated to result, directly or indirectly, in the shares or debentures becoming available for subscription or purchase by persons other than those receiving the offer or invitation, or otherwise as being a domestic concern of the persons making and receiving it.

4 See the definition of "prospectus" in s.2 of the Act.

5 Gower *The Principles of Modern Company Law* (4 ed., Stevens, London, 1979) 350-1.

6 The effect of s.63(2) deserves comment. The subsection merely provides that the section is not to be taken as "requiring" any offer or invitation to be treated as made to the public if it appears to fall within any of the circumstances outlined in s.63(2). It is therefore submitted that the effect of s.63(2) is simply to leave to the court the question of whether an offer in any particular case is, in fact, to be treated as made to the public; s.63(2) only says that such offers are not required to be treated as such. See *Registrar of Companies* v. *Securitibank* (1977) Unreported, Magistrates Court Wellington.

Section 63 does not provide much guidance in determining whether a particular offering is or is not made to "the public". However, the effect of the section appears to be as follows:

(a) an offer of securities to even a handful of people may be an offer to the public if it is calculated to lead to the securities becoming available for subscription or purchase by persons other than those receiving the initial offer;[7]

(b) where securities are offered by way of a renounceable rights issue to existing security holders, the offer is to the public since it is likely that the securities will be subscribed for or purchased by persons other than the original offerees;[8]

(c) Where, however, the securities are offered by way of a non-renounceable rights issue, it cannot be said that the offer is calculated to result, directly or indirectly, in the securities becoming available for subscription or purchase by persons other than the original offerees and, accordingly, the offer is not to the public;

(d) a private placement of securities with investors, whether made by the company or by an issuing house or sharebroker, will not be considered as an offer to the public if the placees intend to retain the securities, or at least do not intend to immediately resell them to the public.[9]

Since section 63 does not purport to provide an exhaustive definition of "the public", it is necessary to refer also to cases decided both prior to and after the enactment of section 63 to assist in deciding whether an offer is to the public in any particular case. Little point is served by comprehensively reviewing the authorities here. It will suffice for present purposes if discussion is restricted to a brief examination of the factors which the courts have considered as important in deciding whether an offer is made to the public.[10]

A. The Number of Offerees

The greater the number of offerees, the more likely it is that the offer will be considered as made to the public. In *Re South of England Natural Gas and*

7 Gower, supra n.5, 351. Gower suggests that the word "calculated" in s.63(2) presumably means "likely", rather than "intended", so that if the securities are likely to be acquired by persons other than the original offerees, the offer will be treated as made to the public.

8 Note, however, that s.48(6) of the Act exempts certain offers of securities to specified classes of existing security holders of a company from the requirement to issue a full prospectus in connection with the offer. Thus, where a renounceable rights issue is made to a class of existing security holders in terms of s.48(6), any document by which the offer is made (such as a letter of offer) need not contain all the information or set out the reports required by the Fourth Schedule to the Act. However, while a full prospectus need not be issued in such cases, the document by which the offer is made must nevertheless be registered with the Registrar of Companies under s.51.

9 Pottinger, McKenzie and Oldfield (eds) *Anderson's Company Law Service* (Brooker and Friend, Wellington, 1976) 4-03.

10 Generally, see Heerey "Directors and Public Issues" (1967) 5 Melb. U.L. Rev. 429, 440-445.

Petroleum Co. Ltd.,[11] three thousand copies of a prospectus headed "For private circulation only" were distributed only to shareholders in certain companies. The court held that, on the facts, the offer was to the public.[12]

But even an offer to one person alone may be sufficient to characterize an offering as being made to the public. In a well-known passage in his judgment in *Nash* v. *Lynde*,[13] Viscount Summer remarked:[14]

> 'The public' . . . is of course a general word. No particular number are prescribed. Anything from two to infinity may serve: perhaps even one, if he is intended to be the first of a series of subscribers, but makes further proceedings needless by himself subscribing the whole.

B. Class of Offerees

Where the offer is made to only a small circle of friends or relatives of the company's officers or promoters, or to select customers or suppliers of the company, it is more likely to be regarded as not having been made to the public. Thus, in *Sherwell* v. *Combined Incandescent Mantles Syndicate Ltd.*[15] a prospectus marked "Strictly private and confidential; not for publication" was distributed by the directors of a company to their friends. It was held that the offer was not made to the public.

C. Capability of Acceptance

Where the offer can be accepted only by a specified category of offerees, it may, in some circumstances, not be treated as made to the public. In *Governments Stock & Other Securities Investment Co. Ltd.* v. *Christopher*[16] Wynn-Parry J., in deciding whether an offer was made to the public, stated " . . . the test is not who receives the [offer] but who can accept the offer put forward".[17] In that case, a circular sent by a company to all the shareholders in two other companies, offering to acquire all their shares in exchange for shares in the offeror company, was held not to be a prospectus since, inter alia, the offer made by the circular could be accepted only by the shareholders in the two offeree companies.

This factor of capability of acceptance has been regarded as the crucial test in two Australian cases.

In *Lee* v. *Evans*,[18] the High Court of Australia held that if an offer is made to a limited number of offerees in such circumstances that the offer is capable of acceptance only by those offerees, it will not be to the public, even though in the

11 [1911] 1 Ch. 573.
12 *Cf. Corporate Affairs Commission* v. *David Jones Finance Ltd.* (1975) 1 A.C.L.R. 239 discussed infra.
13 [1929] A.C. 158.
14 Ibid. 169.
15 (1907) 23 T.L.R. 482. See also the dissenting judgment of Windeyer J. in *Lee* v. *Evans* (1964) 112 C.L.R. 276.
16 [1956] 1 W.L.R. 237.
17 Ibid. 242.
18 (1964) 112 C.L.R. 276.

event that the offer is rejected by the original offerees, a similar offer might be extended to other persons. In his judgment, Kitto J. drew a distinction between[19]

> the case of an invitation which itself is open to acceptance by any member of the public who may be interested and the case of an invitation which itself is open to acceptance by a specific individual only but, if declined by him, is likely to be followed by similar invitations to other specific individuals in succession until an acceptor is found. The first of these is a case of an invitation to the public; the second, in my opinion, is not.

In the second case, *Corporate Affairs Commission* v. *David Jones Finance Ltd.*,[20] the question arose whether a document circulated by a subsidiary company of a holding company to more than 12,500 employees of subsidiaries of that company, inviting the employees to invest in interest-bearing deposits with that subsidiary, constituted an invitation to the public. It was held, following *Lee* v. *Evans,* that the invitation was not to the public since, despite the fact that the number of offerees was large, the invitation was not capable of acceptance by any persons other than a defined section of the community, i.e., employees of subsidiaries of the holding company.[21]

To conclude, it will be apparent from the foregoing that the meaning of the term "the public" has not been satisfactorily resolved either by the courts or by the legislature, and a good deal of uncertainty exists as to what constitutes an offer to the public for the purposes of the prospectus provisions of the Companies Act 1955.

III. THE DEFINITION OF "OFFER TO THE PUBLIC" UNDER THE SECURITIES ACT 1978

A. The Definition of "Offer to the Public"

As under the Companies Act 1955, the registration provisions of the Securities Act 1978 only apply where an offer of securities is made to "the public".[22]

The expression "offer to the public" is not defined in the Act, but section 3 includes certain offers within it and expressly excludes others.

Section 3(1) provides that any reference in the Act to an offer of securities to the public shall be construed as including:

19 Ibid. 287.

20 (1975) 1 A.C.L.R. 239 discussed in Hambrook "Corporate Capital Raising from Employees: The Need for a Prospectus" (1976) 5 Adel. L. Rev. 459.

21 But see the discussion of the case in Baxt, Ford and Samuel *An Introduction to the Securities Industry Acts* (Butterworths, Sydney, 1977) 164-5, where the authors argue that had the company offered shares or debentures, and not simply invited the offerees to deposit money with it, the equivalent provision under the Uniform Companies Act to s.63(1) — which refers only to offers of shares or debentures and not to invitations for deposits or loans — would have applied. That provision, it is submitted, precludes an argument that an offer or invitation to a section of the public to subscribe for shares or debentures is not an offer to the public.

22 Section 33(1).

(a) A reference to offering the securities to any section of the public, however selected; and

(b) A reference to offering the securities to individual members of the public selected at random; and

(c) A reference to offering the securities to a person if the person became known to the offeror as a result of any advertisement made by or on behalf of the offeror and that was intended or likely to result in the public seeking further information or advice about any investment opportunity or services, —

whether or not any such offer is calculated to result in the securities becoming available for subscription by persons other than those receiving the offer.[23]

Section 3(1) is extremely wide in scope and conceivably catches any offer of securities by an issuer; even an offer of securities to one person only may require registration under the Act. This view is fortified by section 3(5) which provides that proof of an offer of securities to one person selected as a member of the public shall be prima facie evidence of an offer of securities to the public.

Section 3(2) provides, however, that an offer shall not constitute an offer of securities to the public for the purposes of the Act in three prescribed cases.

The first case is where the offer is made to any or all of the following persons only:[24]

(i) Relatives or close business associates of the issuer:

(ii) Persons whose principal business is the investment of money or who, in the course their business, habitually invest money:[25]

(iii) Any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public.

As far as offers to the latter category of persons are concerned, if the section ended there, it would seem that offers to a limited class of offerees, such as non-renounceable rights offers to existing security holders of an issuer, or offers of securities to employees of an issuer, or to a small and select circle of its customers and suppliers, would possibly be regarded as being within the exemption. However, section 3(3) goes on to provide that a person shall not be precluded from being regarded as a member of the public in regard to any offer of securities by reason only that he is a purchaser of goods from, or an employee or client of, or a holder of securities previously issued by, the issuer or any promoter of the securities. It therefore appears that an offer made by an issuer to some of its customers or clients, for example, will not be exempted from the prospectus provisions of the

23 Furthermore s.3(4) provides that any reference in the Act to an offer of securities to the public shall be construed as including —
(a) A reference to offering the securities to the public by any means of communication; and
(b) A reference to distributing to the public prospectuses or application forms for the subscription for the securities.

24 Section 3(2)(a).

25 This would appear to include not only offers to finance and investment companies, but also offers to institutional investors, such as life assurance companies and superannuation funds which although not principally engaged in the business of investing money, buy and sell securities in the ordinary course of their business.

Act by reason only of the fact that the offer is made to such a limited class of offerees; an issuer will have to go further and show that the offerees had been selected otherwise than as members of the public.

Another case which, under section 3(2), is not an offer to the public is an invitation to a person to enter into a bona fide underwriting or sub-underwriting agreement with respect to an offer of securities.[26]

Finally, section 3(2)(c) provides that a take-over offer within the meaning of Part I of the Companies Amendment Act 1963 does not constitute an offer to the public of securities for the purposes of the Securities Act.[27]

B. Some Differences Between the Definitions of "Offer to the Public" under the Companies Act 1955 and the Securities Act 1978

It will be seen from the above outline of the scope of section 3 of the Securities Act 1978 that a number of significant differences exist between the definition of "offer to the public" under that section and the definition of that term under the Companies Act 1955.

In the first place, the definition of "offer to the public" under section 3 catches several categories of offer which may be exempt under the Companies Act. Section 3(1) includes within the definition of "offer to the public" offers of securities to any section of the public or to individual members of the public selected at random, whether or not the offer is calculated to result in the securities becoming available for subscription by persons other than those receiving the offer. Thus, non-renounceable offers of securities to members of the public, and offers of the kind involved in *Lee* v. *Evans,* which, as noted, come within the exemption under section 63(2) of the Companies Act, will be regarded as offers to the public for the purposes of the Securities Act and will prima facie require the registration of a prospectus in connection therewith.

In addition, advertisements offering investment advice or services will, in certain circumstances, now be considered as an "offer to the public" for the purposes of the Act and require the registration of a prospectus in conjunction therewith.

The position under the Companies Act relating to such advertisements was discussed in *Registrar of Companies* v. *Securitibank Limited.*[28] In that case, the defendant company had published an advertisement drawing the public's attention to the fact that certain of its employees — wearing a distinctive badge — would be pleased to discuss investment opportunities with members of the public. Anyone not meeting such an employee was exhorted to fill in a coupon included in the advertisement and send it to the defendant in order to obtain a free booklet

26 Section 3(2)(b).

27 Although there is no requirement to issue a prospectus under the Securities Act in connection with such an offer, the offeror company must, however, register and deliver to shareholders in the offeree company a disclosure document complying with the First Schedule to the Companies Amendment Act 1963.

28 (1979) Unreported, Wellington Registry, M172/78.

containing advice about investment. The material supplied to persons completing the coupon contained details of investments available through the defendant company and its subsidiaries. The company was charged with breaches of a number of the prospectus provisions of the Companies Act. It was held by Ongley J. that the advertisement taken in isolation did not constitute a prospectus and furthermore that the material which was supplied to persons who had sent in completed coupons to the company could not be read as part of the published advertisement in determining whether the publication of the advertisement breached section 51 of the Act.[29]

Section 3(1)(c) of the Securities Act 1978 now provides that where a person is offered securities after responding to an advertisement offering investment advice or services and which was published by or on behalf of the offeror of those securities, that offer will be considered as an "offer to the public" for the purpose of the Act and require the registration of a prospectus in connection therewith. In the writer's view, advertisements offering investment advice to the public are not per se caught by section 3(1)(c).[30] Rather, the provision in question is intended to cover the case where a member of the public replies to such an advertisement which has been published by or on behalf of the offeror and is then offered securities of that offeror.

The second important difference to note is that, in light of the definition of "offer to the public" in section 3, it is now questionable whether some of the factors which the courts have previously had regard to in determining whether an offer of securities in a particular case was to the public for the purpose of the Companies Act will be of much relevance in assessing whether an offer is to the public under the Securities Act. For example, it has been pointed out above that the Courts have often looked to the number of offerees in determining whether a public offer is involved; the greater the number of persons receiving the offer, the more likely it is to be regarded as an offer to the public. However, section 3(5) of the Securities Act — which provides that proof of an offer to one person selected as a member of the public shall be prima facie evidence of an offer of securities to the public — seems to indicate that the number of offerees can no longer be considered as a conclusive test in determining whether an offer is to the public.

Furthermore, the courts have sometimes regarded an offer as not being made to the public where it is made to a limited class of persons, such as employees of the offeror, or to its customers and suppliers. However, as noted above, section 3(4) appears to preclude an argument that an offer made to such a select group of offerees is, by reason of that fact alone, not an offer to the public for the purposes of the Act.

29 It was held, however, that the material sent to persons who had sent in completed coupons could be taken into account for the limited purpose of determining whether the advertisement called attention to an offer or intended offer of securities and, therefore, constituted a "prospectus" by virtue of s.48B of the Act. And see also *Registrar of Companies* v. *Bowring Burgess Limited* (1980) 1 D.C.R. 10.

30 Cf. Darvell, supra n.1, 55.

It is clear, therefore, that those practitioners involved in advising corporate clients as to the legal requirements relating to commercial fundraising ventures should bear in mind that when the remaining provisions of the Securities Act come into force, some methods of fundraising which are presently exempt from the prospectus requirements of the Companies Act may require the registration of a prospectus under the Securities Act.

IV. PUBLIC OFFERING — SOME INTERPRETATIVE GUIDELINES

A. The Offerees' "Need to Know" Test[31]

Section 3(1) of the Securities Act 1978 does not provide an exclusive definition of the term "offer to the public". Thus, apart from offers which are expressly deemed by Section 3(2) not to constitute offers to the public for the purposes of the Act, all other offers of securities by or on behalf of an issuer must be carefully examined to determine whether a registered prospectus is required because of the "public" nature of the offer.

Section 3(1)(c), like its predecessor under the Companies Act (section 63), provides little guidance in determining whether an offer is to the public for the purposes of the Act. Further, as suggested above, it may well be that, in the light of the provisions of the Securities Act, some of the factors which the courts have traditionally relied upon in deciding whether an offer is to the public — such as the extent or the exclusiveness of distribution — may no longer be applicable in determining this question.

The prospectus provisions of the Act are intended to protect persons invited to invest in an enterprise by providing them with certain vital information about an issuer and its securities to be able to evaluate the merits and risks of an investment proposal, and to arrive at an informed investment decision. Thus, in determining whether a particular offer is to be regarded as being made to the public for the purposes of the Act, it is considered that the principal focus of inquiry should not be on such factors as the number of offerees or whether the offer can be accepted only by a specified category of offerees, but rather on the need of the offerees in question for the protection afforded by the Act and, in particular, on their need for the kind of information which a statutory prospectus would disclose.

The offerees' "need to know" has been accepted by the courts in the United States as the most important criterion in determining whether an offer is to the public. Under section 4(2) of the Securities Act 1933 (U.S.), the registration provisions of the Act need not be complied with in connection with any transaction by an issuer "not involving any public offering". The scope of the exemption under section 4(2) was considered by the United States Supreme Court in the leading case of *SEC* v. *Ralston Purina Co.*[32] The court considered that the exemption must be interpreted in the light of the purpose of the Act. In the court's view, the Securities

31 Generally, see Hambrook "The Obligation to Provide Offerees of Corporate Securities with Formal Disclosure Documents" (1975) 5 Adel. L Rev. 136.

32 346 U S 119 (1953).

Act was intended to protect investors by promoting full disclosure of information thought necessary to informed investment decisions.[33] Thus, the applicability of the exemption depended on whether the offerees in question needed the protection of the Act. Accordingly, where an offer is made to persons who are shown to be able to fend for themselves and who, because of their position with respect to the issuer, have access to the same kind of information that a registration statement would disclose, such a transaction will be within the exemption under section 4(2).[34]

The approach taken by the Supreme Court in the *Ralston Purina* case is reflected, to some extent, in the Securities Act 1978. It will be recalled that section 3(2) exempts from the registration provisions of the Act offers of securities to, inter alia, close business associates of the issuer, underwriters and sub-underwriters, and persons whose principal business is the investment of money or who, in the ordinary course of their business, habitually invest money. All these persons are sufficiently well informed of investment practices to be able to fend for themselves[35] and, furthermore, are in a position with respect to the issuer to have access to the business and financial information which a prospectus would disclose.[36]

Although the exemptions under the Securities Act are based in part on the offerees' "need to know" test, this factor has never in the past been regarded by the courts as the conclusive determinant of whether an offering in any particular case is to the public. Rather, as one observer has commented, in their vague conceptual meanderings in deciding whether a public offer is involved, the courts have concentrated on such matters as the number of persons approached and whether or not the offer may be accepted by anyone who may choose to take advantage of it, considerations which are extraneous to the disclosure objectives of the legislation. [37]

In the writer's view, the principal factor which the Securities Commission and the courts should adopt in determining whether a particular offer is to the public and, therefore, subject to the registration provisions of the Securities Act, is whether the recipients of the offer in question need the information which a statutory prospectus would disclose in order to make an informed investment decision. Thus, an offering to one person only could be to "the public" if it is shown that that person needed the protection of the Act. Equally, an offer made to a number of persons would not be an offering to the public if the offerees, by virtue of their position vis-a-vis the issuer, have access to prospectus-type information about the issuer, and therefore, do not need the protection of the Act.

33 Ibid. 124.

34 The case involved an offer of securities by an issuer to a number of its "key employees". The court held that the offering was not exempted by s 4(2) since these employees "were not shown to have access to the kind of information which registration would disclose": Ibid. 127.

35 Hambrook, supra n.31, 138.

36 The exemption of offers to relatives of the issuer (s 3(2)(a)(i)) also appears to reflect the fact that such offerees, by virtue of their family relationship, are also in a position to obtain sufficient information from the issuer to evaluate the investment proposal.

37 Hambrook, supra n.31, 143.

B. Some Objective Guidelines as to the Meaning of "the Public"

A simple solution to the difficult interpretative problem posed by the meaning of "the public" in the Securities Act would be to eliminate any reference in the Act to offering securities to "the public", so that any offer of securities would require registration under the Act, and then to provide an extensive list of exemptions removing certain types of offerings from the prospectus requirements. This is indeed the approach adopted in at least one jurisdiction.[38]

While this solution has, at least, the merit of both simplicity and certainty, it is not the approach adopted by the Securities Act. The Act continues to adhere to the concept of "public offering" as a determinant for registration and, accordingly, the issue which must be resolved in any particular offering (apart from offers expressly exempted by the Act) is whether it is made in such circumstances as to be considered as being to the public.

As noted earlier, the Securities Act provides little guidance to assist in deciding whether or not an issue is to the public for the purposes of the Act. Indeed, the problem is compounded by the fact that the Act expressly provides (in section 3(5)) that proof of an offer to even one person selected as a member of the public shall be prima facie evidence of an offer to the public.

The question which arises is whether some attempt should be made in New Zealand to develop more precise guidelines to assist in determining whether an offer in any particular case is to the public. A number of proposals suggesting a more objective test of what constitutes a "public offering" have been put forward (and, in some cases, implemented), and some of these proposals will now be briefly outlined and discussed.

1. *Rule 146 of the Securities Act 1933 (United States)*[39]

It was pointed out earlier that section 4(2) of the Securities Act 1933 exempts from the prospectus registration requirements of the Act any transaction by an offeror "not involving any public offering". While the Supreme Court in the *Ralston Purina* case established the basic criteria to be considered in determining whether an offering falls within section 4(2), the application of these criteria resulted in uncertainty about the availability of the exemption. In an endeavour to formulate objective conditions which an issuer must meet to qualify for the "private offering" exemption under section 4(2), in 1974 the Securities and Exchange Commission, pursuant to its rule-making powers, adopted rule 146. Under the rule, an offering will be deemed not to involve any public offering within the meaning of section 4(2) if all of the following conditions are satisfied:

38 See, for example, the Ontario Securities Act 1978.

39 Generally ,see Ratner *Securities Regulation in a Nutshell* (West Publishing Co., St. Paul, 1978), Alberg and Lybecker "New SEC Rules 146 and 147: The Nonpublic and Intrastate Offering Exemptions from Registration for the Sale of Securities" (1974) 74 Colum. L. Rev. 622; Borton and Rifkind "Private Placement and Proposed Rule 146" (1974) 25 Hast. L.J. 287; McDermott "The Private Offering Exemption" (1974) 59 Iowa L. Rev. 525; Note "SEC Rules 144 and 146: Private Placements for the Few" (1973) 59 Va. L. Rev. 886.

(1) There is no general advertising of the offer, and no oral or written solicitation of persons other than eligible offerees;[40]

(2) The securities are offered and sold only to persons who the issuer has reasonable grounds to believe:

(a) are sufficiently experienced in financial and business matters to be able to evaluate the merits and risks of the investment; or

(b) are able to bear the economic risk of the investment and, prior to the sale, have the services of an investment representative who has sufficient knowledge and experience to make such evaluation;[41]

(3) Prior to the sale of the securities, each offeree either has access to, or is furnished with, the same kind of information that would be included in a registration statement. According to the rule, "access can only exist by reason of the offeree's position with respect to the issuer. Position means an employment or family relationship or economic bargaining power that enables the offeree to obtain information from the issuer in order to evaluate the merits and risks of the prospective investment";

(4) The securities are purchased by not more than 35 persons. The rule does not impose any restrictions on the number of persons to whom offers are made provided that the issuer has reason to believe that persons approached are eligible offerees and to general soliciting or advertising is employed in connection with the offering. Excluded from the computation of the number of purchasers are, inter alia, any persons who purchase for cash more than $150,000 of securities in the offering, provided that the issuer satisfies all the other provisions of the rule with respect to such purchasers. Accordingly, a "private placement" can be made to any number of large institutions as long as each one invests $150,000 or more;

(5) The issuer takes certain steps to ensure that the securities are not resold by the purchasers, except in accordance with the rules governing resales.

Rule 146 is not the exclusive means of satisfying the "non-public offering" exemption under section 4(2). An offering may still be considered "non-public" if it meets the standards laid down in administrative and judicial interpretations of that section.[42]

2. *Ontario Securities Act 1978*

The Ontario Securities Act 1978 has largely eliminated the concept of "public offering" in favour of a mandatory registration requirement for all offers of securities other than those specifically exempted by the Act. The exemptions provided by the Act include offers to banks, insurance companies, the Crown, municipal corporations, registered securities dealers and underwriters: section 71(1). In

40 Ratner, supra n.39, 53.
41 Idem.
42 Idem. For a recent judicial interpretation of the exemption afforded under s.4(2), see *Doran* v. *Petroleum Management Corp.* 545 F.2d 893 (5th Cir. 1977).

addition, the Act also exempts sales of securities to any person who purchases, as principal, securities in consideration of a cash payment of not less than $97,000 (section 71(1)(d)), or where the consideration for the securities is to be paid in assets of the purchaser, where the fair value of such assets is not less than $100,000, (section 71(1)(e)). All these exemptions relate to situations where the purchaser is in a position with respect to the issuer to be able to obtain information from the issuer to evaluate the investment proposal and, consequently, does not need to be furnished with a registered prospectus. For present purposes, however, the most important exemption is that provided by section 71(1)(p), which exempts any sale of securities by an issuer if offers are made to no more than 50 prospective purchasers resulting in sales to not more than 25 purchasers and,

(a) each purchaser purchases as principal, and all of the purchases are completed within 6 months of the first purchase; and

(b) each purchaser is an investor who, by virtue of his net worth and investment experience or by virtue of consultation with or advice from a registered investment adviser, is able to evaluate the prospective investment on the basis of information respecting the investment presented to him by the issuer or has access to substantially the same information concerning the issuer that a registered prospectus would provide; or is a senior officer or director of the issuer or his spouse, parent, brother, sister or child.

(c) the offer and sale of the securities are not accompanied by an advertisement, and no selling or promotional expenses have been paid or incurred in connection therewith (except for professional services performed by a registered dealer).

The thrust of the exemption, as under rule 146, is to ensure that the offerees have the opportunity of obtaining prospectus-quality information before arriving at an investment decision. There are, however, two significant differences between the Ontario provision and rule 146. First, the Ontario exemption requires that there be no more than 50 offerees, whereas under rule 146 no limit is placed on the number of persons who may be approached. Secondly, the Ontario exemption may be used only once by an issuer: section 71(1)(p) provides that "an issuer which has relied upon this exemption may not again thereafter rely upon this exemption". There is no such restriction under rule 146.[43]

3. *Federal Securities Code*

The Proposed Official Draft of the American Law Institute's Federal Securities Code exempts from the registration requirements of the Code any "limited offering" of securities. "Limited offering" is defined as one in which the following conditions are satisfied:

43 The only restriction on the use of the exemption under R.146 is that it may not be used as part of a plan or scheme to evade the registration provisions of the Act. Thus, where an issuer makes a number of offers, relying on the exemption in each case, the exemption under R. 146 (and s.4(2)) may not be available if the offers, in reality, involve a series of steps resulting in a public distribution.

(a) the initial buyers of the securities, excluding institutional investors, do not exceed 35 persons; and

(b) resales of any securities by such persons within 3 years after the last sale to any of the initial buyers (other than institutional investors) do not result in more than 35 owners of those securities (apart from any institutional investors and persons who became owners otherwise than by purchase) at any one time: S.242(b)(1). [44]

Unlike rule 146 and the exemption under the Ontario Act discussed above, the applicability of the Code's proposed exemption does not turn on the offerees' access to information, investment sophistication or experience, or ability to bear the risk of the investment. Thus, while the Code's proposed exemption results in certainty, it does not ensure that the purchasers of the securities will be limited to those who are able to fend for themselves and who do not need the information which a prospectus would disclose.

4. *Eggleston Committee Report*

The Eggleston Committee in Australia, which delivered its report in 1970,[45] considered that the expression "the public" be defined in terms of the number of persons to whom the offer or invitation is made. The Committee accordingly recommended (in paragraph 11 of its report) that an issue of securities be deemed not to be an offer to the public where the total of all offers and invitations in respect of the securities within any period of three months does not exceed 50.

While the Committee's proposal can be criticised on other grounds — for example, the Committee's proposal relates to offers rather than offerees and therefore may not catch one offer made to fifty or more persons, as where an offer or invitation is posted on a notice board in a public place — in the writer's view the major deficiency in the Committee's recommendation is that, like the provision of the Federal Securities Code discussed above, the availability of the exemption does not depend upon whether the offerees in question need the protection of the prospectus provisions.

C. Conclusion

One of the purposes — if not the dominant purpose — of the prospectus provisions of the Securities Act 1978 is to ensure that persons invited to invest in a venture are provided with adequate and timely information as to the nature, structure and functions of the issuer to be able to make an informed investment decision. Accordingly, in determining whether any particular offering is to "the public" for the purposes of the Securities Act 1978, it is considered that both the courts and the Securities Commission should concentrate not on such factors as the number or class of offerees, but rather on whether the persons to whom the

44 In addition, the seller must comply with any rules adopted under the section governing resales of the securities.

45 Company Law Advisory Committee *Report to the Standing Committee of Attorneys-General on the Control of Fund Raising, Share Capital and Debentures* (Government Printer, Melbourne, 1970) (Chairman: Sir Richard Eggleston).

offer is made are able to fend for themselves in terms of obtaining the kind of information which a statutory prospectus would disclose. If the offerees require the protections afforded by the Act, then registration of a prospectus should be required.

Furthermore, in order to possibly provide more objective standards upon which issuers may rely in raising capital in a manner that complies with the Act, the Securities Commission — in much the same way as the Inland Revenue Department lays down guidelines as to its interpretation and application of various provisions of the Income Tax Act 1976 — might consider issuing a ruling along the line of rule 146 and the Ontario exemption discussed above, indicating the circumstances in which it will regard an offering (other than an offer expressly exempted by the Act) as not constituting an offer to the public for the purposes of the Act.