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ARTICLES

NOTES & COMMENTS

BOOK REVIEW

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UNIVERSITI TEKNOLOGI MARA (UiTM)

An Introduction

Universiti Teknologi MARA (formerly known as MARA Institute of Technology) is Malaysia's largest institution of higher learning. It had its beginnings in 1956 as Dewan Latihan RIDA, a training centre under the supervision of the Rural Industrial Development Authority (RIDA).

Nine years later Majlis Amanah Rakyat (MARA) Act, 1965 provided for a change of name from Dewan Latihan RIDA to Maktab MARA (MARA College). The Act also defined a new role for the MARA College -- to train Bumiputras (literally it means "the sons of the soil" - ie the indigenous people) to be professionals and semi-professionals in order to enable them to become equal partners with other ethnic groups (ie the former migrants, especially the Chinese and Indians) in the commercial and industrial enterprises of the nation.

In 1967 Maktab MARA was renamed Institut Teknologi MARA (ITM) (or MARA Institute of Technology). In August 1999, the Institute was upgraded to university status and named Universiti Teknologi MARA (UiTM).

As part of the government's affirmative action policies, UiTM provides education and training in a wide range of sciences, technology, business management and professional courses to 56,408 full-time students in 2000. Another 3,156 have enrolled for off-campus courses. In addition, there are 7,725 students in distance-learning and flexible-learning programmes.

The main campus stands on a 150-hectare piece of land on a picturesque hilly area of Shah Alam, the state capital of Selangor Darul Ehsan, about 24 kilometres from the city of Kuala Lumpur.

The Universiti has also established branch campuses in the various states of the Federation: Sabah (1973), Sarawak (1973), Perlis (1974), Terengganu (1975), Johor (1984), Melaka (1984), Pahang (1985), Perak (1985), Kelantan (1985), Penang (1996), Kedah (1997) and Negeri Sembilan (1999).

The Universiti currently offers 184 programmes conducted by 18 Faculties. These programmes range from post-graduate to pre-diploma or certificate levels. More than half of these are undergraduate and post-graduate programmes, while diploma programmes account for an additional 39%. Some of the post-graduate programmes are undertaken in the form of twinning programmes, through collaboration with universities based overseas.

The following 18 Faculties currently run programmes in the University:

Accountancy; Administration and Law; Applied Science; Architecture Planning & Surveying; Art & Design; Business & Management; Civil Engineering; Education; Electrical Engineering; Hotel & Tourism Management; Information Technology & Quantitative Science; Mass Communication; Mechanical Engineering; Office Management & Technology; Performing Arts; Science; Sport Science & Recreation.

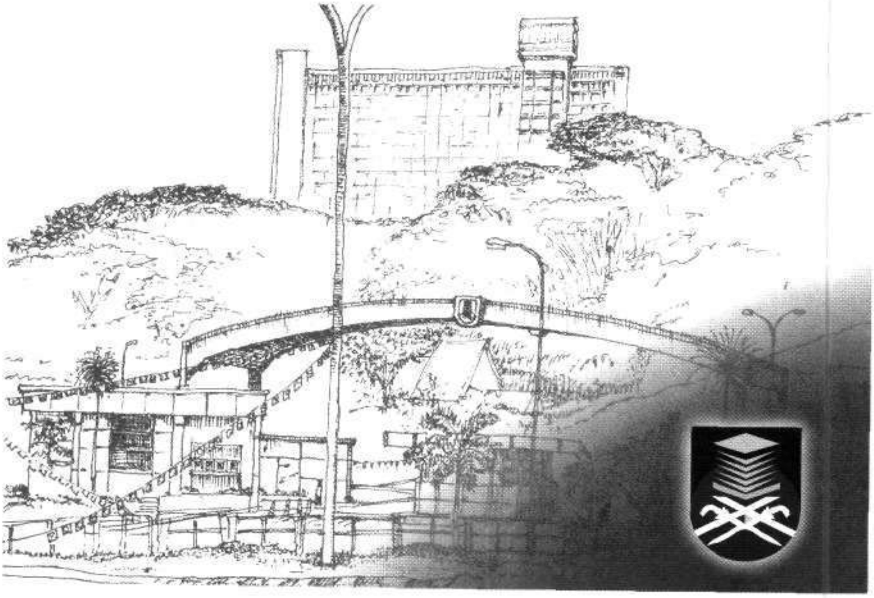
In addition to faculties there are 17 'academic centres' to cater various academic, business, technological and religious needs of the campus community. They are Extension Education Centre (PPL); Language Centre; Centre for Preparatory Education; Resource Centre for Teaching and Learning; Total Quality in UiTM (CTQE); Department of Academic Quality Assurance & Evaluation; Computer Aided Design Engineering Manufacturing (CADEM); Malaysian Centre for Transport Studies (MACTRANS); Text Preparation Bureau; Bureau of Research & Consultancy; Malaysian Entrepreneurship Development Centre (MEDEC); Islamic Education Centre; Centre for Integrated Islamic Services; Business & Technology Transfer Centre.

THE FACULTY OF ADMINISTRATION AND LAW, UiTM

The Faculty of Administration and Law (formerly known as the School of Administration and Law) was founded in 1968. It began as a centre offering British external programmes, the LLB (London - External) and the Chartered Institute of Secretaries (now Institute of Chartered Secretaries and Administrators). The only internal programme offered then was the Diploma in Public Administration and Local Government (DPALG). In 1978 the LLB (London - External) programme was terminated and replaced by the current internal LLB programme. The LLB is a three-year academic degree course based on the structure of the undergraduate law programmes normally offered in the British universities. Unlike most of the British LLB programmes, however, the LLB at the Faculty is conducted on a semester system. In 1982 the Faculty introduced a one-year LLB (Hons) programme towards which graduates of the LLB could advance their studies. The LLB (Hons) is a professional and practice-oriented programme that provides training to students for their career in the legal practice as Advocates and Solicitors. The delivery of the curriculum for this course adopts the method and strategy of simulated or experiential learning. Because of the unique experience it provides to students in their legal training this course has acquired wide recognition and acceptance among the Malaysian public.

The Faculty of Administration and Law enjoys strong connections with the legal profession, particularly the Malaysian Bar, and the industry. It takes pride in continually developing pioneering options in its degree programmes, both at the academic and professional levels. In 1995 the Faculty introduced the degree of Bachelor in Corporate Administration (Hons) to train young and bright Malaysians to hold office as Company Secretaries. In the pipe-line are some new courses - Bachelor of Law and Management (Hons), Bachelor of Administrative Science (Hons), Masters of Law and Executive Masters in Administrative Science.

The Faculty currently comprises some 70 academic staff from both the disciplines of law and administration. It has about 600 students reading for the LLB and LLB (Hons) and 500 students reading for the Diploma in Public Administration and Bachelor in Corporate Administration (Hons). The Faculty admits about 200 students each year.



Main Entrance to Shah Alam Campus

EDITORIAL NOTES

This law journal had a long period of gestation in the Faculty. There were several attempts in the past, by individuals or the faculty collectively, to bring about its parturition. It is no easy task to initiate an academic journal, regardless of the discipline it represents. It demands a high degree of commitment in time, energy and attention. It calls for an intense love of labour for scholarship among a critical mass of the faculty members, either in the editorial board or as article contributors. But, at long last, this journal has arrived.

Many factors led to this successful launch. The recent elevation of this institution to university status created its own impetus. Our strong law programme and its capable teachers demanded, and will benefit from, this specialist forum for academic debate and analysis. There is support within the legal profession and among our many distinguished alumni for such a journal, too. We are delighted by the synergy and collaborative goodwill the notion of a journal has evoked. So, we were able to marshal much expertise and experience to bring out this inaugural issue of the Journal.

Academic faculty at UiTM are part of the worldwide network of academia. We must participate in discussions and debates over issues that are not only of direct academic and professional concern but also of importance to the general public. A journal such as this facilitates reflective and disciplined participation. In doing so, it helps the Faculty, and the University, to undertake its noble role in serving the general community.

A learned journal is one of the major measures by which the weight and prestige of an institution are judged. It reflects the institution's maturity and ability to manage and conduct its specialist discipline. It reflects a confidence among its faculty to offer themselves to be evaluated in the open market place of ideas, and it serves notice of the faculty's readiness to serve the community at large. This Journal, in no small measure, marks the coming of age of the Faculty.

The Journal functions also as a meeting point for law teachers and practitioners who share a common interest in various areas of law. It provides them a source of information on the current and topical issues in their specialised areas. It creates a forum for the exchange of ideas and for engaging in discourse over sometimes intricate and often vexed legal issues. Much is gained by the legal fraternity, as well as the legal system, through such engagements and encounters.

Law teachers, as members of the broader academic community, are aware that it is no longer tenable for them to function solely within their traditional ivory towers, isolated from the reality of the world outside. For career and professional advancement, and for taking their rightful role in the community, no academic can confine herself to her classroom or departmental audience. She must reach for a wider audience. The recognition (or lack of it) that she gains from her peers, both within and without the discipline, will speak for her standing and credibility in the community, both scholarly and otherwise. This Journal will serve as one channel for the Faculty members to reach that wider audience.

There are relatively few academic legal journals in this country. Most existing legal publications cater for the professional needs of legal practitioners. One ramification of this is that there are few discourses on theoretical and abstract legal issues. Yet these issues are important for the fuller appreciation and development of the law and the legal system, by the legislature, the reform bodies and the courts. This Journal will try to answer this need and stimulate discussions on issues that are of interest and relevance to the academic and broader communities.

The labour and skill required for this Journal to thrive will challenge the staff of the institution and the supporters of this initiative among the profession and the wider community. We hope the Journal sails well in fair winds.

Our wish is that Malaysia's legal profession, its legal academic circle and the many students and practitioners of law in this country and elsewhere will benefit from this forum for analysis and reform. We hope this Journal makes an important contribution to debate on vital legal matters in our society. We hope, too, that our quest for self-expression and critical reflection among the members of the legal academia will be assisted by this Journal. It is with great pleasure and some satisfaction at the completion of this worthy task that we complete this inaugural Editorial.

UiTM LAW REVIEW

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ARTICLES

THE PROSPECTUS DISCLOSURE REGULATORY REGIME IN MALAYSIA

*by MOHAMMAD RIZAL SALIM**

Introduction

The relationship between the issuer and subscribers of securities has traditionally been based on the law of contract whereby misrepresentation, whether innocent or fraudulent, will result in the contract being rendered voidable. In addition, the law imposes an obligation on the issuer of securities to disclose certain specified[1] and relevant[2] information.

One may wonder why there is a need to disclose information for the issue of securities. Consider if the legislature enacts a law requiring car salesmen to disclose all information relating to the car to potential purchasers. Or any other merchandise, for that matter. What is the difference between cars and securities?

Unlike cars which can be inspected and purchased on an "as is where is" basis, the value of securities depends very much upon the possible future income which such securities may be expected to generate, weighed against the risks associated with the issuer and its business. Securities are described as "intricate merchandise" which potential purchasers cannot examine without help from the seller.[3] In the absence of disclosure requirements, the risk of fraud was thought to be so enormous that government assistance was needed. Therefore, the legislature has intervened to require that issuers of securities disclose all information which may be material, relevant or desirable to enable investors to make an informed investment decision. This is evident in s 39(1)(d) of the Companies Act, which requires a prospectus[4] to "state the matters specified in Part I of [the Fifth Schedule] and set out the reports specified in Part II of that Schedule". Through this provision, the legislature determines the nature and type of information to be provided in a pro-

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1 Companies Act 1965 (Companies Act), s 37(1).

2 Securities Commission, *Policies and Guidelines on Issue/Offer of Securities* (SC Guidelines), para 10.22(c). See also Securities Commission Act 1993, s 32B which created offences for false or misleading statements, or statements suffering from "material omission".

3 H A J Ford and R P Austin, *Ford's Principles of Corporations Law* (1992) at 388.

4 As defined in the Companies Act, s 4(1), and further explained in sub-s (6) of the same section.

spectus. The Registrar of Companies (the Registrar) is the authority entrusted with approving and registering prospectuses.[5] Any "untrue statement" or "wilful non-disclosure" of information may be dealt with by the investor and the Registrar pursuant to ss 46 and 47 respectively, which provides for civil and criminal liabilities for mis-statements and omissions in prospectus.

Pursuant to the Securities Commission Act 1993 (SC Act), the legislature has introduced a new provision[6] which, when read with the rulings of the Securities Commission (SC),[7] requires the issuer of prospectus to disclose all such information which may be required by investors and his professional advisers to assess the merits and risks of acquiring such securities.[8] This places the obligation on the issuers of securities themselves, and not on the legislature or other relevant authorities, to determine the nature of information which may be required by investors.[9] This requires the issuer to work with professional advisers, together sharing the responsibility of fulfilling the investors' informational needs. Heavier and higher standards of responsibility are required from the issuers, "any of its officers or associates",[10] "a financial person or an expert",[11] or "any other person",[12] to ensure "timely, sufficient and accurate disclosure of all material information".[13]

Is the "intricate" nature of securities the only reason for such disclosure requirement? Or were there some other objectives? The disclosure of information by issuers of securities was required in other markets[14] based on the perception that such disclosure is desirable for the good of the investors and of the nation. This article explores some of the accepted arguments for mandatory disclosure.[15]

Arguments for Mandatory Disclosure

Increasing public confidence

Corporations engaged in any sector of a country's economy form the backbone of the country's economy and wealth. These corporations require access to capital.

5 Companies Act, s 37(1).
6 The SC Act, s 32B.
7 The body empowered to regulate the issue of securities: SC Act, s 15(1)(b).
8 SC, *Due Diligence Practices*, paras 9 - 12 and SC Guidelines, para 10.22(c).
9 Although the pre-vetting function by the Registrar is not dispensed with: see Companies Act, s 42.
10 SC Act, s 32B(1)a.
11 Ibid, para (b).
12 Ibid, para (c).
13 SC, *Due Diligence Practices* at para 11.
14 Countries which provides for mandatory disclosure include the United States, United Kingdom, Australia, Hong Kong and Singapore.
15 There are considerable theoretical debates on the matter, prominently by United States' writers. Arguments for mandatory disclosure were argued by, among others, Seligman, "The Historical Need for a Mandatory Corporate Disclosure System" (1983) 9 J Corp L 1; Coffee, "Market Failure and the Economic Case for a Mandatory Disclosure System" (1984) 70 Virg LR 717. For arguments against disclosure, see Easterbrook and Fischel, "Mandatory Disclosure and the Protection of Investors" (1984) 70 Virg LR 669; Sigler, "Public Regulation of Securities Markets" (1964) 37 J Bus 117; Benston, "The Value of the SEC's Accounting Disclosure Requirements" (1969) 44 Acc Rev 515.

The issue of securities is a relatively inexpensive way of raising capital. Investors, on the other hand, require a return on their investment. It is fundamental that investors have confidence in the value of the securities they will be acquiring and that the issuers will deliver on their promises. If the issuers are allowed to make a glowing but eventually empty and unfulfilled promises, investors' confidence will be affected, and they will withdraw their capital. If this happens on a large scale, the economy would suffer. Therefore, disclosure rules demands accountability by issuers, deters fraud and gives investors access to information.

This view of disclosure to increase public confidence can be traced back to when mandatory disclosure requirements were introduced in the United States. It was asserted that, by requiring the seller to tell the whole truth, disclosure "should give impetus to honest dealing in securities and thereby bring back public confidence".[16]

This view was echoed in Australia by the Campbell Committee,[17] which agreed that the disclosure rules promote public confidence in the securities industry and, more particularly, in companies issuing securities to the public, thus ensuring that investors have all the information necessary to make an investment decision.

Seligman[18] agreed with the view that disclosure increases public confidence by reducing investors' fear of fraud. He said:[19]

> The assumption that investors will be more willing to purchase securities when compulsory disclosure of material information reduces the incidence of fraud, increases the reliability of estimates of firm value, or reduces the volatility of securities price swings is an articulation of the familiar financial theory of risk aversion. Other things being equal, investors assumedly will choose investments with the least risk. To persuade investors to select investments with greater risk, the investment sellers must offer a higher expected rate of return. In this sense, increasing investor confidence in the securities market may have several important economic consequences. By reducing the perceived risk of corporate securities, compulsory disclosure will tend to reduce the risk premia that issuers selling new securities would have to pay, thus increasing the funds available for economic growth. Reduction of investors' concerns that securities fraud waves periodically may drive down securities price levels will tend to increase propensities to save. And reduction in the volatility of market price swings (caused by investor ignorance of material data) will tend to increase allocative efficiency.

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16 In a speech by the President of the United States in the recommending passage of the United Statesl Securities Bill, which was introduced as part of a New Deal programme following the great depression in the 1930s.

17 Campbell Committee, *The Australian Financial System - Final Report of the Committee of Enquiry* (1981) at para 21.124.

18 Seligman, "The Historical Need for a Mandatory Corporate Disclosure System" (1983) 9 J Corp L 1.

19 Ibid at 252.

Unequal possession of information among investors

Information obtained by investors is likely to differ depending upon their ability to obtain corporate information and their skill in analysing the information received. A rationale for mandatory disclosure is to prevent better informed traders from reaping unfair profits from trading on their superior information. Mandatory disclosure helps ensure that all investors have equal access to information. Investors will make an investment decision based on the information that they receive, knowing that the information is accurate and contains all the information that they need to make an informed decision. This will also help prevent speculative trading and insider dealing.

Reduction of waste

Disclosure will help prevent, or at least reduce, the incidence of insider dealing, conflicts of interest and waste.[20] For example, if there is a disclosure requirement for executives' and directors' compensation, it is less likely that executives and directors will over compensate themselves, at the corporations and therefore the investors' expense.

Reducing costs

Mandatory disclosure reduces the costs incurred by investors. Duplication of search and verification costs incurred by investors in pursuing trading gains do not create additional wealth; one party's gain comes at the other party's loss, whereas the process of researching and verifying information consumes real resources.[21] These costs are reduced by mandatory disclosure.[22]

The inadequacy of anti-fraud laws

The remedies provided by common law to compensate defrauded investors are inadequate.[23] In some cases, by the time an investor discovers that he has been

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20 Ibid at 251.

21 Coffee, "Market Failure and the Economic Case for a Mandatory Disclosure System" (1984) 70 Virg LR 717 at 733.

22 On the other hand it was argued that a drawback of requiring disclosure in prospectuses is the costs associated with the issue of the prospectus. The costs are related to the processes required to enable the issuers and related persons to rely on the statutory defence of due diligence through certification and verification. It includes the costs of underwriters, lawyers, accountants, market researchers, etc. The costs associated with disclosure requirements of prospectuses occur at three levels. The first and most significant level is at the level of the corporation. The second is when the prospectus is prepared and lodged with the Securities Commission for registration. The third level occurs at the investors level: see Azzi, "Disclosure in Prospectuses" (1991) CSLJ 205 at 212, quoting Easterbrook and Fischel, "Mandatory Disclosure and the Protection of Investors" (1984) 70 Vir LR 669.

23 The rights of persons who suffered loss as a result of mis-statements and omissions in prospectus are governed by the law of tort for deceit or negligent misrepresentation: see *Derry v Peek* (1889)14 App Cas 337 and *Hedley Byrne & Co Ltd v Heller & Partners Ltd* [1964] AC 465. For a discussion on these cases, see LC Keong, *Securities Regulation in Malaysia* (1997) at 110-117; Woon, *Company Law* (1997) at 431.

defrauded, the corporation from which he purchased the securities will have become insolvent. Further, the expense of litigation is enough to deter a small investor from bringing an action against the corporation. Often he has no choice but to suffer the loss and sell the securities at a much lower price. It is also difficult to prove fraudulent misrepresentation, as the investor would not have access to confidential information of the corporation. Even if investors can ultimately protect themselves through litigation, many will find that the expense or the risk of litigation a sufficiently unpleasant experience that they would quit the securities market.[24]

The Requirement for a Prospectus

In Malaysia, disclosure of certain information is mandated by law. The Companies Act requires companies to submit certain information to the Registrar of Companies, and it is available for inspection by the public. Similarly, the Kuala Lumpur Stock Exchange requires companies whose shares are listed with them to disclose certain information. These are discussed in standard company law textbooks and are outside the scope of this discussion. What is an issue for discussion here is disclosure of information in prospectuses.

When is a prospectus required?

The Companies Act prohibits a person from issuing circulars or distributing any form of application "for shares in or debentures of a corporation unless the form is issued circulated or distributed together with a prospectus, a copy of which has been registered by the Registrar".[25] A prospectus is defined in s 4(1) of the Companies Act as "any prospectus ... notice circular advertisement or invitation inviting applications or offers from the public to subscribe for or purchase or offering to the public for subscription or purchase or offering to the public for subscription or purchase any shares in or debentures of or any units of shares in or debentures of a corporation or proposed corporation."

The concept of "offer to the public"

The meaning of the term "offering shares or debentures to the public" is explained in s 4(6) of the Companies Act, which provides that "offering shares to the public shall ... be construed as including a reference to offering them to any section of the public, whether selected as clients of the person issuing the prospectus or in any other manner ..."

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24 On the other hand it was argued that anti-fraud statutes are sufficient to preserve investors confidence. There is no evidence that there is lesser incidence of fraud with disclosure rules than with anti-fraud legislation alone: see Easterbrook and Fischel, supra n 15 at 638-639.

25 Companies Act s 37(1).

The most problematic of these terms is "offer to the public". Section 4(6) provides an inclusive and therefore not a comprehensive definition of what constitutes an "offer to the public". The High Court of Australia[26] had said that such an inclusive definition is "commonly both to extend the ordinary meaning of the particular word or phrase to include matters which otherwise would not be encompassed by it to avoid possible uncertainty by expressly providing for the inclusion of particular borderline cases."

There are numerous cases on the subject,[27] which is beyond the scope of this article. It is sufficient to say that these cases illustrate the difficulties of determining whether an offer or invitation can be said to be an offer or invitation to the public. Such uncertainty is not appreciated, especially in the securities market.[28]

Bonus and rights issues

Bonus issues and non-renounceable rights issues are exempted from prospectus requirements, as s 4(6)(c) of the Companies Act provides for an exemption in respect of an offer to existing members or debenture holders of a corporation. For

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26 *Corporate Affairs Commission (SA) v Australian Central Credit Union* (1985) 10 ACLR 59 at p 61-62, in relation to the provisions of the Australian Companies Code (the predecessor of the current Corporations Law), whose relevant provision is in pari materia with the Companies Act.

27 See, eg, *Nicholas v. Gan Realty Sdn Bhd* [1970] 2 MLJ 89; *PP v Huang Sheng Chang* [1983] 2 MLJ xcvi; *Mahima Singh v Baldev Singh* [1975] 1 MLJ, 173; *Attorney General v Derrick Chong Soon Choy* [1985] 1 MLJ 97; *Khania Nominees Pty Ltd v. Hamilton* (1986) 10 ACLC 737; *O'Brien v Melbank Corporation Ltd* (1991) 7 ACSR 19; *Lee v Evans* [1965] 1 ALR 614. For a discussion on the topic, see LC Keong, *Securities Regulation in Malaysia* (1997) at 88-92; Woon, *Company Law* (1997) at 411 – 416.

28 It is noteworthy that the Australian Corporations Law has departed from the "offer to the public" concept for the issue of prospectuses. The Corporations Law now requires that a prospectus be lodged and registered for all offers and invitations to subscribe for or buy securities, unless exempted: see ss 1018 and 1017. The Explanatory Memorandum to the Corporations Bill 1988 indicated the reason for the abandonment of the "offer to the public" concept was that the interpretation of the term caused confusion as to whether a prospectus was required in a particular circumstance. See Companies and Securities Advisory Committee, *Prospectus law Reform Sub-Committee Report* (1992) at para 158. The Committee stated (at para 159) that, as a matter of practice, it was always difficult to determine whether or not an offer was an offer to the public or section of the public. This uncertainty invited exploitation and many fundraising schemes sought to benefit from the loophole created by the expression "offer to the public". For the situation in Singapore, see the Companies Act of Singapore, ss 106B - 106J and Woon, *Company Law* (1997) at 434-436. In the United States, the Securities Act 1933 exempts from the Securities Act registration statement requirements any offers and sales of securities made "in transactions by an issuer not involving any public offering": s 4(2), popularly known as the "Section 4(2) Exemption" or "private placements". The underlying principle is that the exemption should be made available only in those cases in which the offerees (and purchasers) of the securities do not require protection of the Securities Act registration. The important factors are:

(a) The number of the offerees (or purchasers) must be limited, but if the securities are of high quality and the offerees (and purchasers) are large, financially sophisticated institutional investors, a significant number may be permissible.

(b) Information generally comparable to that which would have been provided by a Securities Act registration statement and which is material to investors must be known by or provided to the offerees (and purchasers).

(c) The offerees (and purchasers) must be capable of evaluating the merits and risks of the investment.

(d) There must be understandings or obligations in place reasonably designed to prevent resales of the securities by the offerees (and purchasers) to the public. This is an anti-avoidance provision: see Gregory K Palm and Donald C Walkovik, *United States - A Special Report* IFL Rev Special Supplement, July 1990.

a renounceable rights issue, an abridged prospectus will be required, containing the particulars set out in the Fifth Schedule of the Act.[29]

Options

In *The Mutual Home Loan Funds of Australia Ltd v Attorney General for New South Wales*[30] it was held that a simple offer of options over unissued shares is an offer of the underlying shares. Therefore a prospectus is required when the offer is made.[31]

Continuous disclosure and the protection to investors in open market

The issue here is whether investors in the secondary market are entitled to the protection afforded by the law in relation to the disclosure of information by the issuers. The definition of a prospectus in s 4(1) of the Companies Act, which includes an invitation or offer to the public "to subscribe for or purchase shares or debentures", may indicate that it does. On the other hand, the word "purchase" may only apply to the purchase of shares or debentures in relation to s 43(1) of the Act, which provides:

> Where a corporation allots or agrees to allot to any person any shares in or debentures of the corporation 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 shall for all purposes be deemed to be a prospectus issued by the corporation ...

Further, s 42A of the Companies Act provides for a supplemental prospectus only in cases where the prospectus has been registered but before its issue. The Act is silent on the need for a supplementary prospectus for information update after the issue of the prospectus. It is an indication, therefore, that the disclosure obligation applies only at the time of the issue of the prospectus. There is no obligation on the issuer to continuously disclose information which may be material to investors subsequent to the issue of the prospectus.[32] Therefore, investors purchasing securities in the open market will not be protected by the disclosure requirements and, in any event, the prospectus may already be outdated soon after its issue. Therefore, to be able to make an informed investment decision, the investor will have to make enquiries with the stock exchange as to any recent change in the company's opera-

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29 Companies Act, s 39A(1) and (2).

30 [1974] 1 NSWLR 110.

31 See Baxt, Ford & Black, *Securities Industries Law* (1993) at para 321. But note the controversy relating to the nature of options, whether as a continuing offer or conditional offer: *Laybutt v Amocap* (1974) 132 CLR 57; *NCSC v Consolidated Gold Mining Areas NL* (1985) 1 NSWLR 454, 9 ACLR 706, 3 ACLC 424; *Re Asia Oil & Minerals Ltd* (1986) 10 ACLR 333, 4 ACLC 202.

32 Compare with the position in Australia where the Corporations Law requires continuous and periodic disclosure, also known as the "enhanced disclosure regime": s 1022AA. However the purpose of this disclosure is not to protect investors in the secondary market, but to reduce the content of prospectus disclosure for a disclosing entity which has complied with its disclosure obligations under the enhanced disclosure regime.

tions (if the company is listed) and any other disclosures required by law, eg annual returns, accounts and auditing requirements. The problem with these disclosures is that they do not attract the liability for mis-statements or omissions of material or relevant information imposed by law. Investors seeking to claim for civil remedies have no option but to rely upon the imperfections of remedies under the common law.

Contents of a Prospectus

The Companies Act contains a detailed and highly specific list of matters to be disclosed in a prospectus, which is stipulated in s 39 and schedule 5. In addition, s 42 of the Companies Act precludes the Registrar from registering a prospectus if it contains any statement or matter which in the Registrar's opinion is misleading, or if it does not appear to comply with the requirements of the Companies Act. Although there seems to be an affirmative duty on the part of the Registrar to peruse the draft prospectus, there is nothing which obliges the Registrar to vet the draft prospectus in detail to ensure it complies with the requirements of the Companies Act and to determine whether it contains anything misleading before registering the prospectus. Such an obligation would be time consuming and expensive, and would add to the expense of an issue. It also requires, on the Registrar's part, expertise and manpower to vet the draft prospectus and if necessary to communicate with the proposed issuer or their advisers about additional information or materials, or verification of facts. At the very best, the Registrar may satisfy himself that the draft prospectus complies with the requirements of the Act by using a check-list approach, but there is no way the Registrar can be fully satisfied that the draft prospectus does not contain anything which is misleading. Nor would the Registrar be able to detect any omission or mis-statement. Further, there is a lack of accountability on the Registrar's part, as there is no statutory liability imposed on him if he registers a defective prospectus, even if it had conducted a thorough pre-vetting.

Therefore, the acceptance by the Registrar and the registration by him of the prospectus does not mean anything more than compliance with s 42. In addition, the mere failure to register a prospectus pursuant to this section does not make an allotment of shares subscribed for on the faith of the prospectus void or voidable at the option of the allottee.[33] It would appear that the object of the registration requirement is to have a copy of the prospectus permanently recorded before its issue and to give the Registrar some supervisory powers over its form and content. The question arises, is this pre-vetting function by the Registrar necessary? Sceptics may argue that it is not. It is time consuming, and adds to the cost of the issue of the securities. In addition, the greater the period of time between the preparation

33 See *Marshall v Commonwealth Homes and Investment Co Ltd* (1941) SASR 74.

of a prospectus and the issue of the prospectus, the greater the risk of insider trading taking place based on information contained in that prospectus.

The next question is, what should the prospectus reveal? The rationale of mandatory disclosure of information, as had been discussed above, is to increase public confidence, promote equal possession of information among investors, reduce waste and costs, and to overcome the inadequacies of anti-fraud laws. To achieve all these objectives, the prospectus should contain the information required by investors in order to come to an informed decision whether or not to acquire the securities. Therefore all relevant and material information must be disclosed. Unfortunately, there are no such requirement, although the courts have ruled that statements in a prospectus must be made with the "utmost candour and honesty".[34]

Under the Companies Act, although there is no requirement that the issuer must disclose any other information other than the information prescribed under s 39 and the fifth schedule, the Act imposes civil and criminal liabilities for untrue statement or wilful non-disclosure. Section 46(1) of the Companies Act provides for certain categories of persons[35] to be liable to pay compensation to "all persons who subscribe for or purchase any shares or debentures on the faith of the prospectus for any loss or damage sustained by reason of any untrue statement therein, or by reason of wilful non-disclosure therein of any matter of which he had knowledge and which he knew to be material". Criminal liability is imposed under s 47 of the Companies Act for the same offence, ie for an "untrue statement" or "wilful non-disclosure".

The difficulties in the above provisions are numerous.[36] First, the person seeking to impose the liabilities must prove that the statement was untrue and that the non-disclosure was "wilful". Although there is no mens rea requirement for an untrue statement, s 46(3)(d)(i) provides for a defence if the defendant "had reasonable grounds to believe, and did up to the time of allotment or sale of the shares or debentures believe, that the statement was true". This allows the defendant to escape liability by saying that he relied on the information provided by his subordinates or a third party without seeking to investigate or affirm its accuracy or truthfulness. Secondly, "wilful" refers to the doing of an act with intention, or knowledge, or with premeditation. Thirdly, the plaintiff suing under s 46 needs to show causation – the section requires him to show that he bought the securities "on the faith of a prospectus", and that the loss arose "by reason of any untrue statement ... wilful non-disclosure".[37] Fourthly, the range of defendants who may be

34 *Flavel v Giorgio* (1990) 2 ACSR 568.

35 Listed in paras (a) to (d).

36 See discussion in LC Keong, *Securities Regulation in Malaysia* (1997) at 117-123.

37 In *Macleay v Tait* [1906] AC 24 the court ruled that the test to be applied in determining whether a person has acted on the faith of the prospectus is to ask the question: "but for the statement in the prospectus would the outcome of the decision to invest be different?"

sued are limited[38] – the issuing company may not be sued; neither may experts and advisers unless they "authorized or caused the issue of the prospectus".[39]

These deficiencies were perhaps the motivation behind the enactment of a new disclosure requirement regime pursuant to s 32B of the SC Act. This provision applies to any proposal submitted to the SC as required under s 32 of the SC Act. Pursuant to s 32(4) of the SC Act, read together with sub-s 2(a) of the same section, no person shall "make available, offer for subscription or purchase, or issue an invitation to subscribe for or purchase securities in Malaysia" unless "the Commission has approved the proposal under this section." By virtue of this provision, a prospectus must first be approved by the SC before its issue.

Section 32B of the SC Act provides criminal sanctions in respect of false or misleading statements and material omissions. The section reads:

(1) Where any statement or information is required to be submitted to the Commission under this Division in relation to or in connection with any proposal submitted pursuant to section 32 -
   (a) an applicant, any of its officers or associates;
   (b) a financial adviser or an expert; or
   (c) any other person
   shall not
   (aa) submit or cause to be submitted any statement or information that is false or misleading;
   (bb) submit or cause to be submitted any statement or information from which there is a material omission; or
   (cc) engage in or aid or abet conduct that he knows to be misleading or deceptive or is likely to mislead or deceive the Commission.

Except for para (cc) which requires the mens rea of "knowledge" of the persons stated in paragraphs (a) to (c), paras (aa) and (bb) impose liability without the need to prove *mens rea*. However, the section goes further to provide a statutory defence by creating an obligation to persons stated in paras (a) to (c) to conduct enquiries to ascertain that the statement and information provided are true and that there is no material omission. Sub-s (2) reads:

(2) It shall be a defence to a prosecution or any proceeding for a contravention of subsection (1) if it is proved that the defendant, after making enquiries as were reasonable in the circumstances, had reasonable grounds to believe, and did until the time of making of the statement or provision of the information or engaging in the conduct, was of the belief that -

38 Section 46(1)(a)-(d).
39 Section 46(1)(d).

(a) the statement or information was true and not misleading;
(b) the omission was not material;
(c) there was no material omission; or
(d) the conduct in question was not misleading or deceptive.

The effect of the above provision is that the issuer of securities and his advisers may escape liability under s 32B, if they can prove that he had conducted reasonable enquiries. The enquiries to be conducted refer to a "due diligence exercise". The SC said:[40]

> The provision of this statutory defence effectively creates an affirmative obligation by the relevant persons to exercise due diligence and to take steps in ensuring the timeliness, sufficiency and accuracy of the disclosure of all documents, statements and information which are to be submitted to the Securities Commission.

The creation of a "disclosure based regulatory framework"[41] adopting a "materiality" test for disclosure of information, together with the statutory defence, places the responsibility on the issuers of securities and its advisers to conduct a proper and thorough investigation or due diligence exercise, "to enable the investor and his professional advisers to evaluate the risks or merits of his investment in the issuer".[42] In effect, the SC now adopts a general and non-prescriptive disclosure obligation, which places the onus on the issuers and its advisers to determine the information which is to be disclosed to investors.[43] It should be noted that under this new disclosure framework based on the test of "materiality", a person may escape liability for non-disclosure, even if he knows that the information is important to the recipient of the information, if a reasonable person would not regard the information as material.[44]

Under the general disclosure obligation as prescribed by the SC, only relevant or material information needs to be disclosed. The focus of the prospectus is now on the needs of the investor, which the issuer, with the assistance of its advisers, must determine.[45] The issuer and its advisers must therefore be sensitive to the changes in the market and investors' sentiments and react to these changes accordingly.

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40 SC, *Due Diligence Practices*, para 7.
41 Ibid at para 9.
42 Ibid at para 10. See also SC Guidelines, para 10.22(1)(c).
43 This new disclosure framework appears to follow the legislation in Australia. There, the Corporations Law has also departed from the previous prescriptive disclosure requirement provided by its predecessor, the Companies Code (the relevant provisions are similar to the Malaysian Companies Act). The Explanatory Memorandum of the Corporations Bill 1988 states, at para 3033: "These provisions were specific and whilst requiring extensive quantities of material to be disclosed did not necessarily ensure that the investors received adequate information about the securities in question." The Memorandum further stated that the Companies Code "did not provide the information that private and professional investors need to make an informed investment decision.": para 3045.
44 See Baxt, Ford & Black, *Securities Industry Law* (4th ed., 1993) at para 423.
45 SC had suggested the formation of a "due diligence working group comprising senior representatives of the issuer, promoters, advisers all persons who are responsible for the preparation of information and documents for submission which would report and advise the board of the issuer": SC, *Due Diligence*, para 23.

Further, the issuer must supply information which will enable investors to evaluate and review corporate performance and compliance with good corporate governance practices through the supply of information.

Curiously, the legislature has not abandoned the prescriptive requirements and the pre-vetting role of the Registrar together with the "reasonable test" adopted by ss 46 and 47 of the Companies Act. Perhaps it is to make use of the best of the two different disclosure requirements. On the other hand, the dual disclosure regimes have certain disadvantages. First, it adds up to the cost and time for issuing securities. Secondly, there may be a case where investors or their professional advisers will not reasonably expect to find in a prospectus certain information, but the drafters of the prospectus will nevertheless have to include them to avoid liability under ss 46 and 47 of the Companies Act. It is not an issue of whether these two different legislations can co-exist, rather of whether there is a need to have two different statutes with two different enforcement authorities and employing two different disclosure requirements and liability tests on the same subject-matter.

Thirdly, the standard of disclosure of information pursuant to the SC Act is not enacted in the SC Act but rather provided by the SC in their booklet,[46] which does not have statutory force. As a comparison, in Australia, the requirement that the prospectus must contain all such information as investors and their professional advisers would reasonably require is provided in the Corporations Law.[47]

Finally, s 32B only imposes criminal liabilities and not civil liabilities. By contrast, s 1022 of the Australian Corporations Law imposes both civil and criminal liabilities.

The Standard of Enquiries

The SC had ruled that "The extent of due diligence required in any given situation is ... a question of fact which would depend upon the circumstances surrounding each particular case."[48] As guidance, the SC had laid out some factors which should be taken into consideration, while awaiting determination by the courts.[49] Nevertheless, the SC encourages market participants to develop a body of due diligence practices.[50]

As the general and non-prescriptive disclosure requirement was adopted from markets such as Australia, Hong Kong and Singapore, professional advisers in

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46 *SC, Due Diligence Practices.*
47 Corporations Law, s 1022.
48 *SC, Due Diligence Practices*, para 16.
49 Ibid at para 18.
50 Ibid at para 21.

Malaysia had been quick to adopt the due diligence practices in these markets.[51] This is the personal experience of the author, who was involved in due diligence exercises for the verification and certification of information contained in prospectus. However, we will have to wait and see whether the courts will approve this method of verification and certification, or set a different standard of due diligence for the local market.

The standard of enquiries and due diligence came under scrutiny in a leading United States' court decision. In *Escott v BarChris Construction Corporation*,[52] BarChris offered US$3.5m subordinate convertible debentures to satisfy their working capital requirements. It was disclosed in the prospectus that the company was in the business of constructing bowling alleys. BarChris later defaulted on its debentures and petitioned for bankruptcy. Upon a class action taken against the defendants, (which includes the issuer, all eight underwriters of the issue, the signatory to the registration statement (including all of BarChris' directors, the independent public accountant and certain officers of BarChris), the court found that the prospectus was false and misleading as:

(a) it was not disclosed that some of the proceeds were to be used to repay BarChrisí debts;

(b) BarChris was also in the business of operating bowling alleys (and not merely constructing them as stated in the prospectus); and

(c) certain financial information was overstated.

The court then evaluated the conduct of the defendants in detail to determine whether they may rely on their due diligence defence.

In respect of the underwriters and its lawyers, it was found that the underwriters did not make an independent investigation of the accuracy of the prospectus. The underwriters' lawyers assigned a very junior associate to read the documents relating to some of BarChris' subsidiaries for the five previous years. Some of the executive committee minutes of meetings were missing. When the lawyers asked about the missing minutes he was told that they had not been written up, were "not significant", or dealt with "routine matters". The court therefore, found that the underwriters had failed in their duty and could not rely on the due diligence defence, as they had neglected to make some reasonable attempt to verify the data submitted to them. Their investigation was also not adequate, as they had failed to read all the minutes and review all the significant contracts. The lawyers should

51 Perhaps taking the "suggestion" of the SC: see SC, *Due Diligence Practices* at para 23 where the SC mentioned the "suggested manner adopted in some jurisdictions".

52 283 F. Supp 643 (1968)(U.S.D.C.).

have insisted that the missing minutes be written up so that they could be reviewed. They also failed to investigate a certain legal dispute involving the company.

As for the directors and officers, the court found that four out of five executive directors were aware of some of the inaccuracies in the prospectus and thus could not rely on the due diligence defence. As for the outside directors, the court looked at their relationship with the company. Two of the outside directors had professional relationships with the company, one being a partner of the company's law firm and the other a partner in the underwriter. Both were involved in the preparation of the registration statement. Therefore the court held that both could not rely on the due diligence defence as they have not exercised reasonable care. With respect to the other two outside directors, the court applied the test of "a prudent man ... in the management of his own property". These directors made no investigation at all. Both had been directors for less than one month before the offering was made. One director had spent about 10 minutes looking through a draft of the registration statement. The other director never saw it. When amendments to the registration statement were required, both signed the amendments without the registration statements attached. Therefore the court found that these two directors had not conducted reasonable investigations, and could not therefore rely on the due diligence defence.

This case sets an example on the standard of investigation required by the issuer, directors and underwriters. First, there must be an independent investigation conducted on the information provided in the prospectus. Secondly, what may be considered a "reasonable" investigation varies, depending on their state of knowledge. The standard required of a managing director must therefore be a much higher one than one would expect from an outside director. Even the relationship between the outside director and the company may be a relevant factor in determining whether such outside director may be entitled to rely on the statutory defence.

It shall be interesting to see whether these principles will be adopted to set the standard enquiries and due diligence locally. The author submits that the judgment meets the standard of care expected by market participants; and is perhaps also consistent with the expectation of the legislature and SC.[53]

Who Should Be Protected by the Prospectus Requirements?

The United States' Securities and Exchange Commission (SEC) require that prospectuses be completely informative both to the unsophisticated investor and to

53 See SC, *Due Diligence Practices*, at para 11 where the SC said that the disclosure based regulatory framework imposes a "Heavier and higher standards of responsibilities and accountability ... on the issuers and their directors, promoters, advisers, and other persons involved in a proposal to provide the investor and his professional advisers with timely, sufficient and accurante disclosure of all material information".

the knowledgeable student of finance.[54] This requires the drafter of a prospectus to take into account basic information required by ordinary investors and large institutional investors. The Wheat Report suggested that a pragmatic approach needs to be struck between sophisticated and unsophisticated investors.

The SEC's view has been criticised, for it requires the drafting of the prospectus to be "all things to all men".[55] Kripke suggests that the theory that prospectuses can be used by lay investors is a myth.[56] He argues that modern accounting rules which form the basis of prospectuses have become so complex that it takes a person trained in modern financial accounting to begin to understand these accounts.[57] Therefore disclosure should be directed to sophisticated investors who is able to understand it.

On the other hand, it may also be argued that sophisticated investors do not need the protection afforded by the disclosure requirements as they have enough resources to determine the merits and risks associated with any particular securities. Therefore the prospectus should be directed to the less sophisticated investors.

SC allows some flexibility to issuers and its' advisers to take into account certain considerations, by providing that:[58]

> In determining what information is required, regard shall be had to-
> (a) the types and characteristics of the securities and issuer of the securities; and
> (b) the types and characteristics of the persons likely to be the potential investors.

The above provision may be useful in the case of specialty securities such as those which will be listed in MESDAQ. As start up companies without a track record of profitability and high risk venture may be allowed to list their securities in this exchange, the risk taken by the investors is greater. But so are the returns, if the venture proves to be successful. Therefore, these securities will perhaps appeal only to certain sophisticated or professional investors, who may require different types of information from that which may be required by other types of investors.

Apart from the flexibility in allowing consideration to be taken on the type of securities, the issuers and the potential investors, there should be an exemption for issues to institutional investors and other big issues, as found in the legislation in

54 United States' Securities and Exchange Committee, *Disclosure to Investors: A Reappraisal of Federal Administrative Policies Under the '33 and '34 Acts* (1969) ("Wheat Report").

55 Marsh, "New Approaches to Disclosure in Registered Securities Offerings - A Panel Discussion" (1973) 28 Bus Law 505 at 527.

56 H Kripke, "The Myth of the Informed Layman" (1973) 28 Bus Law 631.

57 H Kripke, "The SEC, The Accountants, Some Myths and Some Realities" 45 NYULRev 1151 at 1169.

58 SC Guidelines, para 10.22.

Singapore and Australia.[59] Acknowledging the differences in concept between the regime in Malaysia and those of Singapore and Australia,[60] it will do no harm if issuers are given assurance that such issues will not be considered "offers to the public". Further, a public offer which requires a substantial amount of minimum subscription may also warrant an exemption.

There should also be a case for allowing the issuer to take into consideration the fact that certain matters are public knowledge. There may also be cases where certain information, while it cannot be said to be "public knowledge", is generally known to sophisticated investors and professional advisers.[61] Further, certain information may be required by the stock exchange, registrar of companies, SC or other regulatory body. Providing this information in prospectuses will be an unnecessary burden, as it will not achieve the desired effect to contribute to the existing wealth of information in the market. This information should, however, be deemed to be prospectus information, to enable investors and the authorities to rely on the SC's disclosure requirement as well as ss 46 and 47 of the Companies Act.[62]

Conclusion

Mandatory disclosure of information is an indispensable rule in the securities market. The arguments for mandating disclosure are overwhelming, despite the voices of dissent and the concerns that the costs of issuing securities which may be prohibitive to small issuers with relatively small issues.[63] Malaysia has willingly embraced this regime of disclosure. The question asked here was not whether or not the philosophy behind the mandatory disclosure regime is appropriate for our market (not to say that this issue is not relevant), but rather we have adequately addressed the ever changing corporate landscape and investors' expectations.

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59 See the Companies Act of Singapore, s 106D and the Australians Corporations Law, s 66(3)(a) which provides an exclusion in relation to sophisticated investors, as described in these provisions. This exemption is indicative of the view of the legislature that large institutional shareholders are able to take care of themselves and do not need protection afforded by the prospectus. But see the comments by RP Austin, "The Fundraising Provisions of the Proposed Corporations Legislation" (1989) No 7 *Butterworths Company Law Bulletin* 77 at 92; and John Azzi, "Disclosure in Prospectus" (1991) 9 CSLJ 205 at 219.

60 Where the "offer to the public concept" has been abandoned. See discussion above under the sub-topic "The concept of 'offer to the public'".

61 See Golding and Bancroft, "Secondary Sale of Prospectuses: What Do I Disclose When I Know Nothing?" [1993] BCBC, para 427.

62 See Ian Ramsay, "Incorporation by Reference into Prospectuses: What are the Rationales?" (1994) 12 CSLJ 310.

63 For example, Easterbrook and Fischel argued that the general disclosure requirements possess much of the characteristics of interest group legislation, which give larger issuers an edge as many of the costs of disclosure are the same regardless of the size of the issuer or the offering: see Easterbrook and Fischel, "Mandatory Disclosure and the Protection of Investors" (1984) 70 Vir LR 669 at 671.