SOLOMON BROTHERS

Barristers, Solicitors, Attorneys
Level 40, Exchange Plaza
2 The Esplanade, Perth, Western Australia 6000
PO Box Z5360, St George's Terrace, Perth 6831
DX 82, Perth Email: mailroom@solbros.com.au
Telephone: (08) 9282 5888 Facsimile: (08) 9282 5855

Our Ref: DHS
Enquiries: Doug Solomon
Email: dsolomon@solbros.com.au
Telephone: 9282 5805

10 July 2004

Ms Denise Brailey
Real Estate Consumer Association Inc

By email: denise@reca.com.au
Confirmation by facsimile: 02 9626 1576

Dear Denise

SPRUIKERS & THE CORPORATIONS ACT 2001

As requested, I set out below, in summary, my advice with respect to whether spruikers, such as Mr Henry Kaye and his associated companies and other similar operators, were, and are, properly regulated by the *Corporations Act 2001* and related legislation.

A. BACKGROUND

1. I note your instructions, in summary, with respect to activities of spruikers including:-

   1.1 Advertisements were published for training courses, at times offering free tickets to promotional seminars (said to be worth $75.00), the training courses said to enable people to learn how to earn $9,000 per month. At times, victims were spruicked by being directly contacted in public places such as railway stations and shopping centres. A range of other promotional statements and promises were made to have people attend an initial seminar at which they were pressed to sign up for an expensive training course. Brochures were provided at seminars that advised people that they would be trained to learn the secrets with respect to investing, and promising them a money-back guarantee if they were not satisfied. The victims were also offered finance for the courses, and promised that they would earn $30,000 in the first six months which would enable them to pay off the cost of the course.

   1.2 Many of the victims who attended courses did not complete them. They realised during the first few days that it was not what it was made out to be. However, they did not get their money back despite money back guarantees.

1.3 Some who proceeded to make investments as a result of what was provided at the training courses went into mezzanine mortgage lending, having been advised that this type of high-risk second and subsequent mortgage lending was actually as safe as first mortgage lending.

1.4 Other people who attended courses were encouraged to buy multiple properties, using the equity in their houses to secure deposit bonds, with the result that they did not actually pay the cash deposit out of cash reserves but raised a bond for it. In so doing, they were anticipating selling the property before settlement at a profit and never having to meet the purchase price either. This was a strategy by which many properties could be acquired by an investor with minimal risk.

B. APPLICABLE CORPORATIONS ACT 2001 PROVISIONS

2. Chapter 7 of the Act is very definition-driven. At times, this goes to three levels – a defined term incorporating another defined term which incorporates a third defined term. I will not, in this letter, set out all of the various provisions of the Act, and access to the Act is necessary to follow the summary below.

3. There is more than one type of "facility" as defined in s.762C involved in spruickers' activities. This is because all of the following are involved:

3.1 <u>"facility" definition para (a)</u>

Intangible property (para (a)) of the definition of "facility" in the form of know-how and special methods of investment without cash outlay or risk, which is represented as available to be acquired – ie "made available" (s.761E(2)) – to a person who attends a course; and

3.2 <u>"facility" definition para (b)</u>

The "arrangement" (which is broadly defined in s.761A) by which a person agrees to attend a course to acquire that intangible property; and

3.3 <u>"facility" definition para (c)</u>

The combination of the intangible property and the arrangement for a person attending a course to acquire that intangible property.

4. In considering whether there is a "financial product" involved, because s.763A(1) uses the word "facility", each of the three types of facility referred to in para 3 above must be considered.

5. It is important in considering the types of facility that the definition of "financial product" in s.763A(1) provides that a "financial product" ***<u>is</u>*** a facility "through which, or through the acquisition of which, a person does one or more of the following …". For the type of facility referred to in para 3.1 above, it is the actual acquisition of the facility (the intangible property itself) – which is a facility "through the acquisition of which" which is applicable. For the type of facility referred to in paras 3.2 and 3.3 above, it is "through" the facility – "a facility through which" – which is applicable.

6. The definition of "financial product" in s.763A(1) is that it ***is*** a facility through which, or through the acquisition of which, a person, relevantly to this advice, either makes a financial investment (defined in s.763B) or manages financial risk (defined in s.763C). Once it is established there is a facility of that type, there is, ipso facto, a financial product – nothing more needs to be established.

7. The type of facility referred to in para 3.1 above (intangible property) is a facility ***through the acquisition of which*** a person attending a training course manages financial risk within s.763C in a number of ways, including:-

   7.1 through learning how to use deposit bonds (and managing the consequences of a deposit being payable when the investor does not have available funds to pay it);

   7.2 through learning how to re-sell strata properties bought off the plan before settlement (and managing the consequences of being required to complete a purchase when unable to do so); and

   7.3 through learning how to avoid risk of loss through a borrower's default by investing in mezzanine mortgage lending.

8. The facilities referred to in para 3.2 and 3.3 above (the arrangement to attend the training courses, and that arrangement combined with the intangible property) are facilities ***through which*** a person who arranges to attend a course manages financial risk in the same way as referred to in para 7 above. ***Through*** the ***arrangement*** by which they attend the training course, the person attends the training course and acquires the knowledge of the matters referred to in paras 7.1-7.3 above.

9. Each person who "issues" a financial product "deals" in it: s.766C(1)(b). The term "issue" includes making a financial product "available to a person": s.761E(2). A person who deals in a financial product provides a "financial service": s.766A(1)(b). That activity is carrying on a "financial services business" (defined in s.761A if the test in Division 3 of Part 1.2, other than s.21(3)(e), applies: s.761C. Ss.19 and 20 show that a business is carried on, although the business is part of another business, or carried on in conjunction with another business, and whether carried on by a person alone or together with another or others. Accordingly, each person whose business included offering these financial products, whether alone or with others, and whether as a separate and discrete business or as part of in conjunction with another business, carries on a financial services business and, unless exempted, must be licensed: s.911A.

10. Those who recommend that people should acquire financial products – ie those who recommend either acquiring the intangible property referred to in para 3.1 above or who recommend acquiring an arrangement to attend a training course referred to in paras 3.2 and 3.3 – offer financial product advice (as defined in s.766B).

11. Those who engage in conduct on behalf of a corporation bind the corporation, so long as the conduct is engaged in with express or implied consent or agreement of a director, employee or agent of the company acting within the scope of their actual or apparent authority: s.769B(1). In addition, licensees are generally responsible for the conduct of their representatives: s.917B.

12. Those licensed to provide financial services as required by s.911A must do all things necessary "to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly" (s.912A(1)(a)) and otherwise in accord with financial services law (as defined in s.761A): s.912A(1)(c). Accordingly, those carrying on a financial services business – see para 9 above – who are required to be licensed would (if licensed as required by law) be subject to the obligations in s.912A(1), and would have to have arrangements approved by ASIC to provide compensation to retail clients suffering loss through breach of those obligations: s.912B.

13. Given the reported level of complaints to ASIC about spruickers concerning conduct referred to in para 1 above, it appears most unlikely any could have been granted a licence required by s.911A had they applied. This is because ASIC is prohibited by s.913B(1) from granting a licence if it has reason to believe the applicant for a licence will not comply with s.912A if a licence is granted. ASIC therefore was obliged to:-

    13.1 require each person carrying on a financial services business (see para 9 above) in respect of the financial products issued by spruickers (intangible property and training courses) to cease carrying on that business unless licensed as required by s.911A; and

    13.2 not grant a licence to a person if it had reason to believe the person would not, as required by s.912A(1), if a licence were issued to them, provide the financial services efficiently, honestly and fairly and in accordance with all other financial services law.

14. Accordingly, it appears that ASIC should have put the spruickers out of business – they were not licensed, and (because of the conduct referred to in para 1 above) not fit to be licensed.

C. REMEDIES

15. Because the definitions of "financial product" and "financial service" in Chapter 7 of the *Corporations Act 2001* are adopted, indeed broadened, in s.5 of the *Australian Securities and Investments Commission Act 2001* ("ASIC Act"), all of the prohibitions and remedies providing consumer protection in the form of compensation and other relief in relation to financial services in Part 2 of the ASIC Act – eg unconscionable conduct, misleading or deceptive conduct etc – are, and have been, applicable and enforceable with respect to issuers, and other persons involved, in the issue of the financial products issued by spruikers. The relevant conduct of corporate spruikers is also caught by s.1041H of the *Corporations Act*, and those party to contraventions of s.1041H liable under s.79. There is a right to compensation under the ASIC Act whether or not the issuer of the financial product was licensed.

16. It is important in considering the consumer protection provisions in Part 2 of the ASIC Act to note the broader definition of "financial product" in s.12BAA(2) of the ASIC Act. So long as the facility is of a kind through which people commonly manage financial risks, that facility is a financial product for the purposes of the consumer protection provisions "even if the facility is acquired by a particular person for some other purpose". Hence, a consumer claiming losses need not prove they acquired the facility (see paras 3-8 above) for the purpose of minimising risk, so long as people commonly did so.

17. Another important broadening in the ASIC Act is in s.12BAB(8), which provides that a person who arranges for another to deal in a financial product (see para 9 above) also deals in that product, unless the actions concerned were providing financial product advice (for which the person would be separately liable). This broadens the range of persons against whom compensation may be claimed.

18. Accordingly, not only did ASIC have the power to put the spruikers out of business (paras 9-14 above), there are strong consumer protection provisions in the ASIC Act which are for the benefit of consumers. ASIC is empowered to pursue claims by Court action to recover compensation for the benefit of victims who consent to ASIC doing so: s.12GM(2) and (3) of the ASIC Act. As the limitation period is six years (s.12GM(5)), most of the many victims you are representing would still benefit if ASIC pursued recovery of losses for them from any person who committed or was involved in contraventions. It should also be noted that the Court must give priority to ordering compensation to victims, rather than imposing fines: s.12GCA ASIC Act. Given that one of ASIC's objects is "promoting the protection of consumer interests" (s.12A(3)(b) of ASIC Act), it has every reason to seek compensation for victims of spruikers and, if ASIC refuses to do so, the Minister could be pressed to direct ASIC to give priority to doing so (s.12(1) of ASIC Act).

Please let me know if you wish me to expand upon or clarify any of the matters in the above advice.

Yours faithfully

Doug Solomon

Permission by DB