While open-price share offerings are common in other parts of the world, uncertainties over some sections of the Corporations Law have made Australian issuers wary of the concept. Andrew Lumsden compares the benefits of open pricing with the limitations of fixed-price offerings and highlights the difficulties presented by Australia’s rigid prospectus provisions.

The desire of many vendors and issuers of securities to maximise returns and to minimise the effect of the vagaries of the market has drawn them to look for greater flexibility in pricing when selling securities in large-scale offerings. Although unrestricted open pricing is a relatively recent phenomenon in Australia — to date only the Commonwealth of Australia has sold securities this way — a number of variations on the theme have been adopted (see Table 1).

Many investment advisers believe that fixed pricing is less efficient than open pricing and carries with it the substantial risk of under-pricing the issuer or vendor’s securities. The open-price method has been used for many years in the United States and is probably the most common method in the world for selling equity securities.

Open pricing
In the usual method adopted overseas for open pricing, the issuer, in consultation with the broker or underwriter, establishes an indicative price range for the securities as a basis for marketing the issue. The indicative price range is based on features including the underwriter’s assessment of valuation and market conditions, the marketability of the issue and the issuer’s desire to be able to return to the market to dispose of further securities. The indicative range is incorporated in the prospectus but is not binding, other than as a statement of the underwriter’s and issuer’s belief about the market’s likely valuation of the securities at the time of issue of the prospectus.

The prospectus (including the indicative range of final pricing for the issue) is used to gauge the market for the securities. The underwriter receives non-binding indications of interest from institutions and significant retail clients to purchase amounts of the securities at a specific price. These indications enable the underwriter or broker to build a “book” of orders. On the basis of the book the

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issuer and the underwriter agree on a final price for the securities. At closing, in the United States open-pricing style of underwriting, the underwriter then purchases the securities at the agreed final price and accepts firm orders for their sale to the investors (this technique is unlikely to find favour in Australia while such transactions potentially attract stamp duty — although arguably they may not if the underwriter is acting only as an agent).

The open-pricing method was used successfully in the float of New Zealand’s Telecom Corporation. In that case, the strength of interest in the offering meant that not only was the price set at $NZ2.00 (the upper end of the $1.80 to $2.00 range) but the size of the offering was increased by 50 per cent.

In the United Kingdom, a variation of the US-style open-price method has been popular. The UK practice included a minimum price in the prospectus and applicants were invited to tender at or above that price. The issuer and the underwriter struck a final issue price, based on the tenders, that would allow the issue to be subscribed in full. Those who tendered at or above the strike price subscribed at the strike price; those who tendered below the strike price had their applications rejected.

In Australia, open-priced offers have come in a number of different formats. The case that most closely resembled the US model, while complying with the Australian Securities Commission’s interpretation of the Corporations Law, was Amway Asia Pacific Ltd. In that case the issuer adapted a US offer by incorporating an indicative price range but leaving the final price open and allowing investors the opportunity to “opt out” if the final price was greater than the $US equivalent of the upper indicative value.

Corporations Law requirements

The thrust of the offering requirements of the Corporations Law is to move away from narrow prescriptive requirements towards general statements. The general intention of the Corporations Law is that the primary and secondary securities markets should be adequately informed. The absence of a final price in an offer of securities offends neither the spirit nor the letter of the Corporations Law prospectus requirements.

Section 1022

Section 1022 states, in general terms, the information that should be disclosed in a prospectus issuing or selling securities (for prescribed interests, see Reg. 7.12.12). The Corporations Law requires a prospectus to include all information that investors and their professional advisers would reasonably require and expect to find in the prospectus for the purpose of making an informed assessment of:

- the assets and liabilities, financial position, profits and losses and prospects of the corporation; and
- the rights attaching to the securities.

None of the prospectus content requirements of the Corporations Law, for example sections 1021 or 1022(3), specifically addresses the issue of the price of the securities being offered. The explanatory memorandum to the Corporations Bill 1988 does not suggest the objective of s1022 in terms which address the issue of price.

The “sale” price of a security is not relevant to an investor making an informed assessment of the rights, powers and privileges attaching to the security. Those rights are best defined as elements of a security that are legally enforceable by one person against another (usually the issuer). The powers and privileges include such things as voting rights, restrictions on the number of members, capacity to be a member, entitlement to certificates, cessation of membership, restrictions on the voluntary transfer of shares, procedure to transfer shares — all these elements are inherent in the security. The price of a security (other than its par value) is an incidence of these powers and privileges rather than an inherent feature of them.

What of the assets and liabilities, financial position, profits and losses and prospects of the corporation? Is the price of a security required or expected to enable a prospective investor to assess these matters? There must be a strong case for a “no” answer.

Some argue that to enable an investor to make an informed assessment of the assets and liabilities of an issuer, it is necessary to provide the investor with a pro-forma balance sheet giving effect to the offering and the application of the net proceeds of the offering. This would not hold true for a secondary prospectus, where the financial position of the vendor (as distinct from the issuer) would clearly not be relevant for the purpose of s1022.

The Corporations Law contemplates flexibility in balance-sheet items relevant to the issue price. Section 1028 expressly reserves the right of a corporation, when issuing de-

<table>
<thead>
<tr>
<th>Corporation</th>
<th>Issuer/vendor</th>
<th>Method adopted</th>
<th>Stated price range</th>
<th>Final price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Amway Asia Pacific Ltd</td>
<td>Amway Asia Pacific Ltd</td>
<td>Investors invited to opt in for open pricing or limit their investment opportunity to fixed maximum price</td>
<td>Indicative range of US$16 to US$18.</td>
<td>US$18.00</td>
</tr>
<tr>
<td>Commonwealth Bank of Australia</td>
<td>Commonwealth Bank of Australia</td>
<td>Open pricing with • non-retail applicants invited to submit irrevocable bids and • $0.25 discount on retail offers</td>
<td>None provided. A chart showing the share price history since listing (Sept 91) was included</td>
<td>$9.60 for non-retail investors</td>
</tr>
<tr>
<td>Woolworths Limited</td>
<td>The Adelaide Steamship Company Limited</td>
<td>Open pricing within a stated fixed range (&quot;constrained open pricing&quot;)</td>
<td>$2.15 to $2.45</td>
<td>$2.45</td>
</tr>
<tr>
<td>GIO Australia Holdings Limited</td>
<td>State of New South Wales</td>
<td>Constrained open pricing</td>
<td>$2.10 to $2.40</td>
<td>$2.40</td>
</tr>
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Table 1: Alternatives to fixed-price offers
bentures, to accept over-subscriptions provided certain requirements are satisfied. In particular, s1028(2) prohibits references in a debenture prospectus to the net asset backing for the issue except where the calculation assumes acceptance of all over-subscriptions. The recent Lion Nathan prospectus (dated 30 June 1993) offered $60 million worth of securities with the right to accept over-applications up to an additional $100 million.

It is also common for a prospectus to enable an issuer to accept subscriptions for less than the total of the securities being offered. Presumably it is accepted in these cases that the prospectus does not offend s1022.

If the pro-forma balance sheet in a prospectus included a reasonably based assumed public offering price (on the basis that such financial information was expected by investors) then it must be possible to argue that the issuer had satisfied its obligations under s1022. No doubt the issuer would need to undertake a sensitivity analysis to ensure that there was no price at which there was a material adverse influence on the issuer. Such an adverse result would need to be properly disclosed to avoid liability under s996.

Section 996

The overlap between s996 and s1022 is unclear. Section 996 prohibits an issuer from issuing a prospectus in which there is a material statement that is false or misleading or from which there is a material omission. It is difficult to see how s996 could have been drafted to cast a wider net than s1022. Clearly, if s1022 is intended to be the general statement of what ought to be contained in every prospectus, it ought to be the paramount provision; yet s1022 does not require that a prospectus includes the terms of the offer. Only if a very narrow interpretation of s996 is not adopted (that is, that s1022 is determinative of the matters to be included in a prospectus), must s996 require the issuer of securities to include the terms of an offer.

On the assumption that a narrow construction of s996 is the better view, the question is whether the final price of securities is a material omission within the meaning of s996. For the reasons referred to, there must be a strong argument that the final price of securities is not a material omission.

It is common for the issuer to undertake some scaling-back of large offerings. This fact supports the view that it is not necessary for investors to know with absolute certainty every detail of their proposed investment. The Corporations Law instead focuses on ensuring that investors are properly informed in the offer document of how such matters as entitlement or the final price will be determined.

In addition to the obligations under s996, if indicative prices were to be included in Australian prospectuses issuers would need to be careful that their information about the pricing of the offer was not misleading or deceptive, and so in breach of s996.

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Section 1024

If a prospectus is issued without a fixed price, is the issuer required to lodge a supplemental prospectus that, for example, updates information in the prospectus prepared on the basis of the assumed offer price? Section 1024 requires that the person who lodges a prospectus must lodge a supplemental prospectus containing particulars of any change or a new matter where there has been a significant change affecting any matter contained in the prospectus, the inclusion of which would have been required by the Corporations Law. Section 1024 is wider than s1022 and the supplemental prospectus obligations are not limited to s1022 items but to "any matter contained in the prospectus".

It is interesting that in its public hearing paper about underwriting practices (Policy Hearing 52, at paras. 86-93) the ASC discussed the nature of shortfalls and whether information about a possible shortfall was in the categories contained in s1022. In the ASC's view, the shortfall was "a matter which can only be determined at the close of the issue or sale" and that therefore the legislative intent of s1024 did not appear to extend to disclosure of a shortfall. Would a similar view hold about open pricing — that is, because the price of the securities was only determined at the close of the issue or sale, would it have to be included in a supplemental prospectus?

In the United States it is common practice for prospectuses to be distributed with pro-forma balance sheets prepared to give effect to the offering (at an assumed initial public offering price) and the application of the estimated net proceeds of the offering. The prospectus is updated after establishment of the final price to give effect to the final amount raised, and then circulated to any purchaser of the securities.

Unfortunately neither the current legislation nor the proposed amendments to s1024 would envisage a US-type approach. The current legislation contains no recirculation obligations, although in practice issuers often recirculate supplemental prospectuses to investors (often allowing them to revoke their earlier applications). If open-price offers were to become a feature of Australian practice it would be hoped that issuers would recirculate the prospectus with accounts and other information based on the final price (if the final price were other than the assumed price).

Under the proposed amendments to s1024 (s1024B to s1024E), if a supplemental prospectus is required then the applicant must be given the option to either withdraw its appli-
cation or return the securities and be refunded the application moneys on the basis that there has been a material adverse change affecting the value of the securities. This would almost certainly mean that intending open-price issuers and vendors must prepare the prospectus on the basis of the lowest acceptable price or contemplate investors returning the securities.

Although the provisions of the Corporations Law seem to support the view that the legislation did not intend that issuers and vendors should be obliged to include price in prospectuses, the question remains: should they?

Internationalisation of securities

The Corporations Law should be interpreted in a way that allows issuers and investors maximum flexibility. The ASC has indicated, in Policy Statement 72, that it favours the application of the Corporations Law in ways that promote the internationalisation of the securities market.

While public offerings in Australia have traditionally been on a fixed-price basis, there is no necessity for that practice to continue. The interpretation of the Corporations Law adopted in the Amway Asia Pacific issue appears to allow Australian investors to participate in and Australian issuers to make offers of securities using open-price prospectuses, a form familiar in many jurisdictions.

Unfortunately, in the absence of any definitive statement from the ASC or the courts, issuers will be reluctant to utilise "pure" open-price offers because of a concern that the ASC could issue a stop order (on the basis that the failure to include the price of securities constitutes a material omission). It remains to be seen whether this uncertainty will result in Australian investors being excluded from global offerings, or in Australian issuers and vendors preferring to offer their securities offshore.

Market efficiency

Open pricing assesses market demand at the end of the offer period. There have been many instances where the length of time between the offer date and the close date has meant that a fixed-price issuer has lost value. For example, in the initial Commonwealth Bank float the offer was priced before all expressions of interest had been received from institutional investors and, perhaps more important, well before a significant drop in interest rates and a subsequent rise in the sharemarket.

While the ASC has permitted the circulation of pathfinders before the lodgment of a prospectus (ASC Policy Statement 8) the use of pathfinder prospectuses is not an answer to the marketing and timing problems of a fixed-price prospectus. First, the only people who may be issued pathfinders are prospective underwriters, sub-underwriters, brokers or professional investors. This means that the issuer's pre-marketing activity is essentially limited to institutions unless the market research class relief is used (see Policy Statement 54). Second, there will commonly be a period of some months between circulation of a pathfinder and the close of an offer.

The fixed-price method increases the possibility of significant post-offering price fluctuations, encouraging the "stags" to participate.

Maximisation of proceeds

Many investment houses believe that open pricing provides a more accurate reflection of the likely market price, as well as maximising the proceeds to the issuer or vendor. In the fixed-price offering method, the issuer or vendor sacrifices flexibility and risks loss of value in a rising market. The issue price is fixed with only minimal exposure to the market demand, depending on the level of pre-marketing undertaken by or on behalf of the issuer or vendor.

Since the underwriters shoulder real risk throughout the offer period, they are likely to be conservative in their pricing of the securities, reducing the potential maximum proceeds. An open-price offer gives less scope for the underwriter to limit the price by overpricing the underwriting risk.

Underwriters will need to rethink the form of their existing underwriting commitments. One suggestion is for underwriters to underwrite a minimum price for the securities. Underwriting a price allows issuers and vendors some comfort in a falling market while allowing them to maximise the proceeds of the offering in a rising market.

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