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*Robert L. Knauss**

I. INTRODUCTION

The most important securities market outside the United States is that of the United Kingdom. In both countries, the securities markets play a similar role and provide a viable method for the formation of capital. There are, however, a number of fundamental as well as practical differences in the methods by which the two countries have chosen to regulate their securities markets. This article will examine the current method and extent of securities regulation[1] in the United Kingdom. In order to highlight certain aspects of the regulatory pattern and to make the system more comprehensible to American attorneys, this inquiry will require numerous comparisons with the more familiar practices of the United States. Although any description which includes such comparisons necessarily involves certain value judgments, criticism as such is not intended.

There are three aspects of the regulatory pattern that are fundamental to an understanding of securities regulation in the United Kingdom—particularly in making any meaningful comparison to securities regulation in the United States. The first involves the statutory framework of securities regulation. In the United Kingdom, as in most European countries, there is not so sharp a distinction between corporation law and securities regulation as there is in the United States. The Companies Act of 1948 contains regulations of the type one would expect to see in a state corporation statute, as well as restrictions on the public offer of securities.[2] On the other hand, an

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Research support was provided by the American Society of International Law and the University of Michigan Law School. Much of the research is based on personal interviews conducted in 1968 and 1970. Regulatory changes occur rapidly in both the United Kingdom and the United States, but the general pattern remains as described.

1. Throughout this study the term "regulation" is used in the broad sense to include not only statutory requirements, but also non-official sources of regulation such as that accomplished by the London Stock Exchange and the financial press.

2. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, *as amended*, Companies Act of 1967, c. 81. Sections 1-5 provide for the method of incorporating the

important element of securities law, licensing of securities brokers and antifraud provisions, are found in a separate statute, the Prevention of Fraud Act.[3] Because of this integration of securities matters with other business concerns, the term "securities regulation" is not used in Great Britain. Problems such as those discussed in this article normally would not be separated from questions involving dividend restrictions, liquidation preferences or other regulatory aspects of corporation law.

A corollary to the difference in statutory framework is the dearth of printed regulations, administrative rulings and cases in English securities law. For example, the Companies and Insurance Department of the Board of Trade, the regulatory agency of the government in securities matters, has published few regulations and practically no forms or releases in the last twenty years.[4] This lack of printed material can be refreshing to the American attorney, but it may also lead to frustration by placing a premium on personal contacts and experience with unwritten procedure. The paucity of case law is attributable at least in part to a philosophy of a less active regulatory body. Although the Board of Trade has supervisory and rule-making authority, it views its role as being primarily administrative—a "watchdog and not a bloodhound."[5] Accordingly, the Board has instituted formal proceedings under the Companies Act only when evidence of a violation has been thrust upon it. Furthermore, while it is possible for individuals to bring private actions for violations under the Companies Act, there have been virtually no civil suits involving registration and prospectus requirements, and only a handful of private actions in the whole area of director frauds. Similarly, the concept of the derivative suit by a shareholder is not widely known,

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company in a manner paralleling most American state incorporation statutes. Sections 37-46 deal with the contents of the prospectus and liability for misstatements therein, paralleling requirements of the United States Securities Act of 1933.

3. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45. Sections 1-9 provide for the licensing of securities dealers. Sections 13 and 14 contain broad prohibitions against fraud in securities transactions.

4. The limited rules which have been promulgated include STAT. INSTR. 1960, No. 1216 for rules restricting a dealer's acquiring and disposing of securities. THE RULES AND REGULATIONS OF THE LONDON STOCK EXCHANGE [hereinafter cited as STOCK EXCHANGE RULES with reference to enumerated rule] provide disclosure requirements for companies and regulation of members. *See also* The Protection of Depositors Act of 1963, c. 16, § 1 (prohibition against fraudulent inducement to invest funds on deposit).

5. *See* THE REPORT OF THE COMPANY LAW COMMITTEE, §§ 11, 12, at 226-27 (1967) (discussion of the policy behind and the adequacy of the present regulatory scheme) [hereinafter cited as the JENKINS REPORT].

and there appears to be a reluctance on the part of the individual investor to initiate such an action.[6]

The second basic aspect of securities regulation in the United Kingdom is the dominant position of the London Stock Exchange. Since there is no over-the-counter market in England as it is known in the United States, there are few large issues of securities, other than by "private companies," that do not obtain a quotation on the London Exchange.[7] Moreover, a London Exchange quotation is usually obtained for a securities issue at the time of distribution.[8] As a practical matter, therefore, the London Exchange is in a position to scrutinize virtually every public offering.[9] Although the Exchange has printed requirements for listing, it rarely publishes accounts of its rulings or enforcement activities beyond an annual report and statistical summaries. Again, a premium is placed on knowledge of unwritten practice.

The third factor, which is critical to any comparison between securities regulation in the United States and Great Britain, is the relative lack of marketing of securities in England. The customer's account representative is unknown in the London market, and there are virtually no branch offices of the major brokerage firms.[10] A large

6. *See* R. PENNINGTON, COMPANY LAW 537 (1967). The absence of contingent fee arrangements in Great Britain may be another factor in limiting the use of the derivative suit.

7. As of 1962, there existed twenty stock exchanges in the United Kingdom, in addition to the London Exchange, recognized by the Board of Trade. Five of these, in addition to the London Exchange, are prescribed by the Board of Trade under the Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 39, which gives power to the Board of Trade to grant certificates of exemption. The membership in the remaining fifteen exchanges is small, ranging from one to seventeen firms, and from one to thirty-nine individual members. JENKINS REPORT, *supra* note 5, at § 256.

8. "Issues for which a stock exchange quotation are not sought are in practice rare, and apart from issues of loan capital are relatively unimportant in amount. . . ." JENKINS REPORT, *supra* note 5, at § 222.

9. The 21 British stock exchanges, together with the Dublin and Cork Exchanges in the Irish Republic, are linked together in the Federation of Stock Exchanges which was created in July, 1965, to coordinate regulation through uniform rules. Individual brokers in the smaller cities are similarly bound together by the common rules and regulations of the Provincial Brokers' Stock Exchange.

10. STOCK EXCHANGE RULE 57 (e) authorizes brokers' firms to establish overseas branch offices, subject to specified conditions. In December, 1967, STOCK EXCHANGE RULE 57 (g) was added in order to permit the overseas branch offices of British brokerage firms to hold memberships in overseas stock exchanges.

London brokerage firm with twenty partners may have only six non-partners who deal with individual customers.[11] The rules of the London Stock Exchange expressly prohibit a broker from advertising and from contacting an individual who is not already his client.[12] This restriction on marketing and selling efforts is even more basic than the Stock Exchange regulations would indicate, for brokerage houses as a matter of traditional practice do not attempt to attract the small investor. Even with respect to the large investor or institution, the typical London broker makes little selling effort compared with the practice in the United States.[13] In this regard, it is indicative that individual British stockbrokers, in contrast to their American counterparts, usually are not compensated within their firm on a commission basis. Instead, members and employees of the London firms are generally paid a salary or receive a share of profits that has neither direct nor indirect relationship to the volume of sales and trading.

Different investor attitudes are attributable to this difference in selling practices. Until relatively recently, for example, British investors and brokers were principally concerned with the income and current yield of a security and not its potential for capital gain, which is given far greater interest by the American investor. Accordingly, stock brokers do not continually contact their clients with recommendations for switching from one investment to another, as is often the case in the United States.

With these fundamental aspects of the regulatory pattern of English securities law established, it remains to examine the law in greater detail. The following inquiry will focus on the initial issuance of securities in the United Kingdom. Much of the analysis will be spent on a close scrutiny of the relative roles of the Companies Act of 1948 and the London Stock Exchange in regulating this phase of the British securities market.

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11. Companies Act of 1967, c. 81, § 120 (1) (c) (removed the limit of twenty previously imposed on brokerage partnerships by the Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 434).

12. STOCK EXCHANGE RULE 78 (1).

13. The Stock Exchange itself does some advertising and supplies inquiries with lists of brokers willing to take on new customers. Members of brokerage firms are increasingly active in contacts with institutional investors, and some brokerage firms have full time research analysts. However, the attitude among most brokers has been that "an individual with less than £1000 to invest is more trouble than he is worth."

II. Regulation of the Initial Issuance of Securities

A. *The Distribution of Security Issues*

1. *The New Issue Market.*—Companies in the United Kingdom raise almost all of their externally generated long-term capital through securities issues.[14] On March 29, 1968, the London Exchange had 9,431 securities issues quoted. These listings included securities issued by 3,673 companies registered and managed within Great Britain as well as those of the British Government, various local government authorities, foreign governments and foreign corporations.[15] During the year ending on the same date, the Exchange granted new quotations for 1,351 securities issues. Included in these new quotations were the securities of 106 companies that were previously unquoted.[16] Of these new quotations, 26 involved an offer for sale or a prospectus offering for new equity shares.[17] In 1967, companies quoted on the London Stock Exchange raised a total of 452.1 million pounds, representing 81.4 million pounds through the issue of ordinary shares with the remainder representing preference or debt securities.[18]

It is rare to have an issue of either debt or equity securities of a large public company in Great Britain that does not receive a

14. This is in marked contrast to the situation in the United States, where there is an emphasis on long-term individual loans. Companies in the United Kingdom occasionally obtain long-term funds through mortgages or other secured loans from a single institutional creditor, but the unsecured loan with a term greater than five years is rare. The British creditor institutions normally want a large loan split into bonds or debentures and distributed to others in addition to themselves. The prime example of an attempt to fill this void is the growth of the Finance Corporation for Industry, Inc. (FCI) which arose because of the inability or unwillingness of other financial institutions to provide long-term corporate financing. The FCI is discussed together with similar institutions and finance corporations in British Financial Institutions (published by Her Majesty's Stationary Office 1966).

15. Statistics Relating to Securities Quoted on the London Stock Exchange, for the Year Ending 29 March 1968, at 2 (1968) [hereinafter cited as Exchange Statistics].

16. Exchange Statistics, *supra* note 15, at 5, 6. Included in the 106 companies are 10 overseas companies.

17. In 1965, the total amount of municipal securities issued in the United States was $17.6 billion; in 1966, the dollar total was the same. NYSE Fact Book 59 (1967).

18. Exchange Statistics, *supra* note 15, at 5. In addition, 11 of the 106 quotations for new companies involved tender offers. These terms are explained in notes 28-29 and accompanying text *infra*.

quotation on the London Stock Exchange.[19] Creditor institutions desire a listing of the debt securities that they acquire through placements primarily for evaluation purposes. In addition, some pension funds are restricted in their investments to listed securities, and insurance company regulations require them to report the extent of their security holdings which are not listed.[20] A listing enables an institution to report its security holdings based on the stock exchange offer and bid prices even though it is recognized that there may be little or no active trading in the securities.

A major distinction between the securities markets in the United States and Great Britain is that in the United Kingdom all government borrowing, both by the central government and by local authorities, goes through the London Exchange. In the United States, the stock exchanges are generally not involved in government borrowing either by the federal government or by states and municipalities.[21]

Financial institutions, such as insurance companies, pension funds, investment trusts and unit trusts, play an important role in the British securities market.[22] Recent statistics indicate that such institutions hold approximately 56 per cent of the fixed interest securities quoted on the London Exchange and account for approximately 60 per cent of the trading in fixed interest securities. These same tables show that these financial institutions hold approximately 25 per cent of the ordinary shares and account for approximately 23 per cent of the trading of these shares. In contrast to the United States, the dominant group in Great Britain among these institutions is the insurance companies, followed by the pension funds and the investment trusts. Unit trusts that are comparable to open-end mutual funds in the United States are growing rapidly, but they still do not play so major a role as in the United States.[23] It is estimated that British insurance

19. It is estimated that it would cost a company approximately one-half of one per cent more to raise funds by means of a long-term institutional loan rather than through the device of a bond issue. Furthermore, it would cost an additional one-half of one per cent if the bond issue were not quoted on the London Stock Exchange.

20. *See* Trustee Investment Act of 1961, 9 & 10 Eliz. 2, c. 62 (specific investment standards for trustees).

21. 4 BANK OF ENGLAND Q. BULL. 314 tab. 14 (1968).

22. *See* HOBSON, HOW THE CITY WORKS (rev. ed. 1966); R. KELLETT, THE MERCHANT BANKING ARENA (1967); BRITISH FINANCIAL INSTITUTIONS, *supra* note 14. *See also* 2 BANK OF ENGLAND Q. BULL. tab. 23 & 24 (1965) (statistical measure of the importance of the role of financial institutions in the securities market of Great Britain).

23. The number of unit holdings has risen from £0.66 million in 1960 to £1.64 million by 1966. The number of reporting trusts increased from 53 to 138.

companies have about 20 per cent of their total portfolio in equity securities compared with estimates of approximately 4 per cent in the United States.[24]

2. *Method of Security Issuance.*—A major problem in understanding the securities market in the United Kingdom is the variety of terminology involved. The Companies Act of 1948 uses one set of terms, the London Stock Exchange another, and the financial community often uses a third. It is essential to understand these differences in terminology at the outset.

The Companies Act of 1948 provides for a "private company," which is defined as a company which restricts the rights of shareholders to transfer their shares; limits the number of shareholders to 50 not including employees and certain other exempted categories; and prohibits any invitation to the public to subscribe for any shares or debentures. Of the approximately 500,000 companies which are registered under the Companies Act, all but 15,000 are "private companies."[25] By definition, the prospectus and registration requirements in the Companies Act apply only to public companies. If a private company attempts to sell securities to the public, it loses the privileges of the "private company" exemption.[26]

Total assets increased from £220 million to £553 million. CENTRAL STATISTICAL OFFICE, FINANCIAL STATISTICS, NO. 60, at 66-67 tab. 58 & 59 (1967). Recent statistics indicate that this rise is continuing. 4 BANK OF ENGLAND Q. BULL. 318 tab. 17 (1968). *See generally* MERRIMAN, MUTUAL FUNDS AND UNIT TRUSTS: A GLOBAL VIEW (1965).

24. FINANCIAL STATISTICS, *supra* note 23, at 70-71 tab. 61. Company securities accounted for approximately £70 million of the net £163 million invested by insurance companies in the fourth quarter of 1966. Of these £70 million, £19 million represented investment in ordinary shares.

25. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 28, provides for the "private company." Sections 29 and 30 deal respectively with the consequences of losing the private company exemption and the "statement in lieu of a prospectus" to be delivered to the Registrar of Companies upon cessation of private company status. Originally private companies could achieve an "exempt" status which required less annual reporting among other advantages. *See* Companies Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 129, 161 (1), 161 (2), 190 (1) & 410 (1). This exempt status was abolished, however, in the 1967 amendments. Companies Act of 1967, c. 81, § 2.

26. The advantages of remaining a private company are disappearing. The most recent tax laws have added a corporate surtax for private as well as public corporations and the Companies Act of 1967, c. 81, § 2, requires an annual report, including balance sheet and profit and loss statements, for private companies. *See* note 25 *supra*.

Under the Companies Act of 1948, a public company is exempted from the prospectus requirements when the issue involves shares or debentures that are not offered to the public. Consequently, there is a legal problem in Great Britain similar to that in the United States of defining a "public offering." There is a major difference, however, in that as a practical matter the British legal problem usually does not have to be resolved because almost all securities issues by public companies obtain a listing on a stock exchange. The obtaining of an exchange listing is considered to result automatically in an offer of the securities to the public.

Under the London Stock Exchange's regulations, the listing of a security may be obtained when it is issued by any of the following methods:[27]

(1) *public prospectus.*—By this method, the company sells the securities to members of the public directly without an intermediate purchase of the shares by a brokerage house, as in a firm commitments underwriting. An issuing house may be involved in marketing the securities on a basis similar to a "best efforts" underwriting in the United States. The public prospectus method of distribution had an early popularity, but is now used infrequently.

(2) *public offer for sale.*—Through a public offer for sale, which is the most common form of underwriting in both Great Britain and the United States, securities of the company are purchased by an issuing house and resold to the public. This is similar in operation to a firm commitments underwriting in the United States.

(3) *placing.*—This term has no reference to "private offering" for regulatory purposes or to "private placement," as the term is used in the United States. Placing is used to describe those instances in which the issuing house has purchased the security offering and distributed the bulk directly to large investors, usually institutions, rather than to the public by means of advertisement. Placings are not "underwritten" by institutions, but are distributed directly to them. Even in a placing, however, a substantial portion of the total shares issued must be made available to the general public if a quotation is desired.

(4) *introduction.*—Outstanding securities are introduced on the London Exchange when there is no new public offering. This is

27. The terms refer to the method of underwriting and not to requirements under the Companies Act of 1948.

the usual method employed when securities previously have been listed on a regional exchange, or where a formerly private company is seeking a listing in order to establish a public price for its shares but is not raising new capital. Recently, because the advantages of remaining a private company have diminished, numerous private companies have introduced their shares on the London Exchange.[28]

(5) *tender.*—Under the tender method, securities are offered for competitive bidding by subscribers. A minimum price is set, and normally some underwriting commitment is made.

Obtaining a quotation by any of these methods may or may not demand compliance with the Companies Act of 1948. Although all five methods involve "offerings to the public" as defined in the Act and would be subject to its provisions, some other exemption may exclude the issue from the Act's coverage.[29]

In the United Kingdom, issues are underwritten not only by other brokers and investment bankers, but also by investors who themselves are able to take part of the issue. In a large offering, sub-underwriting agreements may be sent to 500 institutions. This group might include insurance companies, pension funds and investment trusts. Unit trusts do not play a significant role in underwriting because they rarely have available large unused amounts of capital.

Sub-underwriters agree with the issuing house, *i.e.*, the principal underwriter, to take a portion of the issue in return for a set fee. The sub-underwriters are obligated to purchase the shares in the event that the issue is not fully sold. In contrast to the situation in the United States, the sub-underwriters are obligated not directly to the company, but rather to the principal underwriter only.[30] This distinction

28. Introductions typically constitute the bulk of new listings on the Exchange. In 1966-67, of the 106 companies not previously listed, 61 were listed pursuant to applications for introduction of one of their securities. EXCHANGE STATISTICS, *supra* note 15, at 5.

29. In 1967-68, 106 listings for companies on the Exchange were granted. Of these companies' securities, 61 were applications for introduction, 26 were offers for sale or prospectus offerings, 25 were private placements and 11 were tender offers. For definitions of the Exchange's terms describing different methods of securities offerings see, JENKINS REPORT, *supra* note 5, at 1160. In addition, listings may be obtained for rights offerings and for securities previously quoted at a Federated Stock Exchange, of which there were 14 in 1967. EXCHANGE STATISTICS, *supra* note 15, at 5.

30. In the United States, underwriting syndicates are made up only of brokers and investment bankers. Through the "agreement between underwriters," the members of the syndicate authorize the principal underwriter to sign for them and

regarding liability, however, appears to be of little practical importance. A more significant difference is that in Great Britain, most of the sub-underwriters are also the principal investors. The sub-underwriters usually agree to "underwrite" that portion of an issue that they intend to purchase for their own portfolio.[31] Institutional investors who are sub-underwriters rely principally on the reputation of the issuing house in making their sub-underwriting decision. Sub-underwriters, however, do have an opportunity to see the prospectus several days before the general investing public.

In the actual selling of the securities, the issuing house that is acting as principal underwriter takes the majority of shares for distribution and allots a smaller share to brokers for distribution through the London Exchange. The broker then distributes his shares to the public. This may or may not involve contacting some of the same institutions that are involved in the sub-underwriting.

If the issuing house is conducting a public offer for sale, it advertises by publishing a prospectus and follows the specified allotment procedures for distributing the shares to all investors who subscribe. The amount of subscription made by individual sub-underwriters depends on their evaluation of the offering. If they do not believe the offering will be over subscribed, the sub-underwriters may not subscribe themselves at all, but may instead rely on obtaining a share on the basis of their sub-underwriting commitment. If, on the other hand, the individual sub-underwriters believe that the issue will be over subscribed, they will place a subscription based on the number of shares they actually want for their portfolio. In the case of a placement, the issuing house does not advertise, but rather sells directly to its sub-underwriters and other large investors. In either a distribution by advertisement and allotment or a distribution by placement, a substantial percentage of shares must be made available to brokers and jobbers.[32]

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become legally bound directly to the company. Such an "agreement between underwriters" is used in a "firm commitment" underwriting where the managing underwriter and his selling group contract with the selling company to purchase all of the securities for resale. *See* 1 L. LOSS, SECURITIES REGULATION 159-178 (2d ed. 1961); G.J. ROBINSON, GOING PUBLIC §§ 26-34 (1961).

31. Institutional investors do agree at times to participate in an underwriting even when they do not wish to hold the securities in their portfolio. Such a participation derives from a desire to maintain a good relationship with the issuing house. In these situations, if the offering is not a success and the institution is required to take up the shares, the institution is forced either to include the securities in their portfolio or hold them until they are sold.

32. A jobber in a private placement can keep only 10% of the stock made available to him in order to start his book. What happens in practice is that the

In both a placement and an offer for sale, a full prospectus is required. In addition, if there is an offer for sale, the full prospectus must be published in a newspaper, and sale is by subscription. The advertisement is published three days before the stock lists are closed. If the issue is over subscribed, allotment is usually made on a pro rata basis, by lottery, or some other means designed to protect the small investor. If the issue is under subscribed, the principal underwriter and sub-underwriters must make up the difference.

Almost all equity offerings of established companies that take place by one of the above stated methods have been made by means of rights offerings in recent years.[33] In a rights offering, the issuing house serves principally as adviser, but it may also underwrite the rights offering on a standby basis. When companies issue rights for new shares at a price close to the current market price, the company usually retains the existing dividends on the new shares and has the issue underwritten by an issuing house. When the rights issue for the new shares is at a price substantially different from the current market price, the rights themselves acquire value and are traded. Under these circumstances, there usually would not be an underwriting since the company would be assured that the issue would be taken. In addition, the dividend would be reduced on the new shares.

A typical timetable in the United Kingdom for an offering to the public involving advertising and subscription is as follows:

(1) *day one (usually a Wednesday).*—Assuming prior clearance for an exchange listing, the final price for the offering is fixed and letters and calls are made to the potential sub-underwriters.
(2) *day three (Friday).*—The underwriting is completed.
(3) *day six (Monday).*—The advertisement appears in the financial press, usually in the *London Times* and the *Financial Times*, and the prospectus must be delivered to the Registrar of Companies at the Board of Trade on or before the date of publication.

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broker for the issue allocates to the jobber a block of shares at the distribution price. Other brokers not connected with the issue then come to the jobber and ask to be allocated amounts of shares. After the shares are distributed, the jobber leaves 10% on his book for his own use at the commencement of trading. The shares are allocated to the other brokers at the issue price so that, in effect, the jobber receives an extra commission for these shares.

33. The London Exchange rules have special provisions designed to facilitate the making of a rights offering and enumerate the privileges and liabilities of the parties. *See* STOCK EXCHANGE RULES 114, 114 (a) & 115. Normally, a company will have a provision respecting pre-emptive rights in its by-laws.

(4) *day nine (Thursday).*—The stock lists close and the allotment is made.

(5) *day ten (Friday).*—Dealing starts on the stock exchange.[34]

During the period between day six and day nine, stock exchange brokers are usually involved in contacting clients concerning the offering. The principal contacts would be with large investors and institutions, including those who are acting as sub-underwriters and have already expressed a commitment on the prior Friday. By American standards, the actual sales activity by brokers during the time of distribution is usually small.

B. *Regulation Under the Companies Act*

Regulation of securities in England started in an extreme form with the Bubble Act of 1719, which prohibited joint stock companies altogether. This Act was a reaction to the spectacular stock frauds climaxed by the bursting of the South Sea Bubble. The complete restriction on the existence of corporations proved unworkable, however, and the Act was repealed in 1825.

The next approach to regulation came in 1841 as a result of a Royal Commission under the direction of Lord Gladstone. The Commission, after cataloguing the various evils associated with joint stock companies, advocated in the Companies Act the use of a disclosure mechanism that has continued to the present as the basis of regulation in Great Britain. The initial requirements were meager and amounted to little more than a requirement to file the name and purpose of the company. The requirements were tied closely to the process of registration and to the obtaining of limited liability for shareholders. Regulatory control under the Companies Act has, however, been gradually tightened through successive amendments.[35] For example, disclosure requirements in the articles of association have been increased; requirements have been established for the use and filing of the prospectus; the content of the prospectus has been specified; civil liability of parties preparing the articles and prospectus has been tightened; and the distinctions have been made between private and public companies, with disclosure and prospectus requirements applying only to the latter. Recognizing the need for the disclosed material

34. If there are delays, dealing may not start until the following Monday. If there is heavy over subscription, then letters of allotment may not be posted until Monday and dealing may not start until later in the week.

35. The last complete codification of the Act was in 1948, but there were amendments in 1967. See note 2 *supra; see* Knauss, *A Reappraisal of the Role of Disclosure,* 62 MICH. L. REV. 607, 611-13 & nn.19-32 (1964).

to reach investors, underwriter offerings were made subject to the Act's prospectus requirements in 1929.

1. *Restrictions of Distributions.*—The Companies Act contains two basic prohibitions. The first is that every prospectus[36] issued by a company or a promoter of a company must contain specified material.[37] The second is that no prospectus shall be issued by a company unless it has been filed with the Registrar of Companies of the Board of Trade before the date of its publication.[38] Since by definition a "private company" cannot offer securities to the public and maintain its status as a "private company," the restrictions apply only to public companies.[39]

The approach of the Companies Act is similar to the registration and prospectus requirements of the 1933 Securities Act in the United States. In both countries, for example, no written offer can be made unless it is in the form of a prospectus that conforms with the requirements of the respective acts, and is filed with the appropriate government agency. The Companies Act, however, does not provide a number of restrictions found in the 1933 Act. For instance, unlike its American counterpart, the Companies Act does not prohibit oral offers or the private use of a prospectus prior to its publication and filing. Similarly, there is no requirement under the Companies Act to deliver a copy of the prospectus to offerees or purchasers at the time of sale.[40]

There is no specific statutory waiting period in Great Britain, and after the prospectus has been filed with the Registrar of Companies sales may be made immediately. However, if there is to be a public subscription for the shares, the Companies Act requires a three day

36. "Prospectus" is defined in the Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 455, as "any prospectus, notice, circular, advertisement, or other invitation, offering to the public for subscription or purchase any shares or debentures of a company." In addition, § 45 provides that when a company allots any of its shares with a view toward offering them for sale, any document by which the offering is to be made is deemed to be a prospectus. By general concensus, the term is limited to written offers.

37. The Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 38, requires the company to set forth in its prospectus the information contained in part I of the Fourth Schedule to the Act, and to set out the reports in part II prior to the offering.

38. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 41.

39. *See* L. GOWER, PRINCIPLES OF MODERN COMPANY LAW (3d. ed. 1969). Oral invitations are covered by the Prevention of Fraud Act of 1958.

40. However, any form of application for shares of a company must be accompanied by a prospectus. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 38 (3).

delay between the issuance of the prospectus and the allotment of the shares. The Act further provides that if there is a newspaper advertisement, the date upon which it appears shall be construed as the first day of issue of the prospectus.[41] Thus, there is usually a three day delay. But this delay does not appear to be designed primarily as a "waiting period," as the term is known in the United States. It is possible for sales to be made immediately unless a public subscription and allotment method is to be used.[42] The concept of the minimum "waiting period" as a cooling time apparently is not considered so important in Great Britain as in the United States, perhaps because of the lesser selling pressure. Rather, the three day delay is intended to provide investors with an equal opportunity to purchase shares.

The Companies Act either ignores or provides exemptions for many of the problems that cause headaches for attorneys in the United States. The Companies Act has two major exemptions not found in the American securities acts. The first exempts securities that are in all respects similar to shares or debentures previously issued, if those previously issued are currently being traded or quoted on a prescribed stock exchange.[43] The second is a specific exemption to the prospectus requirements for offers of securities by a company to its own shareholders.[44] Furthermore, the Companies Act applies only to a company and to the underwriters who are in fact acting in a professional capacity. There is no open-ended definition of the term "underwriter" as it appears in § 2(11) of the 1933 Securities Act in the United States.[45] This means that in Great Britain there are no restrictions on secondary distributions by control persons, and that problems concerning resales following a private offering are avoided. Another important contrast between the Companies Act and the 1933

41. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 50.

42. *See* JENKINS REPORT, *supra* note 5, at 1478-79.

43. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 38 (5) (b).

44. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 38 (5) (a). Section 55 cancels such exemptions when they are used, directly or indirectly, to make the shares available to the public. Thus while such an offer will be a "prospectus" in many cases, there are virtually no statutory requirements about what it must contain. *See* COLE, MORLEY & SCOTT, CORPORATE FINANCING IN GREAT BRITAIN 3 4 (1967).

45. The Securities Act of 1933, § 2 (11), 15 U.S.C. § 77 (b) (11) (1970), defines "underwriter" as "any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking . . . ."

Securities Act is that there is no need to register oil and gas interests, limited partnership interests, or the broad range of investment plans that fall under the 1933 Act's definition of "investment contract."[46]

The definition of "prospectus" in the Companies Act refers to any offer to the public "for subscription or purchase."[47] While the question is not completely free from doubt, this has been interpreted to exclude from the prospectus requirements any offer involving an exchange of securities. The terms "subscription" and "purchase" have been defined as being limited to purchases or subscriptions in cash. Therefore, registration and prospectus requirements and the "no-sale" problems in the typical merger situation are avoided.[48]

The term "prospectus" is defined in the Companies Act as being an offering "to the public."[49] Thus, on the surface, the Companies Act and the 1933 Securities Act appear similar in their references to public offerings. In operation, however, the terms have developed quite differently. The Companies Act states that an offer or invitation is not considered made "to the public" if

> it can properly be regarded, in all 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.[50]

Although there has been practically no litigation in Great Britain on the question of what amounts to a public offering, certain guidelines are generally accepted.[51] It is clear that the prospectus requirements do not apply to private companies, since by definition the number of shareholders must be limited and the securities cannot be freely purchased or traded. Also, stock options and stock purchase plans to

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46. *Compare* the very broad definition of "security" in the Securities Act of 1933, § 2 (1), 15 U.S.C. § 77 (b) (1) (1970) *with* the limited definition of "share" in the Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 455. The leading United States case interpreting "investment contract" as used in § 2 (1) of the 1933 Act is S.E.C. v. W.J. Howey Co., 328 U.S. 293 (1946).

47. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 455; note 36 *supra.*

48. Apparently the only case in Great Britain construing these terms is Government Stock and Other Securities Investment Co., Ltd. v. Christopher, [1956] 1 W.L.R. 237. In the United States, rule 133 promulgated pursuant to the 1933 Act offers a limited exemption for the exchange of shares in certain mergers, but there is no exemption for any subsequent resale of such shares.

49. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 455; note 36 *supra.*

50. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 455.

51. *See* note 48 *supra*; D.B. BUCKLEY, BUCKLEY ON THE COMPANIES ACT 83 (12th ed. 1949); A. TOPHAM, PALMER'S PRECEDENTS 54 (16th ed. 1951).

employees of a company are considered exempted as private offerings. A public offering occurs only if the prospectus concerns shares which are to be quoted on a stock exchange. Since securities are rarely sold by public companies without obtaining a stock exchange quotation, the difficult interpretative problems frequently encountered in the United States rarely arise.

This combination of exemptions means that from one-half to two-thirds of all registration statements filed in the United States would not be required under the Companies Act.[52] For example, all 1933 Act filings under Form S-8—employee purchase and stock option plans—and Form S-14—mergers and consolidations—would be unnecessary. Most secondary offerings and all offerings of currently listed securities would not be registered. Finally, if the offering is made to an identifiable group, no registration would be required for securities that are not going to be traded.

One result of the series of exemptions in Great Britain is that a company may obtain a stock exchange quotation for a new issue of shares and yet not need to comply with the prospectus and filing provisions of the Companies Act. Securities that are uniform with existing listed securities, securities listed for issue to existing shareholders in rights offerings, and securities listed for use in mergers must all comply with stock exchange requirements, but they are exempted under the Companies Act. Since many listing quotations obtained on the London Stock Exchange are in these categories, the number of prospectuses filed under the Companies Act is much less than the number of new quotations obtained on the Exchange.

In addition to the prospectus requirements of the Companies Act, all sales of securities in the United Kingdom are regulated by the licensing and general fraud provisions of the Prevention of Fraud Act of 1958. The definition of securities in this Act is broader than in the Companies Act, and the fraud provisions cover sales of corporate securities and interests in other investment schemes that would fall within the definition of "investment contract" in the 1933 Securities Act.[53] Furthermore, the licensing requirements of the Prevention of

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52. DISCLOSURE TO INVESTORS, A REAPPRAISAL OF ADMINISTRATIVE POLICIES UNDER THE '33 AND '34 SECURITIES ACTS, ch. 10 (discusses the enormous work load of the S.E.C.) [hereinafter cited as WHEAT REPORT].

53. Misleading statements or failures to disclose material facts in any arrangement "... which is to provide facilities for the participation by persons in profits or income ... likely to arise from the acquisition, holding, management or disposal of any property other than securities. . . ." is prohibited. The Prevention of Fraud Act of 1958, 6 & 7 Eliz. 2, c. 45, § 13 (1) (b).

Fraud Act limit those individuals who can be in the securities business and give the Board of Trade broad discretion and rule-making power. The Board of Trade has exercised its rule-making authority in only two special areas: take-over bids and unit trusts, *i.e.*, mutual funds.[54]

2. *Prospectus Requirements Under the Companies Act.*—Various sections of the Companies Act of 1948 contain provisions relating to prospectus requirements. Section 37 requires every prospectus to be dated, and raises a rebutable presumption that the date of the prospectus is the date of publication. Section 38 requires that the prospectus contain the information referred to in part I of the Fourth Schedule of the Companies Act, as well as the reports specified in part II of the Fourth Schedule. Section 41 requires that a prospectus must be delivered to the Registrar of Companies in the Board of Trade on or before its date of publication. It must be signed by every person who is named as a director or proposed director and must contain: (1) the consent of experts required by § 40;[55] (2) a copy of every "material contract," as required by paragraph 14 of the Fourth Schedule; and (3) any written statements by auditors setting out any adjustments made in the preparation of the financial statements.

The actual substance of the material to be disclosed is set forth in the Fourth Schedule of the Companies Act. While the material required is generally quite similar to that required for a listing by the London Stock Exchange, there are a few primary differences. For instance, the London Exchange has specified in greater detail the information required in the financial statements and specifically requires a ten year auditor's report on profits and losses; the Fourth Schedule, however, requires only a five year report. Also, while part II, paragraph 14 of the Fourth Schedule requires material contracts to be submitted with the prospectus, the London Exchange has no such formal rule. As a practical matter, companies in the United Kingdom concentrate on the listing requirements of the London Exchange and merely file in duplicate the material prepared in that connection with the Board of Trade.

3. *Sanctions.*—The Registrar of Companies in the Board of Trade does virtually no checking of the prospectus material that is filed with

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54. Take-over bids are discussed pp. 128-32 *infra*; unit trusts are discussed pp.116-27 *infra.*

55. Every prospectus, which includes statements purported to be made by experts—*i.e.*, engineers, appraisers, accountants and any other person whose profession lends authority to a statement made by him—must contain a written consent by the expert. The prospectus must also contain a statement that the expert has given and has not withdrawn his consent as it appears in the prospectus. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 40.

that agency. The Act specifically provides that "the registrar shall not register a prospectus unless it is dated, signed in the manner required, and unless it has attached the documents specified."[56] The Board of Trade has read this section very narrowly and has made no attempt to expand its jurisdiction to include the power to scrutinize or to police the filed prospectus. The purpose of the filing of a prospectus is viewed merely as providing individuals with the information needed to bring civil actions.

The staff in the Registrar of Companies office considers their function to be primarily a clerical one. Occasionally a company will send a proof of a prospectus to the Registrar two or three days before the issue date, but most prospectuses are received for the first time on the morning of the issue date, which if advertized is the day it appears in the financial press. As a matter of routine, the prospectuses are checked by the staff for six items:

(1) *date.*—If a prospectus is lodged after the date on the prospectus, there is provision for penalties, but reportedly these have never been imposed.
(2) *directors' signatures.*—A check is made to see that all of the directors named in the prospectus have signed it, or if the signature is made by another under power of attorney, that the power is included among the documents filed.
(3) *experts.*—A check is made to see that a letter of consent has been filed for every expert who is quoted in the prospectus.
(4) *material contracts.*—These are checked to insure that all specific contracts mentioned in the prospectus are included. No attempt is made, however, to determine if there are other, non-material contracts.
(5) *accounting statement.*—A sight check is made to determine if the accounting statements of adjustments is included in the prospectus materials.
(6) *statement of filing.*—The prospectus must include a statement that it has been filed with the Registrar of Companies.

Any deficiencies that are discovered by the Registrar's office are handled in an informal way.[57] For example, a question may be raised about the opinion of an expert if no consent statement is present. In

56. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 41 (3).
57. The author could find no reported instance when the Registrar refused to file a prospectus. It was reported that the Registrar on a few occasions had forwarded a prospectus to the Prosecutions Department of the Board of Trade because the prospectus "did not look right," but there is no information available on what action was taken.

this situation, a call may be made to the company, and a request made that the consent statement be forwarded. The Prosecutions Department, the only section within the Board of Trade staffed by solicitors, is concerned almost exclusively with fraudulent activity under the Prevention of Fraud Act and instances of fraud that come to light upon liquidation of a company. There is no reported instance of any enforcement for prospectus violations. The assumption within the Board of Trade is that the Quotations Department of the London Stock Exchange prevents any dubious prospectus from being filed.

There are apparently no formal records kept by the Board of Trade on the number and type of prospectuses that are filed. Some informal records, including material contracts, are maintained primarily for internal use by the staff of the Registrar of Companies. While the general public has access to these documents, it is reported that they are examined only rarely by persons outside the Registrar's office. These records indicate that during 1966, for example, there were 269 "full" prospectuses filed with the Registrar of Companies. In addition, during that year the Registrar received 194 letters from the London Stock Exchange noting that either a full or partial exemption to filing had been granted under § 39 of the Companies Act. Although no official statistics are available on the matter, it is estimated that less than 10 per cent of the 269 prospectuses filed during 1966 involved issues that did not obtain a listing on a recognized stock exchange.

C. *The Role of the London Stock Exchange in Regulating the Issuance of Securities*

The London Stock Exchange plays the dominant role in the regulation of the securities market in the United Kingdom. The dominance of the Exchange is due not to any direct statutory authority, but rather to the practicalities of the British new issue market. Almost all new security issues obtain a listing on the London Exchange. Moreover, the facilities of the Exchange are employed during distribution, and trading on the Exchange commences as soon as the distribution is complete. Such activity by the London Exchange is in sharp contrast to exchange practices in the United States, where the initial distribution cannot take place on an exchange and no previously unlisted company can obtain a listing until the distribution of securities is complete. In America, all initial distributions take place in the over-the-counter market and the exchanges are not in a position to play any regulatory role during the distribution process. A second major factor contributing to the dominant position of the London Exchange is that members of the Exchange are permitted to deal only in listed securities and securities in certain specified categories.[58] In the United States, however, broker-dealers who are members of an exchange can trade and sell securities that are not listed on that exchange. Thus, the use of Exchange facilities during the distribution process, together with its restrictive trading rules, operates to give the London Exchange a near monopoly over the British new issue market. One result flowing from this pre-eminant position is the listing of many issues that have received no widespread interest and that have no active trading market, whereas in the United States, listing on a major exchange is restricted to securities that have demonstrated substantial trading interest.

The involvement of the London Stock Exchange in distributions has provided the means by which the Exchange has become an important regulatory body. Since there cannot be an extensive public offering unless there is a stock exchange quotation, the Exchange can limit entry into the market by controlling the granting of the listing quotation. To be sure, there are other regulatory forces in connection with a new issue of securities, such as the issuing house, charter public accountants, solicitors, and the financial press, but it is the activity of the London Exchange which has become increasingly more important.

An assessment of the London Exchange's success as a regulatory force would have been generally negative if made as recently as 1960. Since that time, however, the Exchange has moved farther than in the preceeding 100 years. As a point of reference, the regulatory activity of the London Exchange accelerated dramatically after the publication of the Jenkins Committee Report in 1962. Although this report was not directly critical of the activities of the London Exchange, it is apparent that the occasion of giving evidence to the Jenkins Committee provided the Exchange with an opportunity for self-examination. And it is probably not unfair to state that the Exchange has been responding to various subtle pressures in order to avoid the introduction of new and more rigorous legislation.

The following items are examples of important regulatory activity recently undertaken by the London Exchange:

(1) the memorandum of November, 1964, regarding accounting standards for data contained in prospectuses;

(2) the memorandum of guidance regarding acquisitions, published in April, 1964;

(3) the compilation and publication of various memoranda of guidance in June, 1966, concerning the admission of securities to quotation, the "yellow book;"[59]

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58. STOCK EXCHANGE RULE 163.

59. COUNCIL OF THE STOCK EXCHANGE, ADMISSION OF SECURITIES TO QUOTATION: MEMORANDA OF GUIDANCE AND REQUIREMENTS OF

(4) more effective scrutiny of the quality and completeness of the prospectus by the professional staff of the Exchange;
(5) increased regulation of circulars sent to shareholders;
(6) the development of an effective Federation of Stock Exchanges,[60] with the London Exchange playing the controlling role by having its staff review all listing applications even when it is only on a local exchange;
(7) increased activity in the regulation of brokers and jobbers, including the new requirement that accounts be submitted to an exchange accountant;[61]
(8) an increase in the number and caliber of the professional staff; and
(9) a more effective role of the Exchange in the continuing development of the Take-Over Bid Code.

1. *Administration.*—The London Stock Exchange is managed by the Stock Exchange Council. The Council is composed of from 30 to 36 members of the Exchange, divided about equally between jobbers and brokers.[62] The members of the Council serve for a term of three years, with approximately one-third of the membership elected annually.[63] There are two deputy chairmen, usually one broker and one jobber. The Council itself is split into several committees, one of which, the Quotations Committee,[64] has the ultimate responsibility of

THE FEDERATION OF STOCK EXCHANGES IN GREAT BRITAIN AND IRELAND (1966) [hereinafter cited as MEMORANDA OF GUIDANCE]. This volume, commonly known as the "yellow book," is a compilation of memoranda entitled: (1) *Admission of Securities to Quotation;* (2) *Reports by Accountants . . .* ; (3) *Acquisitions and Realization of Subsidiary Companies . . .* ; (4) *Information Required in Prospectuses . . .* ; (5) *Requirements for Quotation for the Securities of Foreign Companies . . .* ; and (6) *Communication of Announcements.* The "yellow book" supplements the Stock Exchange rules and provides standards for all of the federated stock exchanges.

60. The provincial exchanges in the United Kingdom may be compared to the regional exchanges in the United States. The requirements for a quotation, however, are now standardized in Great Britain under the rules of the Federation of Stock Exchanges, which follow the London Stock Exchange requirements. *See* note 9 and accompanying text *supra.*

61. Regulation of accounts of members was first introduced in 1962; the rules were revised and strengthened in August, 1966.

62. In the recent past, the Chairman of the Stock Exchange has been a broker.

63. The members may be re-elected and some of them have served for a considerable period of time.

64. The Quotations Committee has two chairmen, a broker and a jobber; two vice-chairmen, a broker and a jobber; and eight members. Five members are required for a quorum.

passing on all requests for quotations. This committee is also concerned with the continued regulation of companies after they have received a quotation and has responsibility for approving circulars sent to shareholders. The Quotations Committee members, being ordinary lay members of the Stock Exchange Council, have no special expert skills and must rely heavily on the Council's professional staff. This staff, or "executive organization" of the Council, is broken into four main departments: Finance, Quotations, House Administration and Public Relations. The Quotations Department is the counterpart of the Quotations Committee of the Exchange Council and is responsible for all aspects of Exchange business dealing with the quoted companies. The Quotations Department has approximately fifteen professional staff members. This group includes solicitors and chartered accountants. The quantity and quality of the staff members of the Quotations Department has increased about twofold in the last few years, but given the scope of its activities, it still appears to be inadequate.

2. *General Requirements for a Quotation.*—The listing requirements of the London Exchange vary according to the method of offering by the company. In every instance, however, the method of distribution must be approved by the Quotations Department.[65] The quantity of information that is required to be disclosed, the extensiveness of the scrutiny by the staff, and the need to publish the prospectus in the financial press all depend on what kind of security is being sold and how it is being marketed. The most extensive disclosure is required for an initial listing when there is a request for a quotation and the company has no other securities listed. In every such case, a complete prospectus must be submitted to the Exchange.[66] If there is to be a public offering of the securities by an offer for sale, then the prospectus must also be advertised in the financial press.[67] On the other hand, if the company is placing the issue or is not distributing a new issue but only requesting that outstanding securities be quoted, then, in principle, prior approval must be obtained. If the permission is granted, the company is required to submit only a small advertisement that specifies where further information can be obtained.[68]

65. The Quotations Department of the London Exchange combines activities found in the United States at the S.E.C. and at the various exchanges. In addition, it regulates marketing arrangements and other aspects of securities distributions in a manner that has no counterpart in the United States.

66. STOCK EXCHANGE RULES, app. 34, § A, pt. I, para. 2 (A); MEMORANDA OF GUIDANCE, *supra* note 59.

67. *Id.*

If the company requesting a quotation already has part of its capital quoted on the London Exchange, the situation changes. If the securities are identical to currently listed securities, there is no filing requirement under the Companies Act. The Exchange still requires a prospectus,[69] but the information required is considerably less than in the case of a first quotation for the company.[70] If the new securities are of a different type from those already listed, there may be a requirement to file under the Companies Act, but the Exchange is usually willing to grant an exemption if good cause is shown. Rights offerings are exempted under the Companies Act, but if a quotation is desired, the Exchange requires that certain information be disclosed concerning the new securities to be listed.[71] In addition, the Exchange requires that certain minimum data be forwarded to shareholders, usually in the form of a letter of notification.[72]

The rules of the London Exchange require that a final draft of any required prospectus be submitted to the Exchange fourteen days prior to publication.[73] In addition, the Exchange requires that in the case of a public offering, there must be publication of the full prospectus in two newspapers. The Companies Act,[74] however, states that no allotment can be made until three days after the prospectus is issued. Since the publication required by the London Exchange would by definition be the day of issue under the Companies Act, there is in most instances a three day period between the date of publication and the date of allotment. In practice, the three day period serves to alert the investor to the offering and gives him an opportunity to obtain a

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68. The Exchange is able to grant an exemption from compliance with the requirements of the Fourth Schedule of the Companies Act. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 39. The Exchange will frequently grant this exemption in the case of introductions and for placements of a new debt security of a company that already has a quotation for another security. In an offer for sale or a placement of new common shares, a full prospectus is needed and an exemption is given only rarely. However, a partial exemption from some of the disclosure requirements of the Fourth Schedule may be given.

69. STOCK EXCHANGE RULES, app. 34, schedule II, pt. B.

70. *See* note 36 and accompanying text *supra* (explanations of "prospectus" and "introduction" offerings).

71. MEMORANDA OF GUIDANCE, *supra* note 59, at 18.

72. Under current practice, the Exchange does not require that financial statements be sent to shareholders, but they must at least be informed of the purposes of the new capital. MEMORANDA OF GUIDANCE, *supra* note 59, at 18.

73. STOCK EXCHANGE RULES, app. 34, § A, pt. I, para. 2. In practice, the initial contact with the Exchange takes place well in advance of this time.

74. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, § 50.

portion of the allotment. The period thus promotes fairness and gives all British investors an equal opportunity to obtain a portion of any new issue in a manner not recognized in the United States. It also serves as a limited cooling-off period during which the investor can evaluate the issue.

The prospectus may be shown to investors during the time after its final draft has been submitted to the Exchange, but before publication. There are no restrictions on the issuing houses or brokers against contacting investors prior to the time of the advertisement. And since there is no restriction on obtaining a firm offer to purchase prior to the time of the advertisement,[75] the "gun jumping" problem, as it is known in the United States, is nonexistent.[76] Normally, this contact prior to the advertisement would only be made with other brokers and large institutional investors, but to the extent that it is used, it provides an extra "waiting period."

3. *Regulation of Marketing Arrangements.*—The London Stock Exchange's concern with the method of financing is manifested in several ways. First, the Exchange has become increasingly committed to the protection of pre-emptive rights, and only in exceptional situations will it allow an equity offering to be made by a quoted company unless the offering takes the form of a rights offering. Moreover, this must be a true rights offering, rather than a mere open invitation to shareholders to subscribe. In addition, the Exchange recently has required that provisions be made for the sale of rights for the benefit of shareholders who fail to subscribe.

The second major manifestation of the Exchange's concern with the method of financing deals with the amount of stock available to the general public and to jobbers. As mentioned earlier, a quotation on the Exchange is sought for almost all new security issues, even for relatively small private placements of debt securities. The current Exchange requirements for a listing of any new issue, including private placements, is that at least 30 per cent of any class of debt securities and at least 35 per cent of any class of equity securities be available to the public.[77] Jobbers are entitled to at least 20 per cent of an equity offering and 25 per cent of any debt offering. The effect of these requirements is that the relevant percentage amounts must be offered initially to the public and to jobbers. The requirements are justified on the grounds that they help "make a market" and provide the public

75. *See* JENKINS REPORT, *supra* note 5, at 371-72.

76. "Gun jumping" refers to the prohibited practice of executing sales or soliciting offers to buy prior to the effectiveness of the registration statement. 1 L. LOSS, SECURITIES REGULATION 223-45 (1961).

77. STOCK EXCHANGE RULE 159 (2); *id.* app. 34.

with the opportunity to buy new securities. Of course, they are also a result of a justifiable self-interest on the part of the Exchange and its members. Since the Exchange is being asked for a quotation for a security issue, it is important that there be available a floating supply of the securities sufficient to maintain a reasonable market. The jobbers and brokers are able to realize a profit only if there is trading, and trading cannot take place if an issue is held by only a few large investors.

If an offering is oversubscribed, the method of allotment preferred by the London Exchange is a straight pro rata distribution. The Exchange's concern over fairness in allotment of public offerings is another instance of an emphasis that is different from that of the S.E.C. in the United States. The London Exchange's concern has not been directed particularly at gun jumping and selling pressure on prospective purchasers, but rather has been upon providing adequate notice to members of the public so that they may have an equal opportunity to purchase any allotted shares.

4. *Prospectus Formalities Required by the London Stock Exchange.*—While no particular form of prospectus is specified by the London Stock Exchange, the format used in most cases is uniform and can almost always be printed on a single page of newsprint. At the top of the sheet in large print is the name of the company and a description of the securities to be issued. Following this in slightly smaller print are the names of the directors, brokers, bankers, auditors, reporting accountants and solicitors. The body of the prospectus is published in print about one-half the size of normal newsprint. The material is usually subdivided into the following headings:

(1) history and business—a description of the real property;
(2) management and staff;
(3) working capital;
(4) statement of profit prospects and dividend policy;
(5) auditor's statement—a summary profit statement for a ten year period and a summary assets and liabilities statement;
(6) statutory and general information—a history of the capital structure of the company, provisions in the articles of association (articles of incorporation) that deal with various shareholder rights and a summary description of material contracts.

A comparison between the Form S-1, which is the principal form used by corporations in the United States registering a securities issue under the 1933 Act, and Schedule IIA,[78] which contains the

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78. There is a great similarity between the disclosure requirements of the

requirements for a company first seeking a quotation on the London Stock Exchange, reveals considerable agreement on the main items that should be disclosed. However, when one compares the actual information that is disclosed and the requirements that have developed as a matter of practice, the differences are substantial.

5. *Comparison Between British and American Prospectus Contents.* (a) *Description of the Business.*—In the United Kingdom, the description of the business tends to be brief and is stated in general terms.[79] Apart from the date of incorporation, there is little material regarding the history or development of the company. Rarely is any information included concerning competitive aspects of the company's business or the nature of its customers. By contrast, a prospectus in the United States must contain a detailed description of the business and its development over the past five years. In addition, extensive information is required dealing with the competitive aspects of the industry within the national economy and with the competitive position of the particular company within the industry.[80] Finally, the description must include information on the relative importance of the various products of the company and on the nature and importance of major customers.[81]

(b) *Description of Property.*—In Great Britain, the description of the company's property is simply a short factual description of the various premises either owned or held under long-term lease. The purpose of the description is deemed to be in assisting a potential investor to ascertain the company's size and principal products.[82] In the United States, the description of property must relate to the nature of the business[83] and sufficient information must be given so that the investor can judge "suitability, adequacy, productive capacity and extent of utilization of facilities used in production."[84] This description of property must be consistent with the statement made regarding the competitive position of the company in the American economy.

Companies Act and the Stock Exchange. *E.g., compare* Companies Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 37-46 *with* STOCK EXCHANGE RULES, app. 34, schedule II, pt. A.

79. STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, para. 15.
80. Form S-1, item 9.
81. Form S-1, item 9.
82. STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, para. 16 (ii).
83. Form S-1, item 10.
84. Form S-1, item 10, instruction 1.

(c) *Remuneration of Directors.*—In Great Britain, details are required of each service agreement between directors and the quoted company, together with details of each commission arrangement. A single figure may be given for the aggregate[85] emolument paid to the directors as a group. In the United States, aggregate remuneration must be given for both officers and directors, and individual remuneration must be given for all directors and the three highest paid officers who receive in excess of 30,000 dollars.[86] In addition, information is required on all retirement or pension benefits payable to officers or directors and on all stock options or stock purchase or bonus plans.[87]

(d) *Specific Investor Warnings.*—While in the United States the prospectus generally is designed to provide full public disclosure rather than investor protection, certain aspects of the presentation of prospectus material required by the S.E.C. are for the benefit of the relatively unsophisticated investor. When a company is publicly offering its securities for the first time, the S.E.C. will frequently insist that the prospectus contain an introductory paragraph that summarizes various speculative aspects of the issue. Such a warning paragraph may be required because of the absence of an operating history, the current financial position of the company, or the nature of the enterprise. Also, the S.E.C. often will require a company to spell out, in simplified terms, information that is available elsewhere in a more complex form. For example, when a company has issued options for cheap stock or convertible stock, it may be required to specify the price of such stock to the persons receiving it, compared to the price to a new investor and the extent of the diluting effect on the investor's purchase. In Great Britain, all material contracts and security sales within the two years preceeding the time of distribution[88] must be described in order that an investor theoretically can calculate the price of his stock, compared to the price paid by promoters or early investors. Since so many changes of capital take place immediately before a company goes to market, however, this is apt to be a difficult and complex procedure.

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85. STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, para. 21 (v). The Companies Act of 1967, c. 81, § 8, requires the listing of employees earning in excess of £10,000 and a disclosure of any service contracts between the company and its directors.

86. Form S-1, item 17 (a) (1).

87. Form S-1, item 17, instruction 5, para. 6.

88. *See* Companies Act of 1948, 11 & 12 Geo. 6, c. 38, Fourth Schedule, pt. I, item 6.

(e) *Financial Information.*—The greatest disparity between the prospectus requirements of the London Exchange and those of the S.E.C. is in the extent of the financial information disclosed. Neither the London Exchange nor the Companies Act of 1948 requires much detailed information in the profit and loss statement of the prospectus.[89] In practice, a single figure is given for group profits before taxation and the amount deducted for depreciation. Sales data usually are not included. Recently, the London Exchange has requested that turnover (sales) be specified in the prospectus, but this has not been rigorously enforced. Moreover, the 1967 amendments to the Companies Act require that turnover be disclosed in the annual account, and it is generally expected that more information will appear in future prospectuses.[90] At present, however, breakdowns disclosing the cost of goods sold, together with operating and administrative expenses, are not required and are rarely given.[91] In addition, the

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89. Statement of Adjustments is required from accountants by the Exchange, but is not a part of the prospectus. *See* STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, item 21; MEMORANDA OF GUIDANCE, *supra* note 59, at 12, item 7 Statement of Adjustments (Statement of Retained Earnings and Income Statement contain somewhat more information on sales).

90. Companies Act of 1967, c. 81, § 17, schedule 2, para. 13A. The STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, item 17, simply states that a sales turnover figure should be given "wherever possible."

91. The following would be a typical breakdown of the income statement of a United States manufacturing firm:

- Sales
    - Sale returns and allowances
    - Sale discounts
- Net Sales
    - Cost of goods sold (separate statement)
        - Materials
        - Labor
        - Overhead
            - Indirect Labor
            - Utilities
            - Repairs
            - Supplies
            - Insurance
            - Payroll tax
            - Depreciation
- Gross Profit on Sales
    - Selling general and after expenses
- Net Operating Income
- Other Income & Expense
- Net Income

profit and loss statement usually does not include information on non-operating income, such as investment income, or data on such expenses as interest, amortization of debt and the handling of deferred and current taxation.

There is no requirement in the United Kingdom that critical data be disclosed in the balance sheet of the prospectus. For example, the balance sheet does not include an analysis of current assets that specifies accounts receivable and reserve for bad debts. There is also no requirement under the London Exchange rules for a description of inventories or the method of evaluation. The fixed assets usually are not designated by categories with a separate depreciation analysis. Likewise, there is rarely a breakdown in current liabilities, such as accounts payable, trade, accrued expenses, taxes and long-term debt within a year. A financial analyst would find it quite difficult to make a meaningful analysis of a company on the basis of this limited financial information, and in particular, to judge the effectiveness of the utilization of assets with respect to production.

(f) *Extra Information.*—The prospectus requirements of the London Stock Exchange include items of two types that would not ordinarily be found in a prospectus in the United States. First, a prospectus in the United Kingdom must include a description of various items in the articles of incorporation that affect shareholders' rights.[92] Typical provisions that would be disclosed are those relating to borrowing power of directors; the ability of a director to be part of a quorum or to vote in directors' and shareholders' meetings upon matters in which the directors have a personal interest; mandatory retirement and share ownership provisions for directors; and quorum and majority requirements in shareholder voting.[93] In the United States, the only item of this type that must be disclosed is that concerning indemnification of directors and officers.[94]

The other prospectus item that is required in Great Britain but that has no counterpart under the 1933 Securities Act is the requirement of directors' opinions concerning the sufficiency of working capital and the company's profit and dividend prospects.[95] The statement on

92. STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, item 12.

93. STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, items 12 (i), (ii) & (iii).

94. Form S-1, item 29. It may be that there is an even greater need in the United States to require certain aspects of the articles of incorporation or by-laws to be highlighted in the prospectus, due to the important differences that exist in state incorporation acts. These differences in state acts relate not only to the items mentioned above, but also to other areas such as dividend restrictions, cumulative voting and pre-emptive rights.

95. STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, item 19.

working capital must be supported by a letter from the sponsoring brokers or some other third party, such as the merchant bank that advises the company. These two statements in the prospectus probably cause more concern to the company and its solicitors and issuing houses than any other required information. Such directors' opinions are not only omitted from the prospectus requirements in the United States, but they are expressly prohibited from being included in the prospectus.[96] The financial community in England believes that these predictions are extremely important. The broker of the issuer (known colloquially as the company's broker), the issuing house, and the solicitor, as well as the company's directors, all have an interest in insuring that the predictions are reasonable. The general impression is that the predicted profits and dividends are conservative, and it is an exceptional case when a company does not meet its predicted dividends during the first year. As mentioned earlier, British investors, until recently, have tended to buy for income rather than for capital gain; thus, the predicted dividend is one of the most important selling items in the prospectus. In addition, since relatively little information is disclosed to British investors via the prospectus, these predictions are crucial in attempting to formulate meaningful investment decisions.

6. *Disclosure Requirements Other Than at the Time of Obtaining the Original Listing.*—In the United States, prospectus requirements for subsequent issues of securities of a particular company are generally the same as the requirements for the first public issue of that company. The requirements are also the same for securities issues directed to the existing shareholders of a company—rights offerings—and, unless specially exempted, for share-for-share transfers as well. The London Stock Exchange, however, has a short form prospectus for companies that have part of their capital already quoted on the Exchange. In addition there are no formal prospectus requirements for rights offerings, share-for-share transfers,[97] stock-option or stock-purchase plans directed to employees.

In the United States, a company files a registration statement only for the quantity of securities involved in the immediate distribution; each new distribution requires a new registration. The New York Stock Exchange grants a listing only for those securities which are currently outstanding. On the other hand, the London Stock

96. *See* JENKINS REPORT, *supra* note 5, at 14, 65; and WHEAT REPORT, *supra* note 52, at 95-96. *See also* SEC Securities Act Release No. 4666 (Feb. 7, 1964), item 10.

97. However, the Take-Over Bid Code would apply to some aspects of this situation.

Exchange usually gives both a quotation and permission to deal for all authorized shares of the company at the time of initial distribution.[98] Once a quotation is obtained, subsequent sales of the same class of securities may be made by the company through the market. There are no London Exchange rules governing even a large block of stock in a secondary offering or offerings by control persons.[99] The Exchange, however, does exercise some control over rights offerings and share-for-share stock transfers through its regulation of circulars.[100] For instance, one of the general undertakings of all quoted companies is that they send to the Department of Quotations of the London Stock Exchange all circulars sent to shareholders. The London Exchange also insists that certain minimum information be disclosed to shareholders in the letter of notification which is sent to announce a rights offering.[101] Although there are no formal requirements, the Exchange usually requests a statement from the issuing company's board of directors regarding the purpose of the capital that is being raised and an opinion that the money received will be sufficient to accomplish that purpose. Current financial statements and other information on the company are normally not included.[102]

7. *Extent of Scrutiny.*—An evaluation of the extent and depth of scrutiny by the London Stock Exchange of the submitted material is difficult, but there is general agreement that the Exchange is taking a more active role now than ever before. A draft of the prospectus usually is submitted to the Quotations Department several weeks prior to the time of the offering. Comments frequently are made by the Quotations Department and revised drafts are then resubmitted by the company. In addition to its own staff, the Quotations Department occasionally makes use of outside accountants and solicitors. The involvement of outside accountants is usually related to a particular

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98. MEMORANDA OF GUIDANCE, *supra* note 59, at 4.

99. In Great Britain, neither the Companies Act nor the Exchange rules raise problems of secondary offerings. This means that none of the questions regarding sales by control persons or statutory underwriters encountered in the United States are raised.

100. STOCK EXCHANGE RULES, app. 34, schedule II, pt. B, item 9. *See also* MEMORANDA OF GUIDANCE, *supra* note 59, at 7, para. 18. The authority to control circulars stems from the Prevention of Fraud Act of 1958.

101. STOCK EXCHANGE RULES, app. 34, schedule II, pt. B, item 8. Note also, that if newly authorized shares are involved the Exchange can control the rights offering through its discretion in granting a quotation for the new shares.

102. The Stock Exchange usually requires that the rights be offered nil-paid, and the shareholders be given the opportunity to renounce the rights and sell them. Rights are usually traded from 15 to 21 days.

industry problem. In the last few years, for instance, it has often used outside real estate appraisers as consultants in connection with real property companies. The actual scrutiny and investigation is done by the professional staff of the Quotations Department. Once a prospectus has been approved by the Department, rarely will the Quotations Committee or Council members themselves question any aspect of it. Typically, the Council is involved only to negotiate or arbitrate requests by the issuer for a relaxation of the Exchange's requirements.

The scrutiny of the staff of the London Stock Exchange consists primarily in checking to see that all of the Exchange's requirements have been fulfilled. The Exchange does not pass on the veracity of the statements made, but rather concerns itself with checking the documents submitted for omissions and obvious inconsistencies. In this respect, its performance is similar to that of the S.E.C. The S.E.C., however, is more rigorous in the application of its standards. If the S.E.C. writes a deficiency letter after reviewing a prospectus, it will comment that certain material is misleading, ask for information to be expressed in a different manner, or ask for additional information to be disclosed. This kind of substantive evaluation is done only to a limited extent by the London Exchange. Additionally, the S.E.C. frequently asks that back-up reports and studies made by investment bankers be submitted in confidence for its own use, while the London Exchange rarely makes such requests. The London Exchange normally relies upon the presumption that an issuing house has made a thorough independent study of the issuer and would not distribute the security unless it had done so. Also, while the S.E.C. demands extensive disclosure of the speculative aspects of an issue, there are no extra disclosure requirements imposed by the London Exchange for new or promotional companies.[103]

The staff of the S.E.C. will often challenge factual statements made in a prospectus, based upon their knowledge of the particular industry or of activities of similar companies. The staff of the London Exchange is not equipped to make this challenge, nor would such a challenge be considered proper except in the case of a flagrant violation. The S.E.C. requires more information to be disclosed in areas such as the nature of the competition, the description of the business and properties, the material interests of the directors and promoters, and the notes supplementing the financial statements. For this reason the average prospectus in the United States is two to three times

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103. A few promotional companies have obtained a listing in recent years. Examples are companies involving earnings of entertainers. There is interest in the financial community in opening up access to the Exchange to newer, more speculative offerings.

longer than the English prospectus; moreover, this extra material is primarily descriptive and, therefore, more subject to challenge.

An examination of the published prospectuses of several securities issues during the period from 1966 to 1968 reveals that the London Exchange has not been particularly strict in enforcing its own requirements. For example, the Exchange regulations call for the disclosure of turnover or gross trading income during the three years preceding the issue whenever possible. In spite of this requirement, actual turnover figures were usually not given.[104] In many instances, the expression of turnover has been allowed merely in terms of percentage increase over prior years. This makes it impossible to determine actual sales or cost of sales.[105] The description of the business is supposed to include a breakdown of information on profits and losses as well as assets in each of the major activities or divisions of the company. Turnover figures are supposed to contain a breakdown between the important trading activities. Nonetheless, these breakdowns usually are not given in any form, and if present, are in such general terms that they are of little use. Similarly, a separate requirement for geographical breakdown of assets and profits is often ignored or expressed in general terms; a country-by-country designation is rarely given. It is reported, however, that the Exchange has recently been enforcing these requirements more rigorously.

The Exchange requirements mentioned above all go beyond requirements in the Companies Act. But the Exchange as a self-regulatory structure has been reluctant to move too far beyond current industry practice. The Exchange is aware that relatively few companies disclose this information and thus is reluctant to enforce disclosures at the time of a distribution when it may prejudice a company in its competitive position. Furthermore, the Council of the London Exchange is subject to great pressures. Some investors and members of the financial press continually work for greater activity by the London Exchange and for new direct government regulation.[106] Others, including most issuing houses, are strongly opposed to new regulation from any source, including the Exchange. Brokers and

104. Disclosure of turnover is now required in the annual account. Companies Act of 1967, c. 81, § 17, schedule 2, para. 13A. However, the extent of detail required if such a disclosure appears in a prospectus remains an open question.

105. It also limits other ratio analyses: sales related to stockholders equity (rate of issuance); net sales related to operating expenses (operating ratio); sales related to fixed assets; and inventory usage.

106. *See, e.g.*, H. ROSE, DISCLOSURE IN COMPANY ACCOUNTS, *Criticism of Disclosure* (2d ed. 1965).

issuing houses alike profit from increased quotations and are reluctant to make the listing process more complex.[107] Those who argue for more regulation in order to increase investor confidence encounter arguments based on the immediate short-term burden on companies and their advisers. It is perhaps indicative that there is a discrepancy between the Exchange's own view of the extent of its disclosure regulation, and the issuing houses' and solicitors' view of the same regulation. The Exchange states that it closely checks and thoroughly scrutinizes materials submitted; the issuing houses and solicitors say, however, that the scrutiny has not been particularly close. They believe that the Exchange relies primarily on the reputation of the issuing house and broker that sponsors the issue. While the issuing houses, brokers and solicitors recognize this reliance by the Exchange, they generally take the position that their primary client in distribution of securities is the company rather than the investors. In case of conflict, they normally negotiate on behalf of the issuing company.

The typical prospectus in the United States tends to be schizophrenic. It contains extensive detail designed to satisfy the financial analyst and expert, and yet is written in a manner designed to put the small, unsophisticated investor on guard. The typical British prospectus is weak in both respects. Financial analysts are dissatisfied with the extent of information and the prospectus contains much less than its American counterpart in the way of warnings for the unsophisticated investor. The London Exchange does not require a company "to do the sums" for the investor. For example, in the United Kingdom a prospectus usually discusses profits and dividends in terms of a percentage of capital, as stated in the articles of incorporation—an arbitrary and relatively worthless statistic. For many English investors, the most important single item is the yield based on the price of the shares to the investor. Yet until quite recently, the yield was rarely given in the prospectus and was usually left to be calculated by the investor.

It is commonly stated that institutional as well as individual investors in the United Kingdom read the prospectus only to determine the names of the directors, the issuing house, the broker and the predicted yield. The attitude of the London Exchange, as reflected in its review of prospectuses, indicates that it is also more concerned with the men behind the issue than with the detail disclosed in the prospectus.

107. An increasing number of brokers and jobbers are reported to be pressuring the Council for more rigorous enforcement of Exchange regulations and urging fellow members to take a long-term view.

8. *Direct Regulations.*—The London Exchange does not distinguish between its role in supervising adequate disclosure and its role in the direct regulation of a company's activities. Part of the difficulty in comparing the systems of securities regulation in the United Kingdom and the United States is the close interplay of these two roles of the London Exchange. In making any appraisal, it is necessary to separate the question of the effectiveness of the regulations in preventing fraud and investor loss, as opposed to the effectiveness of the regulations in promoting financial markets and facilitating their function of channeling capital into the most effective enterprises. It is obvious that these goals are not completely separate, since protection of investors leads to investor confidence and better markets. Yet it is also true that certain types of regulation have a more limited overall effect on the operation of the securities market.

The London Exchange is reluctant to acknowledge its role in direct regulation. It does not want to appear to be a policeman of corporate behavior or a guarantor of quoted securities. Nonetheless, the London Exchange engages in direct regulation of various forms. First, the Exchange insists that the corporate structure and material contracts do not impinge on certain minimum rights of shareholders. The articles of incorporation of listed companies must contain certain prescribed provisions that are designed to offer to the shareholder such minimum protection. In addition, the Exchange will challenge specific articles, by-laws, or long-term contracts that appear to be unfair to the company or to shareholders. For example, a company recently seeking an Exchange listing had provisions in several long-term service contracts which effectively prevented shareholders from removing directors from office. It was not enough for the company to disclose the provisions; the Exchange insisted that they be changed. In another case, the Exchange challenged corporate by-laws that resulted in an executive committee of directors having a veto action over the vote of the full board of directors. In this manner, the Exchange preserved the traditional division of rights and powers between shareholders, directors and management. To a limited extent, the major stock exchanges in the United States exercise similar control.[108]

The second form of direct regulation by the London Exchange is the role it plays as the conscience of the financial community. This regulation is informal and consequently more difficult to assess. Exchange officials constantly stress their reliance on solicitors, issuing

108. For example, the New York Stock Exchange will not list non-voting stock.

houses, brokers and accountants. This reliance extends beyond insuring disclosure. The Exchange apparently relies on these participants for such items as: insuring the truth of any statements made; insuring a fair price for securities and preventing unreasonable dilution for new investors; preventing incompetents or individuals with poor reputations from being in a management position; restricting compensation to promoters and control persons; and preventing false markets and insider trading. Moreover, the Exchange requires that the accountant submit letters to the Exchange which are partly statements of fact and partly statements of opinion.[109] Yet the Exchange does not second-guess a company or issuing house on the price of an offering; it believes competitive factors alone should decide this matter. In addition, the Exchange does not solicit from a company information that it is expected to hold in confidence.[110] In spite of this, the Exchange does prod the other segments of the financial community to exercise an active role in investor protection. At the same time, it provides them with a rationale for their dealings with clients.

The S.E.C. and the exchanges in the United States serve this same function, but to a much lesser extent. With few exceptions, the emphasis is directed toward disclosure and there is little S.E.C. pressure that would prompt a company to change its corporate structure or limit executive compensation. The London Exchange maintains a much more active "rogues gallery" than anything comparable in the United States. If the London Exchange believes that an individual who is proposed as a director or officer has a poor reputation, informal pressure will force his removal.[111] It is also important to note that the London Exchange has occasionally refused to grant a listing solely on the basis of the quality of the issue. Although exchanges in the United States also refuse listings based on quality, the effect of denying a listing in Great Britain is virtually to prevent the company from selling securities to the public.

109. MEMORANDA OF GUIDANCE, *supra* note 59, at 14, para. 13. The role of the accountant is discussed in detail pp. 91-97 *infra*. In general, it can be stated that the London Exchange relies heavily on the opinions of the auditor and considers him the most important key to investor protection.

110. Recently, the S.E.C. has requested internal memos prepared by underwriters. *See* SEC Securities Act Release No. 4666, *supra* note 96, at item 25.

111. This gallery has been described in various interviews, and is frequently mentioned in descriptions of the operation of the City. *See, e.g.*, JENKINS REPORT, *supra* note 5, *Minutes of Committee;* A. MERRETT, M. HOWE & G. NEWBOULD, EQUITY ISSUES AND THE LONDON CAPITAL MARKET 15 (1967).

The final form of direct regulation is the London Exchange's requirement that every company seeking a quotation be sponsored by a broker who is a member of the Exchange. This may be a hold-over from the club concept of the Exchange: a new securities issue, like a new member, must have a sponsor to vouch for its reputation. The Exchange normally deals with a company through its broker. The Exchange attempts to build a continuing responsibility in the broker and has used the original sponsoring broker to contact a company in matters concerning trading problems and approval of circulars. In the original negotiations concerning the nature of the offering and the content of the prospectus, the formal contact is with the broker, and he usually acts as intermediary between the issuing house or solicitor and the Quotations Department. If matters become complicated and discussion prolonged, or if time becomes critical, negotiations take place directly with the company. This direct contact by a non-broker is a matter of privilege, not of right. The Exchange considers it an important aspect of its regulation that a broker, a member of the Exchange, has a direct responsibility for every company and every issue in which there is a quotation.[112]

D. *Other Regulatory Restrictions on Security Issuance*

1. *Bank of England.*—Under the Borrowing Act of 1946, the British Treasury has authority to restrict all issues of stock and debt securities unless they have received prior consent of the government.[113] The purpose of regulation under that Act is two-fold: to restrict foreign security issues in order to protect the British balance of payments; and to control the timing of domestic issues. To effectuate this broad scheme, the regulations extend not only to matters of timing, but also to the amount borrowed and the terms of the debt issue.[114]

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112. Members of the London Exchange themselves admit that there are great differences between brokers in how seriously they take their responsibility. One member candidly reported, " . . . a company can always find some broker who is prepared to sell his soul for a fee."

113. Borrowing (Control and Guarantees) Act of 1946, 9 & 10 Geo. 6, c. 58. Under this authority the Treasury issued the Control of Borrowing Order of 1958, STAT. INSTR. 1958, No. 1208, *as amended,* Control of Borrowing (Amendment) Order of 1959, STAT. INSTR. 1959, No. 445, *and* Control of Borrowing (Amendment) Order of 1967, STAT. INSTR. 1967, No. 69.

114. Permission may be given but the amount cut. For example, Australia recently requested permission to sell £20 million worth of bonds, but authority was granted to sell £10 million.

The Treasury has delegated its regulatory power under the Borrowing Act of 1946 to the Bank of England.[115] In their application to foreign borrowers, the regulations require the consent of the Bank of England whenever non-resident persons, including governments, request to raise capital either through an issue of securities denominated in sterling, or a direct borrowing in sterling, such as a bank loan. Under current practice, borrowing of this nature is severely restricted. Consent is given to residents of Australia, New Zealand, South Africa and the Irish Republic only in situations which promise an early, substantial and continuing benefit to Britain's balance of payments.[116] Consent for borrowing by residents of less developed sterling area countries is easier to obtain, but consent is rarely given to non-sterling or non-Commonwealth countries. The Bank of England considers blue chip foreign government issues to be in active competition with issues of the British and local governments and is concerned with any activity that increases the cost of domestic security issues.

Permission under the Borrowing Act is no longer required for foreign borrowing in non-sterling currency. This means that international dollar bonds by foreign governments or companies need not be given specific permission. Of course, all investments in non-sterling currency are subject to general exchange controls and must be purchased through the pool of investment securities known as "investment dollars."[117]

The extent of control over domestic issues depends on the identity of the borrower. The Bank of England has authority to regulate both the terms and timing of all securities issued or guaranteed by the British Government, a local authority or a nationalized industry.[118] This power to regulate extends to all aspects of the securities involved, including the amount that is issued, the rate and life of the security, the coupon rate, the amount of discount and the premium. The Bank

115. *See* note 113 *supra.* A Capital Issues Committee was also established.

116. Bank of England announcement of May 3, 1966.

117. Exchange Control Act of 1947, 10 & 11 Geo. 6, c. 14. The premium for investment dollars has been in the range of 15 to 25%. As a matter of practice, the Bank of England gives permission to merchant banks to trade in international bond issues without the requirement that it be done with investment dollars. This is done to aid the financial community in maintaining its active role in underwriting and trading in these securities. The argument is made that commissions obtained by the merchant banks help the balance of payments. The Bank of England does not believe that any significant amount of international bonds is actually taken up in England.

118. *See* Trustee Investment Act of 1961, 9 & 10 Eliz. 2, c. 62, schedule 1, pt. II, §§ 1-5.

of England's primary concern is whether the financial market will absorb the securities at reasonable terms,[119] and the Bank relates all its decisions to the needs of the national government. In its regulatory capacity, the Bank has placed severe limitations on the access to British securities markets by other gilt-edged securities that the Bank believes may compete with the various government securities. The waiting time, or queue, for long-term local bonds has recently run as long as seven to eight years. Within this general scheme, some issues are given priority. For example, issues by the Greater London Council are released prior to other local issues and short-term issues, *i.e.*, two to three years, usually can move in on a separate list with almost no waiting. Furthermore, maturing issues are generally given priority in order to enable renewal on approximately similar terms.

The Bank of England has direct authority to regulate only the timing, and not the terms, of private corporate debt issues. In practice, the actual timing of domestic corporate debt issues is handled through the government broker, a senior member of the London Stock Exchange, who receives a request for an issue date several months prior to the anticipated issue.[120] While the Bank claims to control only the timing of an issue, the real goal is to spread out the issues entering the market in a manner sufficient to serve as an indirect regulation of the cost of capital. By this system, the Bank seeks to prevent fluctuation in the cost of government and corporate borrowing. If there were no government control of timing, the terms would be established by the competitive pressure in the market. To the extent that corporate bonds compete with government bonds, the self-interest of the government dictates low rates and the queue system appears to be directed to this end. During the past several years, the queue for corporate bonds has ranged from three months to over a year. There was no queue for ordinary shares during the same period because there had been a general dearth of equity issues in the market during the prior few years. One effect of the queue system is to discourage corporate use of the securities markets because of the uncertainty and delay. But some argue that since the queue usually causes delay only in fixed interest financing, it encourages corporations to issue equity securities. There is, however, little evidence to support this hypothesis.

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119. These bonds are given priority over the blue chip overseas Commonwealth government issues.

120. The significant date is that of the "impact time," rather than the closing date. The impact date is the date of the underwriting and pre-placing effort, and is usually a week to ten days prior to the actual subscription date.

In weak and undeveloped securities markets, a queue can be justified simply as a device to stabilize large fluctuations in the price of securities. In the relatively sophisticated British securities market, however, a queue for corporate securities issues appears detrimental to the dual goals of encouraging corporate investment and promoting the role of the securities market as a source of funds. By contrast, the United States has no direct control over access to its securities market. Securities issues of states and local authorities are virtually free of any regulation and they openly compete with federal and corporate bonds.[121] Foreign borrowers are restrained by the interest equalization tax, but this is more a form of exchange control for balance of payment purposes than an attempt to control the timing, interest rates or terms of a debt issue. Indirectly, however, the United States Federal Government influences supply and demand in the American securities market by such means as its monetary policies, the activities of the Federal Reserve Board, fixing margin levels, setting discount rates and conducting open market operations.

Aside from its direct control, the Bank of England plays no other role in regulating securities issues.[122] It has no authority to check the prospectus of any issue with respect to disclosure requirements. Apart from consultations with the government broker, the Bank has relatively little direct contact with the London Exchange, although the Exchange occasionally may call upon the Bank's economic intelligence department for information and statistical data concerning a particular individual or company.

2. *Issuing Houses.*—It is frequently said that the most effective regulation of new securities issues is done by the issuing houses.[123] In the Jenkins Committee Report, the role of the issuing house in investor protection was described as follows: "Reference should also be made to the part played by the Issuing Houses through whom most new issues of any importance reach the public, and who are concerned for their own credit to see that proper standards are maintained."[124]

There are no statutory provisions for the activities of the issuing houses. There is not even a single definition for the term, "issuing

121. In the United States, municipal bonds are given an indirect subsidy by the government in that they are tax free to the investor.

122. The Bank of England does play a role, however, in the regulation of issuing houses, in granting licensing exemptions and in administering the Take-Over Bid Code.

123. *See* R. PENNINGTON, *supra* note 6, at 198. He comments that the backing of an issuing house in the sale of a security will decidedly affect investor confidence and in the case of small or unknown companies is a virtual necessity.

124. JENKINS REPORT, *supra* note 5, at § 225.

house." In practice, it is used to describe both a type of merchant bank[125] and a type of business activity performed. In the case of the latter definition, the reference is to the functions of underwriting, marketing and arranging for a security issue—the term "sponsoring the issue" is used in the vernacular of the financial community. The two definitional concepts become confused in that the activity of an issuing house will vary depending on the type of security offering. For example, in both rights offerings and private placements the services of an issuing house may not be used at all, and in every such case, they are used to a lesser degree than in public offerings. Recently, there have been numerous offerings to the public that have taken place without using any services of a merchant bank. A broker, solicitor or some other individual may perform the financial functions of an issuing house.[126] In most instances, however, when securities are being offered to the public, one of the large merchant banks that is a member of the Issuing House Association will perform some function in the offering.

The major merchant banks are often financial advisers to the company that they represent since they have a long-term and continuing interest in the company. In most instances, they also recognize an implied responsibility to the investing public and realize that the London Exchange looks to them to assume some regulatory role. There is little agreement among the issuing houses, however, on the extent of this role. Usually the issuing house itself does the initial drafting of the prospectus. It is then carefully checked by one of the large firms of solicitors. In addition, the issuing house is usually the negotiator between the company and the London Exchange, although formal contact is made through the company broker.

The regulatory function performed by the issuing house in a securities offering in Great Britain is comparable to that performed by a major investment banking or brokerage house acting as an underwriter in the United States. In both countries, the underwriter has two sets of clients: the company that is attempting to raise capital and the underwriter's investor clientele. The underwriter's responsibility is to protect the interests of both. The primary incentive of the underwriter, however, is self-interest; it does not wish to have its name attached to an issue that is not successful. It realizes that its future success depends in large part on the satisfaction of the investors with

125. There are 56 members of the Issuing House Association of which 16 are clearing house banks. It is reported that 7 merchant banks do over 50% of all new issues. A. MERRETT, M. HOWE & G. NEWBOULD, *supra* note 111, at 23.

126. Cazenone & Co. is reported handling more issues than any other issuing house. A. MERRETT, M. HOWE & G. NEWBOULD, *supra* note 111, at 26.

whom it deals. The underwriter must thoroughly investigate the company before it can offer advice on financing and must present a plan that is reasonable to both the company and the investors. The underwriter acts to protect his own interests, and to the extent these interests coincide with those of the investing public, the underwriter performs an indirect but indispensable role in protecting the interests of the investing public.

It is difficult to find any tangible basis of regulation by issuing houses beyond this self-interest. The Issuing Houses Association is a very loose-knit association and, aside from its participation in the Code controlling take-over bids, it does not purport to set standards for its members or to serve as a self-regulatory body.[127] It is basically a trade association that both provides a forum for the discussion of common problems and represents its members to the public.[128]

The extent of independent investigation by an issuing house in connection with a new security issue is subject to significant variation depending on many factors, including the extent of the prior relationship between the issuing house and the company. Recently, some issuing houses have insisted on an independent set of accounts prepared by their own accountants and have instituted formal procedures to obtain information from the company and its staff. The procedures usually include inspections both by members of the issuing house and by outside experts. In some instances, however, it is reported that issuing houses work only on the basis of information reported to them by the company, and several issuing houses have expressed concern over the caliber of work done by some of their competitors. The London Exchange is aware of differences in the quality of the independent investigation by an issuing house; the Exchange apparently adjusts the amount of its own scrutiny of a new securities issue in relation to the level of confidence it has in the particular issuing house involved.

There are also those who are concerned about the dramatic increase in competition between merchant banks and believe it has brought a lowering of standards. This concern is based on the fear that if issuing houses are too rigorous, they may lose clients to less scrupulous competitors. Indeed, it does appear that rarely is a corporation turned down by an issuing house, and it is generally believed that a company can always find someone who will handle its offering and application

127. The Issuing House Association is clearly not a self-regulatory body in the sense of the London Stock Exchange or the Institute of Chartered Accountants.

128. The Association has become more active in connection with the Take-Over Bid Code.

for a quotation. Merchant banks that are the primary issuing houses have become more oriented to a role of corporate adviser. Their major activity in this respect is the selling of financial advice and services in connection with mergers, take-over bids and general matters of corporate policy. This orientation, coupled with the greater size and heterogeneity of the investing community, perhaps has resulted in merchant banks identifying their interests more closely with their corporate clients than with the investing public. Moreover, individual merchant bankers in firms are often company directors. The presence of such people on the board of directors may be beneficial to the company, but it creates an inherent conflict of interests for the merchant banks when they are acting as underwriters. It also seriously affects the ability of the firm to offer an independent source of investor protection.[129]

Issuing houses and their counterparts in the United States perform a valuable role in investor protection. Contrary to a frequently stated view, this role does not appear to be greater in Great Britain than in the United States. Particular firms in both countries maintain high standards. No investment banker or underwriter wants to be associated with an unsuccessful financing venture for a company. In both countries, however, there is a significant variation in standards among issuing houses and in neither country should too much reliance be placed on the institutional role of an issuing house or underwriter apart from the particular issuing house's reputation.

3. *The Accounting Profession.*—The accounting profession in Great Britain plays a role in securities regulation that in many respects

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129. In this connection it is enlightening to contrast the testimony of the representatives of the Issuing House Association before the Jenkins Committee with that of members of the London Stock Exchange. Apparently, the sole concern of the issuing houses' representatives was to protect corporations from further regulation. They were opposed to any regulation of non-voting shares or pre-emptive rights, both of which were supported by the London Exchange as a matter of investor protection. The issuing house members also testified that there was no need for any new investor protection or prospectus requirements in rights offerings or share-for-share transfers. The attitude of those testifying can be summarized by two statements: (1) that in rights offerings and share-for-share transfers an investor is sufficiently protected if he follows the advice of his directors; and (2) "I think the point is we cannot do it [provide investor protection] by legislation, but the force of city opinion and financial advice can judge in individual cases." JENKINS REPORT, *supra* note 5, at 353 (statement on pre-emptive rights), 357 (statement on Exchange offerings), 359 (statement on non-voting shares), 366 (statement on investor protection). On these items, the views of the issuing houses contrasted not only with those of the London Stock Exchange but also with the Financial Analysts Association.

is broader and more influential than in the United States. The Companies Act requires certified accounts to be filed annually and certified financial statements to be included in the prospectus prior to a new security offering.[130] To be qualified to give a certification under the Companies Act, an auditor must be licensed either by the Board of Trade or by a member of a body of accountants recognized by the Board of Trade.[131] The London Stock Exchange also requires certified financial statements prior to granting a quotation.[132] The Exchange relies heavily on the formal certification of the accountant and, in addition, requires various letters of opinion from accountants to augment the certification. In a less formal but equally important function, accountants provide reports that border on investment advice to issuing houses, brokers and other members of the financial community.

In contrast to the officially recognized functions of British accountants, there is relatively little direct regulation of the accountants themselves. Membership in the four recognized accounting bodies in the United Kingdom is similar to membership in the American Institute of Certified Public Accountants (A.I.C.P.A.) in the United States, but Great Britain has no counterpart to the licensing requirements that exist in every state in the United States. The only statutory controls on accountants are those contained in the Companies Act in connection with serving as an auditor for a registered company.[133] The Board of Trade exercises no authority or restriction

130. Companies Act of 1948, 11 & 12 Geo. 6, c. 38, §§ 124-29, 147-63; Companies Act of 1967, c. 81, §§ 3-12; INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES, THE ACCOUNTANCY PROFESSION IN THE UNITED KINGDOM, ITS DEVELOPMENT AND STRUCTURE 21 (1966) [hereinafter cited as ACCOUNTANCY].

131. ACCOUNTANCY, *supra* note 130, at 17. The general accountancy bodies in the United Kingdom which are recognized by the Board of Trade for the purposes of the Companies Act are: The Institute of Chartered Accountants in England and Wales; The Institute of Chartered Accountants in Ireland; and the Institute of Certified and Corporate Accountants. *See also* PROFESSIONAL ACCOUNTING IN 25 COUNTRIES, ch. 19, at 10 (1964); K. SMITH & D. KEENAN, COMPANY LAW 139 (1966).

132. STOCK EXCHANGE RULES, app. 34, schedule II, pt. A, item 21.

133. ACCOUNTANCY, *supra* note 130, at 5 & 7. Most actual regulation of accountants in the United States is in the form of self-regulation. While the C.P.A. certificates are issued by each state, the examination and standards are set by the A.I.C.P.A. In effect, it is the A.I.C.P.A. that issues the certificates while the states license practice in that state if one passes the Uniform C.P.A. Examination. There are minor differences in the extent of the examination from state to state, but not in the content.

over the accounting bodies that it has recognized. There are no officially designated educational, ethical or accounting practice standards. Rather, each recognized body sets up minimum standards for entrance into the profession and general ethical standards.[134]

The certification of the financial statement that is required under the Companies Act must deal expressly with the following matters:

> (1) whether, as auditors, the certifying parties have obtained all the information that they deem necessary for their audit;
> (2) whether proper books of account have been kept by the company, and whether proper returns adequate for the audit have been received from branches not actually visited by the auditors;
> (3) whether the company's balance sheet and profit and loss account agree with the company's books and returns;
> (4) whether, in the auditors' opinions and to the best of their knowledge according to the information and explanations given to them, the accounts give a true and fair view of the company's financial position.[135]

There is, however, no specific statement in the accountant's certification, as there is in the United States, that the balance sheet and related statements of income and retained earnings have been examined and prepared in accordance with generally accepted accounting principles. Thus, there appears to be a greater range in the quality of reporting in the British accounting profession than there is in the United States.

For public companies that are quoted on the London Exchange, the applied standards and the quality of accountants are comparable to those found in the United States. The Institute of Chartered Accountants in England and Wales, the largest of the accounting bodies recognized by the Board of Trade, has rigorous standards for admission. An individual must be an articled clerk, *i.e.*, an apprentice, for a period of from three to five years and must then pass an extensive series of examinations.[136] The Institute has approximately

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134. ACCOUNTANCY, *supra* note 130, at 13. There are officially designated standards for ethics in clauses 20 and 21 of the Supplemental Royal Charter. INSTITTUE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES, MEMBERS HANDBOOK, *Practical Points,* § P, at 11. *See* PROFFESSIONAL ACCOUNTING, *supra* note 131, ch. 19, at 11.

135. ACCOUNTANCY, *supra* note 130, at 17, 18; THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES, GENERAL PRINCIPLES OF AUDITING, *Statement on Auditing No. 1,* at 8 (1961); and PROFESSIONAL ACCOUNTING, *supra* note 131, ch. 19, at 14.

136. ACCOUNTANCY, *supra* note 130, at 5-10. In the United States, a college degree plus a minimum number of credits in accounting courses is

42,500 members and a professional staff of over 100.[137] The Institute has a regular procedure for handling complaints when they are submitted by members of the public, as well as a standing investigating committee that takes disciplinary action against members. The Institute also has a professional standards committee that is designed to encourage members to follow recommendations of the Institute in connection with achieving uniform auditing procedures. For example, the Institute recently issued a statement on auditing which recommended detailed procedures for internal control and verification of physical assets.[138] The Institute thus far has concentrated its efforts on improving existing accounting and auditing procedures, rather than attempting to establish uniform accounting principles. In this respect, the Institute's activity is similar to that of the A.I.C.P.A., although the latter organization also has been taking some reluctant steps toward uniformity of accounting principles and financial reporting.

When a company is seeking a quotation on the London Stock Exchange, the issuing house involved frequently will require an independent investigation by auditors other than the company's regular auditors. When this is done, the prospectus will contain the names of both accountants, one of whom is designated as "the reporting accountant."[139] As an unwritten rule, the Exchange insists that either the company's accountant or the reporting accountant be one of a relatively small number of major accounting firms. The Exchange places great reliance on the reputation of these firms. A firm brought in as a reporting accountant frequently will insist on conducting an extensive independent audit check of the company, including checks on internal control, verification of inventories, inspection of the actual physical plant and circularization of accounts receivable.[140]

As discussed earlier, the degree of disclosure in the financial statements of British companies is much less extensive than is required

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required. In most states, a practice requirement from one to three years is required before completing all parts of the C.P.A. exam.

137. ACCOUNTANCY, *supra* note 130, at 10; THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES, REPORTS AND ACCOUNTS 21 (1966). "The number of members of the Institute on January 1, 1967 was 43,457." *Id.*

138. THE INSTITUTE OF CHARTERED ACCOUNTANTS IN ENGLAND AND WALES, INTERNAL CONTROL, *Statement on Auditing No. 4* (1964).

139. ACCOUNTANCY, *supra* note 130, at 21.

140. *See* London Times, March 6 & 7, 1970, for a description of the use of separate accountants.

in the United States. A significant omission is that of subsequent balance sheet events and of events that have occurred after the company's year end.[141] Moreover, the information that is disclosed is not scrutinized to the same extent as in the United States. The Board of Trade does not check any filed financial statements, either the annual accounts or those submitted in connection with new issues.[142] The London Exchange, while taking a somewhat more active role in the last few years in the overall scrutiny of prospectuses, still has done relatively little with financial statements. In this regard, the only noteworthy effort to date is a recent memorandum prepared by the Exchange in consultation with the Institute of Chartered Public Accountants that specifies the form of presentation of certain items of the financial statement. This memorandum has now been incorporated into the London Exchange requirements.

Although less information is actually disclosed in the financial statements by the accountant, and in spite of the fact that there is less scrutiny of the financial statements by the regulatory authorities, the role of the British accountant in securities regulation is more substantial than that of his American counterpart. Accountants in the United Kingdom are expected to make judgments of value and fact to a much greater extent than are accountants in the United States. This situation derives in part from the historical role of the accountant in the United Kingdom. Within a British corporation, the auditor has long been considered an officer of the company and a vital part of its management.[143] He also is expected to be independent of management and to play the neutral role of an umpire watching over shareholder interests. British accountants do almost all the tax work, and are heavily involved in liquidations and as trustees. They frequently act as financial advisers to individuals and are entitled to obtain a share in commissions from members of the London Exchange on securities sales and from insurance companies on sales of insurance policies. British accountants also are continually asked to render opinions to investment bankers and other members of the financial

141. PROFESSIONAL ACCOUNTANCING, *supra* note 131, ch. 19, at 15.

142. A demand by 200 shareholders or a shareholder holding not less than one-tenth of the shares issued is necessary before the Board of Trade will appoint an inspector to investigate the company's affairs. The application must be supported by such evidence as the Board may require in order to show good reason for investigation. If from the inspector's report it appears to the Board that any person has been guilty of a criminal offense, the matter is referred to the Director of Public Prosecution. *See* K. SMITH & D. KEENAN, COMPANY LAW 143-45 (1966).

143. *See* The Queen v. Shacter, [1960] 1 All E.R. 61 (Crim. App.).

community regarding such matters as the soundness of various companies.

This reliance upon the opinion of the accountant is evident in the requirements of the London Stock Exchange. Accountants must submit letters to the Quotations Department concerning three separate matters.[144] The first is merely a statement that generally accepted accounting principles have been used in connection with any audit of stock or other work in progress. This is a matter that would normally be handled by opinion letter in the United States.[145] The other two items ask for opinions concerning the reasonableness of amounts taken for depreciation and amortization, and the reporting of the equalization of taxation provisions.[146] These opinions call for highly subjective judgments by the British accountants. In addition, the directors of a company are required to give their opinions regarding the sufficiency of working capital and the prospects for earnings for the coming year.[147] While the accountant does not sign these opinions of the directors, it is generally assumed that the accountants approve them and that they are justified by the financial account of the company.[148]

Reliance is also placed on the value judgments of the British accountants in the independent audit required of member firms of the London Stock Exchange.[149] In referring to the sections imposing this requirement, the Institute of Chartered Public Accountants has made the following statement: "Important responsibility rests upon the independent accountant. The report required of him is partly a statement of fact and partly a statement of opinion."[150] The financial community appears to rely more upon the certification and

144. MEMBERS HANDBOOK, *supra* note 134, at 6; STOCK EXCHANGE RULES app. 34, schedule II, pt. A, item 21.

145. MEMBERS HANDBOOK, *supra* note 134, at 6, 7.

146. MEMBERS HANDBOOK, *supra* note 134, at 7, ¶ 12.62.

147. MEMBERS HANDBOOK, *supra* note 134, at 21, ¶ 12.65; PROFESSIONAL ACCOUNTING, *supra* note 131, at 28.

148. PROFESSIONAL ACCOUNTING, *supra* note 131, at 28. In the U.S. the accountant certifies only the financial statements indicated in his opinion letter; all the other parts of the report are written by the company, and the accountant has no responsibility for its contents.

149. MEMBERS HANDBOOK, *supra* note 134, at 9.

150. MEMBERS HANDBOOK, *supra* note 134, at 8. He has to state as a fact whether the balance sheet shows assets (as specially defined) in excess of liabilities (as specially defined) to an extent not less than the minimum margins of solvency. An opinion must also be given that the balance sheet gives a true and fair picture of the affairs of the firm, and that it complies with various requirements.

opinion of the accountant than upon the information disclosed in his account. This attitude corresponds with other aspects of securities regulation in Great Britain; the principle emphasis is placed on the men behind the companies and "the integrity of management," rather than on full disclosure of company results. There is less concern than in the United States over whether the accountant has disclosed essential information sufficient to permit the investor to determine for himself the status of a company. Instead, reliance is directed to the fact that an outside expert, the accountant, has investigated the company and, in his opinion, the accounts contain nothing fraudulent or misleading.[151]

III. Regulation of Trading

A. *The Mechanics of the Secondary Market*

1. *The Secondary Market in Securities.*—A recent survey by the London Stock Exchange estimates that 2,500,000 British citizens—approximately seven per cent of the population—directly own securities quoted on the London Exchange. In addition, it is estimated that 22,500,000 persons in Great Britain are indirect investors through life insurance, pension schemes and unit trusts.[152] Almost all secondary trading of these securities is done through the London Exchange. This is true not only of ordinary shares of corporations, but also of fixed-interest corporate securities and government securities. There is no over-the-counter market as it is known in the United States, and there is virtually no trading in unlisted securities. Some trading of listed securities does take place through non-members of the London Exchange—generally by merchant banks matching orders of institutional investors—but it is relatively minor.

Brokers on the London Exchange are required to submit trading data in only six broad categories:

(1) British Government and government guarantees under 5 years;
(2) British Government and government guarantees over 5 years;
(3) local authority bonds;
(4) overseas government, provincial and municipal bonds;

151. *See In re* Thomas Gerrard & Son, [1967] 3 W.L.R. 84; 111 S.J. 329; [1967] 2 All E.R. 525.

152. Revell & Moyle, Owners of Quoted Ordinary Shares (1967).

(5) fixed-interest preference and preferred shares; and
(6) ordinary shares.[153]

Comparison of the total value of the securities in these categories to the turnover rate of the securities reveals that there is an active and extremely liquid market in British Government and government guaranteed securities, but that there is a relatively low turnover and trading volume in British local authorities, overseas government and all fixed-interest and preferred securities.[154] In terms of monetary value, trading in ordinary shares represents only about 20 per cent of the trading volume that takes place on the London Exchange.[155] On the other hand, in terms of the number of transactions, about 80 per cent of the trading is done in ordinary shares. Although statistics on individual securities are not available, it is estimated that there are relatively free trading markets in roughly 1,000 of the approximately 8,000 securities of the 3,842 listed companies. By United States standards, active securities trading exists in only about 200 securities.

Under the current London Exchange rules, it is not permissible for a member to trade individually; rather, he must be a member of, or be associated with, a firm of at least two members.[156] In contrast to the situation on the New York Stock Exchange, where a large brokerage firm may have only one or two partners that actually have seats on the New York Exchange, it is necessary in Great Britain to be a member of the London Exchange in order to be a partner of a stock exchange firm. The firm may, however, employ trading clerks who have authority to go onto the floor and actually transact business in the name of the member firm; in fact, much of the actual trading is done by these clerks.[157] On the New York Stock Exchange, on the other hand, all of the actual floor trading is done by members only.

As of March 24, 1967, the London Exchange had 3,208 members, divided into some 225 broker firms and 45 jobber firms.[158] Amalgamations and combinations have continued to diminish these numbers. In large part, the movement toward merger of member firms can be traced to the 1966-67 decline in the business and profits of stock exchange firms.[159] The contraction of trading volume during

153. The Exchange furnishes this information to the Bank of England daily, but only publishes the figures on a monthly basis.

154. *Bank of England Statistical Quarterly Report.*

155. *Id.*

156. STOCK EXCHANGE RULE 86 (1).

157. STOCK EXCHANGE RULES 59, 67 (1).

158. MEMBERS BOOK OF LONDON EXCHANGE.

159. It is indicative that during this period 217 members resigned compared to 137 new members. In addition 30 members died, which left a net loss of about

that period was attributed to changes in the tax laws. Britain, for the first time, instituted a long-term capital gains tax and, at the same time, altered the corporate tax. These changes resulted in less attractive dividend yields; the economy suffered a general slow-down; and, finally, securities prices slowly slipped. This recent tendency for stock exchange firms to merge into larger trading units has been particularly true of jobber firms. It is argued that the larger trading units are necessary in order to allow the jobbers to take a large position in the various securities markets and to trade in larger blocks of stock. Furthermore, it is contended that greater efficiency results from larger units and that this helps overcome increasing costs.

2. *The Jobbing System.*—The jobbing system in Great Britain involves a complete separation of the functions of broker and dealer. The jobber does not deal directly with the investing public; rather, his contact is only with brokers.[160] In every transaction the jobber is, at least in form, a principal who is buying or selling for his own account. A broker must execute every transaction through a jobber and is not permitted to cross orders within his own firm or to deal directly with other brokers. In contrast, on the New York Stock Exchange, brokers are constantly dealing directly with other brokers. The function of the jobber on the London market has been described as follows:

> His job is primarily to create a market by setting his price to reflect the balance of buying and selling in stock, and at the same time, in his capacity as a principal, to act as a buffer against short term variations in price. He cannot by himself influence the ebb and flow of supply and demand for more than a very short period of time and he would never willingly become, even for a short period, the equivalent of an investment trust, if by so doing his ability to make a market becomes affected. He should act on the principle that a "fast nickel is better than a slow dime."[161]

The role of the specialist on the New York Stock Exchange corresponds in many ways to that of the jobber. However, unlike the jobber, the specialist usually enters a transaction only when there is a lack of buyers or sellers at a reasonable price. On the London Stock Exchange, the jobber is involved in either the buying or selling end of

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100 members. The price of membership fell to a low of £20 in 1966, as compared to a price of over £2000 three years earlier.

160. In respect to all of their business, jobbers do not simply sit back and wait for brokers to call them. The major jobbers are active in selling securities and contacting brokers. Although jobbers are not supposed to have direct dealings with clients, they do in fact have extensive contact with major institutions and constantly furnish them with information.

161. Lewis, *Jobbing Today,* THE STOCK EXCHANGE JOURNAL, March, 1964, at 21.

every transaction. Trading on the London Exchange can be compared to trading in the United States on an "organized" over-the-counter market.

Both jobbers in Great Britain and specialists on United States exchanges tend to be extremely defensive about their roles. As a result, public statements by members of both professions stress the public service functions of their roles and imply that they involve great personal sacrifice. Nonetheless, the irrefutable fact remains that the jobber, like the specialist, is in business to make a profit. A fuller understanding of their respective roles can be achieved by bearing in mind this fact. The jobber is interested primarily in the volume and velocity of the turnover. In an active securities market with numerous buyers and sellers, the jobber primarily matches orders. He buys and sells for his own account as a principal, but, as a practical matter, his risk is small because his profit from each transaction is in the nature of a commission. The "jobber's turn" compensates him for playing this matching role. A jobber may accumulate a substantial long or short position in active securities, but since there is a large turnover of these securities, the positions fluctuate. Jobbers make most of their profits from this activity on the 100 most actively traded securities.[162] Perhaps one reason for the defensive attitude of the jobber is that it is in the most actively traded securities that his function is least needed because there tends to be great liquidity in these securities and jobbers are able to handle large block transactions. In these active securities, the major jobbers are often willing to give a firm price on as much as a one million pound order.

Approximately 400 to 500 other securities have occasional active trading markets, depending on the general level of the market and on specific news items relating to individual companies. In these securities, the jobber's profits still come from the jobber's turn, but since there is less turnover and a narrower market, there is a greater risk to the jobber in building large positions. In the remainder of the quoted securities, the markets are relatively inactive. Jobbers are reluctant to maintain large positions in these inactive securities because capital is tied up and there is a great danger of capital loss from rapid price fluctuation. Jobbers are particularly reticent about becoming short in such securities. It is in the large group of relatively inactively traded securities that the jobber function is most needed. At the same time, it is in these securities where there is the greatest risk

162. The most actively traded securities naturally vary. It is indicative that until recently there were 18 jobbers handling the stock of Imperial Chemical Industries (I.C.I.). Through amalgamation and combinations of jobber firms the number is now reported to be about 12.

to the jobber and the smallest amount of profit. In these less actively traded securities, a jobber will often refuse to handle a large transaction unless he knows there is a purchaser or seller on the other side.

On the London Exchange, the notion of a stock exchange monopoly is based not on the fact that all transactions take place on the floor of the Exchange, but rather on the fact that Exchange members must be involved. Members of the London Exchange may deal in quoted securities at any time or place so long as the transaction is with a jobber.[163] This procedure is in contrast to that of the New York Stock Exchange, where members are required to transact all business on the floor of the New York Exchange and where all transactions must appear on the Exchange's ticker tape.

A controversy currently exists between merchant banks and jobbers regarding the extent to which the large orders of institutions should go through a London Exchange broker or jobber. The merchant banks argue that in the case of many securities, the jobbers cannot handle the transaction and thus the bank itself must find the other party. In many issues, particularly fixed-interest securities (bond issues) that were initially placed privately, there is no liquidity for the shares on the Exchange. If an institutional investor wishes to sell a large block, it must be arranged through another institutional investor or group of investors. Brokers will often play an active role in arranging block transfers, binding the purchaser or buyer to the other side and then putting the whole transaction through a jobber. In this type of transaction, the jobber usually will be given a very small turn. There are no restrictions on either merchant or commercial banks in arranging block transactions. Many of the large merchant banks act as investment advisers for large institutional investors and frequently arrange transactions with their own clients and with the clients of other banks. In these instances, neither the Exchange broker nor the jobber obtains any commission. Members of the Exchange argue that unless jobbers are given business by which they can profit, they will not be able to perform their function when dealing with less active securities.

The Exchange has recognized the problem of maintaining jobber profits by insisting that "put through" business be given to jobbers and by insisting that even in the private placement of debt securities, jobbers be entitled to at least 30 per cent of the offering. This latter restriction gives jobbers what in effect amounts to an underwriting

163. One of the largest jobber firms has a trading post at its office, and is reported to transact as much business by telephone after hours as it does on the Exchange floor.

commission. Perhaps other steps such as allowing jobbers to deal directly with institutions in certain block transactions would be more effective in maintaining jobber profits. Nonetheless, the jobbing system is an efficient one for transacting business and results in increased liquidity and general price stability. However, neither the jobbing system nor the specialist system can create markets where none previously exists.

The maintenance of free and open markets may be evaluated by a variety of criteria, including the avoidance of conflicts of interest, the presence of competitive markets and a full disclosure of trading data. The jobbing system performs relatively well in the first two areas. The separation of functions of broker and dealer in Great Britain also reduces conflicts of interest in the trading process. If a jobber were permitted to have a retail operation, it would be difficult to protect both his self-interest and the interest of the investor. For example, a large position obtained by the trading branch of a jobbing firm might lead to increased sales activity in the retail branch in order to reduce the position. This is a situation that occurs in the United States in over-the-counter securities. Furthermore, the specialist and other members on the New York Stock Exchange may act either as agents for customers or as dealers in their own accounts. If this situation is not regulated, the member's self-interest may compete with that of his client. The recent trading rules of the New York Stock Exchange have limited the extent to which ordinary members may trade for their own accounts on the floor of the Exchange,[164] and extensive rules regulate trading by the specialist in competition with trading by members of the public.[165] Likewise, brokers in the United Kingdom must place all their own orders through a jobber or must sell to the public at a price that is equal to or lower than the price that a jobber would charge for the same securities.[166] On the London Exchange, the jobber does not have public customers and all trades, therefore, are exclusively for his own account. As a matter of practice, individual members of jobber firms keep all their personal transactions outside of the firm. All of their own transactions are put through brokers like those of any other investor.

Potential conflict of interest problems arise in two other situations. The first is when London Exchange members become directors of public companies. Jobbers do not become directors of public companies precisely because it is felt that this would create too great a

164. N.Y.S.E. RULE 91 (taking or supplying securities named in an order), RULE 92 (limitations on members trading because of customers orders).

165. N.Y.S.E. RULE 104 (dealings by specialists).

166. STOCK EXCHANGE RULE 87.

potential for conflicts of interest. The same restrictions, however, do not apply to brokers. Many people in the financial community think this is unwise and are critical of the practice. When a broker is a director of a company, there is always the tendency to read something into any transaction that he conducts in his own company's securities. The second potential conflict of interest situation arises when jobbers are involved in take-over bids. Probably the most serious problem exists when the jobbers have access to information that is not available to the general public. There are no ground rules in these situations on what the jobber is obligated to disclose or what actions he is to take.[167] The danger of a false market and manipulation is increased when there is only a single source of supply of a security. Even for inactively traded securities, the presence of at least two jobbers for every security provides some competition, although a second jobber may offer little actual investor protection.

Judged by the third criteria by which the maintenance of free and open markets may be evaluated—the full disclosure of trading data—the jobbing system in Great Britain is weak. There is no ticker comparable to that maintained by the New York Stock Exchange. Volume and price information is not available. Furtheremore, while the jobbers "mark" some trades, they are not required to disclose any information to the London Exchange or any other authority. The marking system does insure that the price of actual trades is publicly known, but it does not provide for disclosure of either the number of shares transferred or the volume of shares traded at that price. The marks are reported in the financial press as a way to protect the jobber and broker from criticism by customers. In this respect, it is an improvement on the over-the-counter market in the United States, where the bid and ask price is disclosed, but not the actual price at which the transaction takes place. The markings for the inactively traded securities tend to be fairly accurate. In respect to the more actively traded securities, however, many bargains are not marked, and, in general, the markings are less representative.

As mentioned earlier, brokers disclose daily their total trading to the London Exchange in six broad categories. But there is no disclosure by brokers of their volume in individual trades. Although the jobber keeps an account of all his transactions with brokers in the different securities in which he is trading, most jobbers would object to regulations requiring disclosure of actual trading volume and prices in individual securities on a daily basis.[168] Their objection would be

167. The City Code on take-overs and mergers offers broad general guidelines, but does not specifically treat jobbers duties.

168. Some of the largest jobbers are extremely efficient and control

that if the jobber had to disclose all of his transactions, the position of the jobber in individual securities would become known and he could be vulnerable to buying or selling pressure. For example, if a jobber disclosed that he had been purchasing a large number of shares and thus probably had a long position, this could make it difficult for him to sell the shares without substantially lowering the price. Consequently, jobbers fear that they would not be able to take long positions if these had to be disclosed, particularly with respect to inactively traded securities.

Because of the lack of any central source of trading data, the London Exchange is not in a position to operate a stock watch program, nor is it in a position to make effective investigation of unusual price movements. Although individual jobbing firms are able to disclose from their records all of the transactions in the particular securities, this information usually is not disclosed to the Exchange. The London Exchange may, however, obtain the trading data by a Council investigation if a special request is submitted. Many brokers and some jobbers acknowledge the problem of lack of reporting and feel that efforts should be made to achieve some disclosure of trading data in at least the more active securities. But in spite of the paucity of trading data and the lack of regulation, the trading system on the London Exchange is held in "high" regard by the investing public. The separation of functions, the presence of at least two jobbers in most securities traded, and the generally high reputation of the members of the London Exchange all contribute to the positive belief of the investing public that the London market is fair and that the prices are honest.

3. *The Brokerage Function.*—The most startling comparison between the secondary trading markets in Great Britain and the United States involves the differing roles played by the stock broker in the two countries. The brokerage firms in London do not advertise and have practically no sales personnel who are not members of the London Exchange. For instance, a relatively large firm with a maximum of twenty partners[169] may have less than ten other individuals in the firm who would ever deal directly with customers. Branch offices are permitted under strict conditions, but there are few in existence. The main offices of the firms are located near the London Stock Exchange and are not equipped for direct customer

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operations with computers. They are able to provide the various brokers with a print out of all transactions on a daily basis. This allows the individual brokers to check their own records against those of the jobbers.

169. Until 1968 a partnership was limited to twenty partners. Some stock exchange firms have expanded slightly in the past two years.

contact. There is no ticker tape and few waiting rooms; one usually visits one's broker only by appointment. A recent survey of individual investors made by the London Exchange indicated that only about 30 per cent of the individual investors deal in securities through brokers and only about 10 per cent have a particular broker of whom they ask advice. Furthermore, over 50 per cent of the individual investors indicated that they deal in securities through their banks.[170] The role of the banks, however, is strictly that of an intermediary because they do not actively sell or give investment advice; they simply transmit orders to brokers. Under the rules of the London Exchange, banks, solicitors and chartered accountants can all share in commissions up to a specified percentage of the commission.[171] Members of brokerage firms and employees generally are compensated either on the basis of a salary or a bonus reflecting the direction of the firm's total profits. The only compensation on a commission basis to members and employees of brokerage firms is the practice of returning commissions to those who introduce business personally. This is in sharp contrast to the practice in the United States, where most brokers advertise extensively, have numerous branch offices and employ many salesmen. Furthermore, almost all American securities salesmen are compensated on the basis of commissions related to their individual business.

In addition to the differences in trading operations in the two countries, there are also differences in attitude. The stock broker in the United States recognizes that he is involved in marketing, and most are willing to be characterized as salesmen. The typical stock broker in England would be horrified by this description. Some brokers in Great Britain, however, particularly in the larger and more efficient firms, are beginning to take active steps in the marketing of securities. This activity has been directed particularly toward institutional investors, and, in this respect, some London brokers maintain extensive investment research departments and supply material to their major institutional clients. Part of the basic difference in attitude toward selling stems from the underlying approaches to security investment. In the United Kingdom, the investor traditionally has been concerned primarily with yield rather than with capital appreciation. A British investor would buy securities for a certain percentage return on his investment and sell only when this yield was not maintained. The concept of purchasing securities for capital appreciation is only slowly becoming accepted by investors and brokers. This

170. *Survey of Share Ownership,* THE STOCK EXCHANGE JOURNAL, September, 1965.

171. STOCK EXCHANGE RULE 199.

change in attitude in Great Britain is being stimulated by investment institutions that are performance conscious.

Automation is coming slowly both to the London Exchange itself and to its members. A few of the large jobbers and some brokers recently have installed computers and other devices to handle bookkeeping and to obtain current quotations. In many of the brokerage offices, however, the process of obtaining a price quotation is still quite leisurely. The situation at the London Exchange itself does not help matters: there is no ticker tape, and all prices have to be obtained by sending clerks out onto the trading floor and having them report back to price boards maintained by the brokerage firms. However, a price dissemination service for active stocks that will use television receivers wired to a centralized service is being initiated by the Exchange Council. In addition, the new London Exchange building and new automation will hopefully change current practice.[172]

There are no statistics available to indicate the extent to which securities are purchased on margin in Great Britain,[173] but it is assumed that relatively little margin buying is done. There are no restrictions imposed by the London Exchange on margin sales by Exchange members, and they are exempt from any restrictions by the Board of Trade.[174] The only limitation on a broker is a practical one based on his own ability to borrow funds and his confidence in his client.

B. *Statutory Restrictions and Regulation by the Board of Trade*

1. *General Description.*—The statutory restrictions on the selling and trading of securities are contained in the Prevention of Fraud Act of 1958.[175] The Act makes a three-pronged attack on the problems surrounding investor fraud: it prohibits securities dealing except by

172. See the description of new building communication plans in the Exchange publication, REBUILDING OF THE STOCK EXCHANGE (1965).

173. STOCK EXCHANGE RULES 96-99 cover bargains and settlement of accounts.

174. Licensed dealers are forbidden from selling on credit.

175. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45. The 1958 Act was essentially a re-enactment of the Prevention of Fraud (Investments) Act of 1939, 2 & 3 Geo. 6, c. 16. The Protection of Depositors Act of 1963, c. 16, has since added a few amendments to the 1958 Act. The Companies Act of 1948 which regulates the internal activities of companies and the initial issuance of securities is not concerned with trading subsequent to the original issue. The Prevention of Fraud Act resulted from the work of two special committees appointed to investigate abuses in selling practices. The reports of these

licensed dealers or other persons specifically exempted from licensing; it prohibits the distribution of any circular relating to the purchase or sale of any security unless distributed by a licensed or exempted dealer; and it makes false or deceptive statements in connection with the sale or purchase of a security or other investment contract a criminal offense.

While the form of the Act gives the Board of Trade authority to regulate those who trade in securities, the Board plays a relatively small role in the actual operation of the Act. Primarily, the Board determines who is entitled to an exempted status. Once a broker-dealer is within this category, the Board of Trade exercises no further regulation or control over him. Although accurate statistics on trading volume are not available, it is estimated that over 90 per cent of all securities trading is handled by persons who are in an exempted status under the Prevention of Fraud Act. For the small group of dealers in securities that in fact is licensed, the Board of Trade has issued some regulations concerning trading activity. Even in this instance, however, the Board of Trade does not take an active role in regulation. Enforcement action under the licensing authority or under the general fraud provision is rare.

2. *Regulation of Dealers in an Exempted Status Under the Prevention of Fraud Act.*—Those British dealers exempted from the licensing provisions and the prohibitions against the issuance of circulars in the Prevention of Fraud Act fall into three categories: members of recognized stock exchanges or recognized associations of dealers; dealers acting as managers or trustees for unit trusts; and dealers who are exempted specifically by the Board of Trade. In the first two categories, the Board does not approve individuals as such, but only verifies that they are either members of an approved organization or officers of a properly licensed unit trust.

The Board of Trade has authority to declare that any group of persons is a recognized exchange or association of dealers. The Board has complete discretion and is specifically given authority to vary or revoke an order granting recognition. The Board of Trade currently recognizes four exchanges and five associations.[176] In no instance has recognition been made conditional, and there have been no restrictions attached to any exchange or association or to any broker

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committees revealed flagrant instances of fraud both in the selling of securities and in the handling of investor funds. BOARD OF TRADE DEPARTMENT COMMITTEE ON FIXED TRUSTS, REPORT, CMD. No. 5259 (1936) [hereinafter cited as the ANDERSON REPORT]; BOARD OF TRADE DEPARTMENT COMMITTEE ON SHARE-PUSHING, REPORT, CMD. No. 5539 (1939).

176. ANNUAL REPORT BOARD OF TRADE (1967).

or dealer member. The Board has not issued any regulations governing the exchanges, nor has it required reports of any type to be submitted. The Board of Trade does not check unusual price movements of traded securities or the trading practices and behavior on the recognized exchanges. The internal rules of the exchanges are not checked and there is not even a flow of information to the Board of Trade on the nature of the rules or the extent of the discipline exercised by the exchanges over their membership.

During the Jenkins Committee investigation, some members appeared surprised at this complete lack of regulation by the Board of Trade over recognized exchanges and associations. At the end of the Board's testimony before the Committee, Professor Gower made the following statement:

> In reply to earlier questions it is said the great advantage of channeling things through the stock exchange and licensed dealers was that you were able to exercise supervision over them. However, because of your reply to the last five or six questions we are not sure what the supervision is.[177]

There is apparently some feeling by the Board of Trade that it lacks authority to regulate the exchanges. In public statements, the Board has clearly expressed a reluctance to take an active regulatory role whether or not they have the authority.[178] In stating, however, that the Board of Trade is unaware of what takes place on the various stock exchanges—both in respect to aspects of trading and to the various internal rules and regulations controlling the members of the exchanges—criticism is not indended. It is simply that the Board of Trade does not feel responsible for such matters.

A comparison between this complete lack of regulation of trading in Great Britain and the regulatory activities of the S.E.C. in the United States is dramatic. Starting from a similar statutory basis, the S.E.C. exercises a supervisory, as well as a licensing, role. Direct regulation of trading and stock exchanges by the S.E.C. has been extensive, particularly in the past few years following the Special Study of the Securities Markets.[179] Throughout its history, the S.E.C. has demanded comprehensive reports from both the exchanges and their members and has moved actively in response to specific complaints and problems.

Aside from exempting members of the stock exchanges, the Board of Trade also has authority to grant exemptions from the licensing

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177. JENKINS REPORT, *supra* note 5, at 1535.

178. JENKINS REPORT, *supra* note 5, at 1532.

179. REPORT OF SPECIAL STUDY OF SECURITIES MARKETS OF THE SECURITIES AND EXCHANGE COMMISSION, H.R. DOC. No. 95, 88th Cong., 1st Sess. (1963).

provisions and the restrictions on distributing circulars to a broad group of dealers. The principal bases for granting an exemption appear to be financial soundness and general reputation within the financial community. The main business of an exempted dealer must be other than that of dealing in securities.[180] As a practical matter, this group of exempted dealers includes most merchant and commercial banks and the large institutional investors that sometimes act as underwriters.[181] Individuals who occasionally deal in securities, such as solicitors or accountants, do not need an exemption. The Board of Trade recognizes that dealers in the exempted status are completely free from all restrictions. For instance, they do not need to be members of any exchange or association; there are no minimum capital requirements; there is no need for them to make reports to any third party; and they are free from the regulations that apply to licensed dealers—including the requirements to maintain certain books and records, and restrictions on credit sales of securities.

As a matter of practice, all applications for exemptions are forwarded to the Bank of England for a report. The Bank of England advises the Board of Trade both on aspects of general reputation and financial soundness. Although the Board is not obligated to follow the opinion of the Bank, this is almost always done. If an application is made by a party unknown to the Bank, it will conduct an investigation. The Bank does not exercise any direct regulation over dealers, but it does request that certain statistical reports be filed with it. Most "exempted dealers" are banks, and thus recognize the general supervisory role played by the Bank of England.[182]

The regulatory scheme established by the Prevention of Fraud Act is designed to place most of those dealing in securities under some trade association or stock exchange; it assumes that the organization will exercise direct regulation. In practice, however, there is little regulation from any source other than the London Stock Exchange. It could be argued, therefore, that there would be more effective regulation if it were required that all dealers other than members of the London Stock Exchange be licensed because there exists at least some restrictions and reporting requirements for the licensed dealers.

3. *Licensed Dealers.*—As mentioned earlier, the number of dealers actually licensed is relatively small and includes only those parties who

180. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45, § 16.

181. Exempted dealers are listed annually in Board of Trade publication PARTICULARS OF DEALERS IN SECURITIES AND OF UNIT TRUSTS.

182. The Bank of England has taken a more active role in respect to the code on take-overs and mergers.

are not members of a recognized stock exchange or association, and are not an exempted bank or insurance company. There are only about 75 licensed dealers listed in the 1967 report of the Board of Trade.[183] In addition, it is acknowledged by the Board that many of these may be out of business. Since there are no provisions for a periodic check on licensed dealers, the Board of Trade would not be informed when they stopped trading in securities. When it comes to the attention of the Board that a licensed dealer has stopped doing business, the dealer is merely removed from the list.

The Board of Trade may deny a license if the applicant has been convicted of an offense involving fraud or dishonesty or for acts in violation of the Prevention of Fraud Act.[184] In addition, the Board is given wide discretion to deny a license "by reason of any other circumstances whatsoever which either are likely to lead to the improper conduct of business by, or reflect discredit upon the method of conducting business of, the applicant or holder or any person so employed by or associated with him . . . ."[185] In practice, however, this discretionary power of the Board of Trade is rarely used.

The Board of Trade has issued one set of regulations for licensed dealers. These regulations include requirements on the form of contract notes, requirements for the maintenance of certain books, accounts and documents, and a prohibition against licensed dealers being involved in any margin, contango, or put-and-call business. The regulations also contain specific provisions relating to take-over bids. In order to continue in business, every dealer is required to maintain a minimum capital of five hundred pounds. The Board of Trade does not require that any reports be made by licensed dealers, nor are there any continuing checks made on their activities. There is little information available on the kind of business carried out by licensed dealers due primarily to the Board of Trade's belief that licensed dealers are generally small operators or foreign brokers and that they account for a very small percentage of the security business.

C. *Regulation by the London Stock Exchange*

While membership in a self-regulatory group is recognized under the Prevention of Fraud Act as forming a basis for an exemption from licensing, the London Stock Exchange is the only body that performs any substantial regulatory role.

183. ANNUAL REPORT BOARD OF TRADE (1967).

184. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45, § 5.

185. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45, § 5 (2) (b).

1. *Requirements for Exchange Membership.*—Admission to membership on the London Stock Exchange is based on approval by the other members of the Exchange. The candidate must be male, at least 21 years of age and a British citizen.[186] The candidate must have been a clerk in training with a member firm for a period of three years or have had some other professional experience. Furthermore, as of 1970, candidates are required to pass an examination on the operation of the London Exchange and the securities markets.[187] The procedure involved is similar to that for obtaining membership in a private social club: the candidate must have a proposer and seconder, both of whom must be members, and his name must be posted for a period of eight days prior to being voted on by the membership committee. The principal restrictions referred to in membership requirements relate to whether the member will have the financial backing and stability necessary to meet all of his bargains.[188] Finally, the candidate must have a "seat" or "nomination," and unless this is obtained from another source—*e.g.*, inheritance—it must be purchased. The purchase of a nomination is a requirement prior to the time of election. The price of a nomination has ranged from as much as 2,000 pounds to as little as 20 pounds in the last few years. Although these entrance requirements appear meager, they are more difficult than they were a few years ago. In 1962, a two-year apprentice requirement was first instituted; in 1965, the duration was increased to three years. It was not until 1970 that the examination requirement took effect.

A member firm may hire clerks who are "authorized" to transact business under the authority of the firm. An authorized clerk, known as a dealer, must have at least two years experience before he can attain that status.[189] There are no examinations or educational requirements for the hiring of clerks and their activities are the responsibility of the member firm. As mentioned earlier, a clerk can transact business on the London Exchange, but, as a condition to this privilege, all partners of the employer firm must be members of the Exchange. The distinction between authorized and unauthorized clerks concerns only the matter of who may trade on the floor of the London Exchange. An authorized clerk may appear on the floor and trade either as a broker or as a jobber. An unauthorized clerk, however, may appear on the Exchange floor, but cannot handle any transactions himself.[190]

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186. STOCK EXCHANGE RULE 33.
187. STOCK EXCHANGE RULE 33.
188. STOCK EXCHANGE RULE 33.
189. STOCK EXCHANGE RULE 58.
190. STOCK EXCHANGE RULE 68 (1).

There is no direct supervision by the London Exchange over members' office employees. Nor are there restrictions on the number of sales personnel that a firm may have, although in fact most firms hire relatively few salesmen who are not members of the Exchange. The chief reason for office personnel, including salesmen, to become members of the London Stock Exchange is not merely because it is a requirement for ultimate partnership, but also because membership without partnership entitles the holder to a larger commission on clients' business than non-members can claim. The London Exchange does list individuals connected with the firm that may sell or deal with the public because such persons usually transact business on the floor of the Exchange as well. However, the Exchange also includes those known as half-commission, or associate, members (*i.e.*, non-partners) of firms.

2. *Regulation of Trading.*—There are few specific regulations concerning the trading activities of brokers and jobbers in the United Kingdom when compared to those in the United States. However, the rule book issued by the London Stock Exchange is fairly extensive and, in the minds of London stockbrokers, the burden of rules and restrictions is rapidly increasing. A member is not allowed to advertise or issue circulars to parties other than his own clients.[191] Aside from this, there are no restrictions on the selling practices of British brokers and dealers. There are no restrictions on margin account or margin selling by brokers, nor is there any recording requirement to reflect the extent of margin trading.

The degree to which British brokers trade in their own account is uncertain. There is no restriction on a brokerage firm having an investment account, but it cannot sell directly to customers from this source. Customers must first be offered shares obtainable from a jobber or be offered shares at prices better than those obtainable from a jobber.[192] This requirement, however, appears to be directed primarily at maintaining business for London Exchange members rather than at the prevention of manipulation or the creation of false markets.

The commission system tends to channel the great bulk of business through the London Exchange, although some substantial transactions involving institutions take place off the floor of the Exchange. The Exchange keeps a registry of agents of different categories and allows a commission to be shared with them. Under current rules, a bank may be given one-fourth of the commission, and other agents, such as

191. STOCK EXCHANGE RULE 78.
192. STOCK EXCHANGE RULE 199.

solicitors and accountants, may receive up to one-fifth. A substantial part of individual trading business comes to the broker through intermediaries.[193]

The London Exchange seeks to control potential manipulation by its rule concerning false markets. The rule states: "No member can knowingly or without due care deal in such a manner as shall promote or assist in the promotion of a false market."[194] This rule has served as the basis for disciplinary actions in the recent past, but there are no routine checking procedures and members of the Exchange acknowledge that there is little or no supervision of their trading activities. Critics assert that it is impossible to have adequate regulation of trading until there exists a more complete disclosure of trading data by the members. As mentioned earlier, under the current regulations, jobbers are not required to make any reports of their trading activity in individual securities to the Exchange. No records are maintained on trading volumes or prices of individual securities. It is impossible to reconstruct the complete trading pattern of a particular security, and fluctuations of price within a single trading period cannot be determined.

The professional staff of the London Exchange plays only a small role in the scrutiny of trading activity. No one is assigned the responsibility of regularly checking for unusual price activity.[195] This phase of Exchange activity is left almost entirely to members of the London Exchange Council. The general sentiment is that the members of the Council, being continuously on the floor of the Exchange, "keep their ear to the ground."

The London Exchange recently has taken steps to encourage prompt disclosure of company activities that are likely to affect prices. Regulations require prompt and simultaneous announcement on the Exchange floor of unusual corporate events. The Exchange equates disclosure to the floor with disclosure to the investing public. Moreover, the Exchange encourages companies to make announcements during trading hours, between 9:30 a.m. and 3:30 p.m.[196] The

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193. STOCK EXCHANGE RULE 199.

194. STOCK EXCHANGE RULE 73 (b).

195. There are plans for mechanization and better scrutiny of trading by the Exchange. Also the large jobbers that have computers are able to check on unusual price and volume movements.

196. Although the Exchange requests companies to make announcements during trading hours, a substantial number do not. There is a view that making announcements during trading hours gives the professional trader an unfair advantage over the rest of the public, and that announcements should be made overnight.

concern for having announcements made on the Exchange floor is due in part to the large amount of trading that takes place after hours. Yet the London Exchange rarely contacts the company to ask if there is any information that may account for an unusual price movement.[197] By American standards, the London Exchange seems much less concerned with unusual price fluctuations. The London Exchange rarely suspends trading since suspension is considered an extreme action and takes place only when there is evidence of some improper corporate behavior. When trading in a security is suspended, however, it normally remains suspended for a considerable period of time.

The London Exchange receives a fair volume of complaints concerning the activities of a corporation or a broker. Letters complaining about a company are usually channeled through the Quotations Department to the company's broker.[198] The Exchange takes a somewhat inconsistent view of its relationship to a listed company: in spite of the fact that a company signs an undertaking agreement, the general attitude is that the London Exchange has no direct control over the company. The only sanction available to the Exchange is withdrawal of the company's quotation. Such drastic action, the Exchange believes, is more harmful than beneficial to the investor in most cases. As a consequence, the Exchange rarely follows up on any complaint letter involving corporate activity unless the case involves a situation already under independent investigation.

Letters of complaint about the activities of a broker or a jobber usually come from relatively small investors and typically involve complaints about failure to deliver securities, excessive commission charges or poor investment advice. These letters are handled in a sympathetic, polite manner and are answered primarily with a concern for public relations. If the investor originally purchased through a bank, the Exchange will inform the investor that it is the bank that more appropriately might answer the complaint. In this way, a large number of complaints are channeled through the bank that dealt directly with the customer. In these cases, the London Exchange rarely hears of the situation again. When the investor has dealt originally through a broker, the Exchange usually responds to the

197. Occasionally, when such unusual movements in the security are brought to the attention of the Stock Exchange Council, an investigation is made. Usually the results of these investigations are not made public. In one or two instances recently, investigations have resulted in disciplinary actions against brokers. As a result of one recent investigation, brokers were warned against trading with certain individuals.

198. The Exchange always attempts to communicate through the broker who handles the company business.

customer. At the same time, the Exchange, through the Membership Department, asks the broker to contact the customer. The matter almost invariably stops at this point; only one or two instances occur each year that actually involve a hearing before the Exchange Council. The Exchange appears to be concerned primarily with settling the matter without adverse publicity and tends to assume that any error was an innocent or accidental mistake. It does not regard itself as a policeman and every inquiry is commenced with the attitude that the broker or jobber involved acted properly.

In viewing the regulation of members by the London Exchange, it is important to remember that a substantial part of the actual trading that takes place on the floor of the Exchange is done not by the members themselves, but by authorized clerks. There are almost no direct Exchange restrictions on the authorized clerks, but the firm itself is held responsible for their actions. This removes one step in the direct regulation by the Exchange, while still preserving the scheme as a whole.

There are occasional discipline problems concerning a breach of the rule against advertisng. Until June, 1969, the names of brokerage firms could appear in print only in a prospectus or when a financial journalist mentioned a firm in a published financial report. This restriction is now relaxed to allow a firm's name, or its individual members' names, to appear either on television or in the financial press. Apparently, however, most of the older members of the Exchange approve of the restriction against advertising. They feel that any investor with a substantial financial interest is able to find a broker, and they are not particularly interested in attracting the small investor. There is a strong feeling in most firms that the small investor is more trouble and expense than he is worth. While this is probably true, it is a direct consequence of the relatively inefficient method of handling transactions utilized by many of the firms. Some brokers and jobbers have expressed a desire to be permitted to advertise and to make a concentrated effort to attract new investors. They generally agree that there is a need to protect the investor from false or misleading claims, but they regard advertising as one way to introduce desirable competition into the securities business. This issue is becoming more critical since many unit-trusts advertise extensively and there is a fear that they will attract investors away from a direct interest in the market. Many members of the London Exchange would like to see the development of an active secondary market involving the small investor similar to that in the United States. Allowing greater sales effort would help accomplish this goal.

3. *Regulation of Financial Stability.*—In recent years, the London Exchange has taken several steps to insure the financial stability of its

members. In the early 1950's, the Exchange established a compensation fund to provide investor protection against losses due to the failure of a stock exchange firm. Since that time there have been numerous claims on the fund, and a substantial volume of money has been paid to investors. Consequently, the Exchange has taken steps to insure that its members are financially sound. Under current Exchange regulations, an individual member is not allowed to trade; only firms with at least two members may trade. Since 1962, the Exchange has required its members to prepare a balance sheet and has required each firm to have an independent annual audit. In 1966, an additional requirement was added: each firm must forward its balance sheet within a stated interval after the end of each six-month trading period to an Exchange accountant for examination. The Exchange accountant must be one of the major accounting firms and must not be the accounting firm that conducts the firm's audit. The Exchange requires a minimal capital balance of assets over liabilities equivalent to 5,000 pounds per partner. The Exchange accountant has authority to request information from the member about any matter concerning the account. Apparently, the Exchange itself does not wish to pry into the business of its members and there are elaborate procedures to preserve the confidentiality of these reports. Like the United States exchanges, the London Exchange desires full public disclosure by a corporation, but not for its own members.

IV. The Regulation of Unit Trusts

A. *Background*

The unit trust in the United Kingdom is an investment device similar to the open-end mutual fund in the United States. Investors pool their resources under a trust deed with the acquired investments held by a trustee. The capital is invested by a mangement company. The trust deed sets out the respective responsibilities of the management company and of the trustee, and provides for a division of the beneficial interests among units held by the investors.[199]

The unit trust form of investment is not new to English investors. In the nineteenth century, trusts were formed by placing a large block of securities of one company in the custody of a single trustee who issued certificates that represented a share of the beneficial interests of the trust. An early English decision held that these trusts were

199. Most trust deeds are terminable after 20 years, but in practice, provisions for extending the trust's life are utilized so that their lives have been indefinite.

immune from the provisions of the Companies Act. The court reasoned that the certificate holders did not form an association carrying on a business.[200]

Unit trusts are to be distinguished from "investment trusts," which also have a long English tradition. Investment trusts are not true trusts, but are conventional corporations regulated by the Companies Act. They have as their business purpose the investment of their shareholders' capital in securities of other companies. The investment trust is similar to the closed-end mutual fund that exists in the United States. The open-end mutual fund has not developed in Great Britain, both because of this early history and because companies are prohibited from purchasing their own shares under the English Companies Act.[201]

The nineteenth century unit trusts held securities of a single company.[202] The first of the modern English unit trusts, formed in the early 1930's, had a trust fund consisting of securities from different companies, although the specific investments were fixed by the terms of the trust deed. The fixed funds have been largely replaced by trusts that allow managers more freedom to vary the nature of the underlying investments.[203] The modern trust deed may or may not specify the types of securities in which the manager may invest.[204]

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200. Smith v. Anderson, 15 Ch. D. 247 (C.A. 1880).

201. Arguments in favor of the open-end investment company were presented to the Jenkin's Committee by Mr. S. I. Fairbairn, the head of the Municipal and General Securities group, and by the Institute of Chartered Accountants. On the other hand, The Economist and the Association of Unit Trust Managers strongly endorsed the unit trust scheme. JENKINS REPORT, *supra* note 5, at 267, 706 & 710.

202. ANDERSON REPORT, *supra* note 175, at 7. This mixture of securities from several companies is what distinguished the modern trusts from the 19th century trusts. In a fixed trust the trust fund securities could be varied; each beneficial interest represented a certain share of fixed investments.

203. In 1936 there were 67 different trust funds with portfolios totaling £50 million. ANDERSON REPORT, *supra* note 175, at 7. By 1939 these figures had increased to £96 and £80 million respectively. JENKINS REPORT, *supra* note 5, at 710. In mid-1958 unit trust funds were worth about £60 million, but by 1961 there value had increased to over £200 million. *Memorandum by The Economist*, JENKINS REPORT, *supra* note 5, at 267. This spectacular growth has continued throughout the 1960's. As of April, 1967, there were 158 authorized unit trusts with a total portfolio of £695.5 million.

204. An analysis of the trust deeds of the 45 unit trusts operated by members of the Association of Unit Trust Managers revealed three main categories. One type of deed provided a list of permitted securities in which funds might be invested to the exclusion of all other securities. Of the six unit trusts in this

The early unit trusts were predominantly "appropriation trusts." Under this arrangement, new investments were purchased first by the managers as principal and then transferred to the trust fund at the current market value in return for corresponding new units. In turn, these units were then sold to the public for cash. Some appropriation trusts continue to exist, but most of these are in the form of "cash trusts."[205] The cash trust variation authorizes managers to sell units to the public on behalf of the trust; the cash vests directly in the trust, and the trustee purchases securities at the direction of the manager.[206]

While the trust mechanism may appear cumbersome, it is argued that the basic feature—separation of the management company from the trustee—provides real protection for the investor. The trustee is usually one of the large British banks.[207] Its primary function is to act as the custodian of the capital and income, and to serve as a registrar for all unit holders.[208] In addition, most trustees exercise some control over advertising, changes in investment policy, and changes in management. The degree of control granted and the trustee's use of its control varies considerably from case to case. There is, however, no reported instance in which a trustee has changed or dismissed a manager, who is generally responsible for administering the trust. More specifically, the manager is responsible for calculating the bid and ask price of the unit, maintaining a market in the unit,

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category, two were rather restrictive, limiting investment to 34 specified securities, and one was virtually unrestricted, having a list of 450 different securities. Twenty other unit trusts worked under deeds allowing managers total freedom to select investments but required the trustee's consent before a selected security could be initially purchased. Most of the deeds in this second category gave the managers complete control over future purchases and sales of any security which had received the consent of the trustee. The remaining 19 deeds provided for even greater flexibility, giving the manager authority to invest in any security quoted on a recognized stock exchange or any other security approved by the trustee. *See generally Supplementary Memorandum by the Association of Unit Trust Managers,* JENKINS REPORT, *supra* note 5, at 723-26.

205. The cash trust is the only type of appropriation trust currently authorized by the Board of Trade.

206. JENKINS REPORT, *supra* note 5, at 118.

207. It is reported that The Midland Bank is trustee for about 40 different unit trusts. In a few instances companies serve as trustee.

208. *See generally*, JENKINS REPORT, *supra* note 5, at 660-64 (Committee questions to the officers of the Association of Unit Trust Managers). As custodian, the trustee must be certain no new units are issued unless securities of corresponding value have been deposited.

preparing income distributions and managing the fund's investment portfolio.[209]

Another modern development has been the public sale of unit trust shares coupled with insurance policies. The Board of Trade has taken the position that insurance companies can sell these policies by any of the traditional selling methods, including the door-to-door technique. The United States approach of defining variable annuities as securities has not been followed in England.[210] This means that English insurance companies have virtually a free hand not only in selling insurance-linked unit trusts, but also in other aspects of account management as well.

B. *Current Regulation of Unit Trusts*

In 1936, the Board of Trade appointed the Anderson Committee to examine all aspects of fixed trusts and to recommend appropriate government action.[211] The Committee broadened the scope of its inquiry to embrace unit trusts as well. The basic thrust of the Anderson Committee proposals was to treat the unit trust as a special type of limited company; investor protection was to be secured by disclosure, which would enable the investor to analyze and compare the various unit trusts.[212] The Anderson Report contains much more in the way of specific recommendations than the later Jenkins Committee Report.[213] Parliament, however, has never responded to the Anderson Report with the type of legislation recommended—a system of registration and regulation similar to that provided by the Companies Act. Instead, the approach has been to regulate unit trusts under the Prevention of Fraud Act[214] and to prevent advertising and

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209. *See Memorandum by the Association of Unit Trust Managers*, JENKINS REPORT, *supra* note 5, at 709. It is estimated that one group of managers—the Save & Prosper group—control approximately 50% of the funds invested in the unit trusts. Recently some of the large clearing banks such as Lloyds and Westminster have begun to manage unit trusts.

210. In S.E.C. v. Variable Annunity Life Ins. Co. of America, 359 U.S. 65 (1959), the United States Supreme Court held that variable annunities sold by insurance companies are securities.

211. ANDERSON REPORT, *supra* note 175, at 7.

212. ANDERSON REPORT, *supra* note 175, at 21.

212. ANDERSON REPORT, *supra* note 175, at 21.

213. JENKINS REPORT, *supra* note 5, at 706; ANDERSON REPORT, *supra* note 175, at 27. The Anderson Report contains an excellent discussion and analysis of the regulatory problems of unit trusts.

214. This Act was designed primarily to prevent share-pushing. JENKINS REPORT, *supra* note 5, at 117. The Act was the first legislation expressly dealing

the issuing of circulars unless the trust is "authorized" by the Board of Trade. The statute has remained virtually unchanged since 1939, but the semi-official and unofficial regulations by the Board of Trade have grown extensively.

The key to the system of regulation is § 17 of the Prevention of Fraud Act.[215] Section 17 provides that the Board of Trade may authorize the existence of any unit trust scheme that meets certain specified conditions to the satisfaction of the Board. The authorization of a unit trust scheme has two important consequences: first, the trustee and manager are exempt from the provision of the Prevention of Fraud Act, which prohibits securities dealing unless the dealer is exempted or properly licensed;[216] and second, the manager is exempt from the Act's prohibition against distribution or possession of any circulars encouraging the purchase or sale of securities.[217] However, the general exemptions in the Act, which cover members of recognized stock exchanges and others such as large banks, do not apply to the activities of the unit trusts.[218] Thus, even if both the trustee and the manager have exemptions under the Prevention of Fraud Act for their usual securities dealings, they still could not issue circulars that relate to a unit trust unless the unit trust, itself, is authorized.

The tax consequences of obtaining authorization are also important. The current British tax laws exempt an underlying trust from the institutional capital gains tax. This exemption applies, however, only to authorized unit trusts. Unless all members of an unauthorized unit trust are exempt, as in the case of a charitable unit trust, the British tax laws make a continuation of such a trust impractical.

The Board of Trade has not attempted to bring insurance-linked unit trusts or investment trusts (*i.e.*, closed-end mutual funds) under its jurisdiction. Units of such trusts are traded like the securities of any other public company under the Companies Act.[219]

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with unit trusts. The provisions from the 1939 Act were re-enacted and consolidated in the Prevention of Fraud (Investments) Act of 1958, and, therefore, have remained the basis for unit trust control for 28 years.

215. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45.

216. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45, § 2 (1) (c).

217. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45, § 14 (3) (a) (iv).

218. See the licensing provisions in the 1958 Prevention of Fraud Act and the exemptions provided in § 17. The proviso to § 14 (3) expressly declares that the exceptions stated in § 14 (3) (a) for such persons as members of recognized stock exchanges do not apply to unit dealing.

219. Although a "unit trust scheme" is defined in § 26 (1) of the 1958 Act,

The specific statutory requirements for authorization under the Prevention of Fraud Act appear to be rather limited. The Act requires that the trustee and the manager be incorporated in the United Kingdom and have places of business in the United Kingdom; that the trustee be independent of the manager; and that the trustee have a specified minimum capital and sufficient assets to meet its liabilities.[220] In addition, the trust deed must fulfill the requirements of the first schedule of the Act "to the satisfaction of the Board [of Trade]."[221] It is this last provision that has provided the real basis for the development of the regulation of unit trusts.

In a manner uncharacteristic of securities regulation in Great Britain, the Board of Trade has used great imagination and initiative to *expand* its meager statutory base and to provide substantial regulation over the unit trust. The approach of the Board is typified by its regulation of sales fees. The Prevention of Fraud Act provides simply that the trust deed must include the manner of calculating the sale and purchase price and the yield of the units. Operating from this base, the Board of Trade has refused to authorize a unit trust if the amount of the service charge stated in the trust deed exceeds a maximum limit set by the Board. The Board has contended that the words "to the satisfaction of the Board" vest discretionary power in the Board. Since the Act requires that each deed state the manner in which prices for units are calculated, an appropriate exercise of this discretion would include setting a maximum fee. In the one case challenging this discretion, the authority of the Board of Trade was upheld.[222]

Furthermore, the Board of Trade requires that certain items be included in the trust deed as a condition to authorization.[223] The

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so that the underlying investments could consist of "securities or any other property whatsoever," only trust funds consisting of securities and cash have been authorized.

220. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45, § 17.

221. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45, § 17 (1) (c).

222. The use of this power was challenged in Allied Investors' Trusts, Ltd. v. Board of Trade, [1956] Ch. 232. The Board of Trade had refused to authorize a unit trust because the amount of the service charges stated in the trust deed exceeded the maximum arbitrarily set by the Board. The Board contended that the setting of maximum service charges under the 1958 Act was a proper exercise of this discretion, since the service charge was an integral of the unit price. The court accepted this argument and upheld the Board's action.

223. The Board of Trade requirements relating to the First Schedule have been printed and are distributed to interested persons.

Board requires that the trust instrument contain provisions identifying the charges that can be added to the unit price, both at the time of sale and at the time of redemption or repurchase.[224] In calculating the yield, the yearly income of the trust is to be determined by taking the dividend income from the underlying securities, less a specified periodic service charge, less net tax requirements. The initial sales charge cannot exceed five per cent of the unit price. Contractual plans are permitted, but there can be no front-end load and the five per cent sales charge cannot include more than one and one-half per cent as a sales commission.[225] The Board of Trade also requires that the trust deed contain a provision that securities purchased by the manager be invested in the trust at the lowest price on a recognized stock exchange on the day of investing.[226] Moreover, there cannot be any indemnification clauses designed to protect trustees against fraud, negligence or acts of their own agents.[227]

The Board has set a number of specific accounts which must be maintained, and has designed these accounts to reveal gross and net profits that the managers derive from the fund. Among the other items to be included are the sales commissions paid to those persons marketing the units, the cost to the manager of repurchased units and the proceeds derived from the sale of repurchased units. The accounts

224. The Board has also laid down rules for calculating the repurchase price of units; the price so calculated has become known as the Board of Trade price. It is calculated by taking the sales price of the securities corresponding to the units, (or if the securities are not sold, the highest market bid price of the corresponding securities) *together* with an aliquot share of all other assets held by the trustee (cash, etc.) *less* any duties, commissions, and charges payable with respect to the sale of such securities or which would have been payable if the corresponding securities were sold. To determine the repurchase price for each unit, the resulting total from above is divided by the number of units sold, and this quotient is reduced by the lesser of 3d or one per cent.

225. These are unwritten requirements. They must be determined from existing trust instruments of authorized unit trusts, and from direct contact with the staff of the Board of Trade.

226. In appropriation trusts, however, the securities sold by the manager to the trust on the same day the manager bought the securities are to be vested in the trust at the price paid by the manager. In any other case, the securities are to be vested at the lowest offered market price on a recognized stock exchange on the day of vesting. The trustee is to be empowered to unilaterally reject any securities which, in his opinion, infringe the terms of the trust deed.

227. JENKINS REPORT, *supra* note 5, at 30-31. The Committee, pointing to the broad indemnity clauses protecting managers and trustees, recognized the danger of unit trust investors being left without legal remedies for fraudulent and negligent handling of their funds.

must also show the proceeds from the sale of underlying securities of liquidated units, advertising expenses and total service charges received.[228]

There are limitations established by the Board concerning the minimum diversification of the trust. No more than five per cent of the fund may be invested in a single security, and the fund is forbidden to acquire more than ten per cent of the total shares of a single company. The trust is also forbidden, by unwritten rules, from investing in any assets other than securities,[229] from borrowing or investing on borrowed capital and from investing in unquoted securities unless specifically authorized in the trust deed.

Through the device of undertakings, the Board has used its discretion to impose the requirement that the unit trust manager refrain from marketing units door-to-door. The Board also requires undertakings that it be notified of any change in the trustees, that the trustees exercise effective control over the affairs of the trust and that the trustees remain independent of the manager.[230] These requirements for obtaining or retaining authorization have evolved over a period of time. There has been, however, no direct attempt to obtain agreement from earlier unit trusts that they will conduct their business in accordance with the current standards.

In addition to these requirements, the Board of Trade not only keeps its own rogues gallery, but also checks with the Bank of England and occasionally with the London Stock Exchange to insure that those persons requesting authorization to start a unit trust have a good record. Authorization of a unit trust occasionally has been denied on the grounds of the poor reputation of the participants, although this has never been given as an express reason.

The Prevention of Fraud Act provides for the revocation of authorization by the Board if the conditions of the authorization are not fulfilled or if circumstances relevant to the authorization have changed.[231] The Act also provides that the Board of Trade may

228. There must also be accounts showing the distribution of the fund value among the various securities and particulars on the income distribution to unit holders.

229. JENKINS REPORT, *supra* note 5, at 118.

230. Undertakings are required in letter form to be sent to the Board of Trade.

231. A procedure for handling a revocation is set down in § 17 (2) of the 1958 Prevention of Fraud Act. As just stated, the power to revoke authorization has never been utilized. Section 17 (3) directs the Board to publish annually particulars of every authorized unit trust. Finally, § 12 provides that the Board of Trade may appoint inspectors to investigate and report on the administration of

appoint inspectors to investigate and report on the administration of any unit trust.[232] To date, there is no reported instance of the Board of Trade's entering into any revocation proceedings; nor has there been any instance in which inspectors have been appointed.[233]

Beyond the activities of the Board of Trade, two other relatively minor means of regulating unit trusts exist. First, the London Stock Exchange allows shares of unit trusts to obtain a listing and has special disclosure rules relating to unit trusts.[234] Relatively few unit trusts, however, have obtained Exchange quotations for their shares and the effect of the Exchange regulations has not been great. Second, approximately 75 per cent of the unit trusts belong to the Association of Unit Trust Managers. Historically, this Association has engaged primarily in lobbying. Recently, however, it has played a more active role as a self-regulatory body. The Association's Code of Conduct requires that all advertising be submitted in advance to the Secretary of the Association. The Association also regulates the commissions paid to the intermediaries that sell units. Under the Code, intermediaries must belong to a recognized professional group or satisfy the Association on an individual basis. This is considered to be the first step in the attempt to regulate selling practices.[235]

C. *Areas of Current Concern in the Unit Trust Regulation*

Many of the recommendations of the Anderson and Jenkins Reports concerning unit trust regulations have been implemented through the informal development of rules within the Board of Trade. There are differing opinions of the effectiveness of the existing unit trust regulation; nonetheless, the following concerns frequently are expressed within the financial community.

1. *Codification.*—There is a need for the consolidation and codification of the regulations that are now in force by the Board of Trade. Many rules can be determined only through interviews with the Board, although some have been written in the form of Board of Trade notes. While there is concern about the unchecked discretion

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any unit trust scheme, if it is in the interest of the unit holders and the matter is one of public concern.

232. Prevention of Fraud (Investments) Act of 1958, 6 & 7 Eliz. 2, c. 45, § 12.

233. The Board of Trade staff for unit trust requirements appears to be of high quality but extremely small and overworked. In 1968 there were only two persons involved and they also had responsibility for licensing and granting exemptions for dealers under the Prevention of Fraud Act.

234. STOCK EXCHANGE RULES, app. 35.

235. Financial Times, May 20, 1967.

that exists in the Board of Trade, there is also a desire to give current regulations retroactive effect so that it would not be possible for established trusts to continue to operate as originally constituted.

2. *Income Disclosure.*—There is a need for better disclosure and control over the income received by managers. Income is produced in a unit trust in a number of ways, several of which are neither obvious nor exposed. One source of income is derived from the sale of new units and the buying and selling of existing units. There also may be a profit derived from holding the unit while the market rises, and an astute manager can earn a price-spread profit due to the gap between the offered and the bid price of the underlying securities.[236] Income can also be obtained from brokerage fees collected from the trust for dealing in the underlying securities. The manager sometimes obtains a split commission and other reciprocal arrangements are common. In addition, when a manager sells securities directly as a result of advertisements, it may keep the full five per cent sales charge that includes the one and one-half per cent sales commission. All of these sources supplement the manager's normal service charge, which itself has been criticized because of the various ways that it may be calculated. While there have been some suggestions that these items should be specifically regulated, it is generally agreed that as a minimum there should be fuller disclosure than at present.

3. *Maximum Sales Charge Regulations.*—The regulation of service and sales charges by the Board of Trade has been questioned because

236. The Association of Unit Trust Managers sought to justify unit dealing arguing that it enables the managers to better control the expansion and contraction of the fund, since underlying securities need not be bought and sold at the moment units are bought and sold, and better control of the fund enables them to improve the trusts' performances because buying can be avoided during narrow markets and vice versa. *Memorandum by the Association of Unit Trust Managers,* JENKINS REPORT, *supra* note 5, at 668. This argument appears to carry little force, as the managers could operate just as effectively with a cash slush fund owned by the trust as they do with their own cash. Profit from unit dealing appears to be inherent in an investment scheme where a major portion of those buying and selling units are small, unsophisticated investors who frequently buy on an up-market and sell on a down-market. One prominent manager testified that he was unaware of any manager who failed to profit from unit dealing and that his company had profited for 29 consecutive years regardless of the character of the securities market. JENKINS REPORT, *supra* note 5, at 706.

Neither the Anderson Committee nor the Jenkins Committee recommended the prohibition of managers dealing as principals in units. The Anderson Committee, however, recognized the problem and sought to control it by requiring the distribution of extensive accounts revealing all forms of the manager's profit.

of the lack of specific statutory authority.[237] Beyond this, however, there is the complaint that the maximum charge limitations are arbitrary and unrelated to actual costs. The charge limitations are uniform, while costs vary with the size of the fund and the unit turnover. It is argued that the control of charges may have several undesirable effects. For example, it may encourage managers to rely on their profits from dealing in units and brokerage rather than on the service charge for their investment advice. The Board of Trade argues, however, that the control of charges has had the beneficial effect of discouraging advertising and active selling pressure. This is probably true. On the other hand, it is argued that the limits may encourage resort to block offers that may be prejudicial to existing unit holders[238] or that may make it difficult for new funds to enter the market and become competitive.

4. *Regulation of the Manager and Trustee.*—Under the current scheme, managers and trustees assume only a minimal legal responsibility toward the unit holders. Correspondingly, there is a paucity of remedies available to the unit holders.[239] The current regulatory scheme provides three types of protection. First, the Board of Trade has power to investigate the administration of the unit trust and to withdraw its authorization. This power has never been used. Second, all trust instruments authorize the trustee to exercise control over the

237. There is no historical basis for charge control in either the Anderson Report or the Parliamentary debate related to the Prevention of Fraud Act. JENKINS REPORT, *supra* note 5, at 1557.

238. Because the low charges would not cover sustained advertising, managers utilize block offers to concentrate their advertising. JENKINS REPORT, *supra* note 5, at 718-19. A block offer is an offering of a large number of units in a block sale for a limited period at a set price or at the current value of the unit, whichever is lower.

239. The Jenkins Committee suggested that all managers and trustees covenant that the unit trust scheme properly complies with the law, that the unit holder should be given civil remedies for breach of all statutory requirements even if they are not in the trust deed, and that the managers should be subject to criminal penalties for failure to comply with statutory rules. The Committee also suggested that the Board be given power to remove managers and trustees and appoint new ones in their place. The Anderson Committee was also especially concerned with the relative lack of control by unit holders in comparison to shareholders. To increase the influence of a unit holder, it was recommended that all trust deeds provide power and machinery to remove the manager and trustee by a majority vote of the unit holders, and that the deeds provide for a unit holders committee whose powers were to be defined by the holders themselves (among the powers to be specifically given to the committee was a power to initiate legal proceedings on behalf of the trust).

manager and even to dismiss the manager. In practice, the bulk of the control resides in the manager and it is probably unrealistic to expect the trustee to check on anything other than the most obvious type of fraud. In addition, the trustee normally has strong pecuniary interests that discourage him from disrupting his relationship with the manager.[240] Third, the required disclosure of information concerning the administration of the trust is designed to enable the investing public to check on improper practices. As suggested earlier, however, only minimal information is required to be disclosed and the legal remedies available for false or misleading information are limited.

5. *Regulation of Selling Practices.*—Finally, there has been a growing recognition that explicit regulation of selling practices is needed. At present, advertising is regulated only by the limits imposed on service charges and the self-regulatory activities of trustees and the Association of Unit Trust Managers. Limiting advertising expenditures, however, has been criticized as an indiscriminate method that limits good as well as bad advertising. Conceivably, it would be better to formulate rules regarding content. Door-to-door selling is regulated only through undertakings required of newly authorized trusts, and there is no restriction on the common practice of providing extra compensation to stock brokers, bankers, investment counselors and others. This practice has been criticized as a disruption of their role as independent agents and as an incentive for pressure selling. Furthermore, there is no regulation of the insurance industry with respect to its door-to-door selling or management of unit trusts.

6. *Comparison with the United States.*—The above comments are made with the recognition that, in some respects, the regulation of unit trusts in the United Kingdom is broader and more specific than the regulation of selling practices by limiting initial sales charges and forbidding front-end load funds. There is also concern in the United States over the standards for determining appropriate service charges for managers. In both of these areas, the United Kingdom has specific restrictions. In many respects, the role of the non-affiliated investor in the United States is similar to that of the trustee in the United Kingdom. Although the British trusteee appears to carry out its functions in better fashion, the disclosure requirements are more stringent under the Investment Companies Act in the United States. There is also a greater continuing control exercised by the S.E.C. over both the nature and diversification of the investment of mutual funds, and the real or potential conflicts of interests.

240. The recommendations made by the Anderson Committee and the law relating to the sale of company shares would provide workable rules.

V. Take-Over Bids

A. *Introduction*

A take-over bid refers to an attempt by one company to gain control of another through the acquisition of a sufficient number of shares of the latter's voting stock. This method is in contrast to merger, consolidation or a purchase of the assets of one company by another. There may be a variety of reasons for choosing one method, or combination of methods, over another. One fundamental advantage of gaining control of a company through a take-over is that the purchase of shares sufficient to control the target company can be accomplished without the cooperation—and even over the opposition—of the directors of the acquired company.

The tender used in the take-over may involve cash or securities or both. Consequently, security regulations problems often arise in a take-over bid situation. The purchasing company makes a public offering if it utilizes an issued security to effect a share-for-share transfer of the securities of the target company. In the United States, this new offering would have to be registered in the same manner as any other public offering. The Companies Act in the United Kingdom exempts such a new offering from regisration since only purchases for cash, not share-for-share transfers, are subject to the registration requirements of the Companies Act. Nevertheless, if the new shares were to be listed on a stock exchange, they would be subject to the same disclosure requirements as any other new issue. On the other hand, in cash-tender offers, the purchasing company is not issuing securities. Thus, the usual registration and listing requirements would not apply in either Great Britain or the United States.

Shareholder protection during a take-over bid is needed in order to insure disclosure to minority shareholders so that they can make sound investment decisions regarding whether or not to sell stocks. This can be characterized as a need for a reverse prospectus, which, in effect, would provide disclosure protection to the minority shareholder at the time of "selling pressure" during a take-over bid. Such a reverse prospectus would complement the disclosure requirements of the Companies Act and the Exchange Rules currently provided at the time of "buying pressure" during an initial offering of securities. Additionally, there is a need to regulate the mechanics of the bid process and to prohibit certain kinds of activities that work to the disadvantage of minority shareholders. For several years, the financial community in the United Kingdom has recognized the need for special investor protections during take-over bids. The measure of effectiveness of securities regulation appears to be judged in large part on the basis of the take-over bid protection. This problem has received more attention in the United Kingdom than any other problem of securities regulation.[241]

B. *Disclosures Required During a Take-Over Bid*

In the normal take-over bid situation, the purchasing company circulates a purchase offer to all shareholders of the target company. Under the Prevention of Fraud Act of 1958, the circulation of documents with a view to acquisition, as well as the disposition of securities, is prohibited unless there is some specific exemption or unless the parties circulating the documents are licensed by the Board of Trade. A corporation is exempted under the Act only when it is circulating documents to its own shareholders. Consequently, unless a corporation becomes a licensed dealer or obtains a special exemption from the Board of Trade, the actual circulation of a take-over bid offer must be made by a broker, issuing house, bank or other exempted party.

As part of its rules of conduct for licensed dealers, the Board of Trade has issued specific requirements dealing with the contents of take-over offers. These requirements officially apply to the relatively few licensed dealers. In practice, however, it is reported that they are followed by banks, brokers and others in an exempted status. The rules require that the terms of the tender offer must be delivered to the offeree corporation not less than three days prior to the time that the offer is made to its shareholders. The document containing the offer must include the following information:

(1) for stock exchange securities, the price range during the period of six months preceding the offer;
(2) provisions that the offer remain open for at least 21 days unless it is totally withdrawn;
(3) if the offer is conditional, the latest dates on which the offeror can declare it unconditional;
(4) if the offer relates to less than the total number of shares, provisions for a pro rata tender of shares by offeree shareholders;
(5) the number of shares in the offeree company held by the offeror;
(6) details on the terms of the offer, time of payment and nature of payment; and

241. Although not a part of the original study, a brief description of take-over bid regulation is included. More has been written on this aspect of securities regulation than any other. *E.g.,* Pennington, *Takeover Bids in the United Kingdom,* 17 Am. J. Comp. L. 159 (1969).

(7) whether any special benefits or any special contractual arrangements have been promised to directors of the offeree company.

Additionally, the rules of conduct provide that if a licensed dealer circulates a response from the directors of the offeree corporation, the response must contain specified information. Although this provision, like the other provisions found in the rules, is not legally binding upon companies that communicate directly with their own shareholders or that utilize an exempted broker or bank, it is generally reported to be followed in practice. The information in the response to be circulated must include the following:

(1) the number of shares held by each director, and whether the director has accepted or intends to accept the offer with respect to these shares;
(2) whether the directors hold any shares in the offeror corporation;
(3) whether there has been offered any payment as compensation for loss of office, and whether any director has an interest in the contracts entered into by the offeror; and
(4) whether there has been any material change in the financial position of the offeree corporation since the date of the last balance sheets.

Furthermore, the British stock exchanges have direct control over disclosures made during a take-over bid situation if new securities are to be offered through a share-per-share transfer. First, the offeror company can be made to make disclosures in connection with its listing application. Second, the circulars of listed companies that are sent to their own shareholders are controlled by the stock exchanges. Third, any recommendation to accept or reject an offer must be submitted to the stock exchanges. Finally, the exchanges have adopted the regulations promulgated by the Board of Trade described above.

C. *The City Code on Take-Overs*

The rules for licensed dealers were enacted in 1960. In 1963, the London Stock Exchange issued the Revised Notes on Amalgamations and Mergers that were designed not only to cover gaps in the disclosures during take-over bid situations, but also to take tentative steps toward regulating the conduct of brokers and other parties involved. One of the main objectives of the Revised Notes was to prevent persons who had inside information of the pending bids from making a profit from their knowledge. A second goal was to insure equality of treatment of shareholders during a time when bids, counter-bids and revised bids were being made. A third objective was to give shareholders sufficient information to make their own decisions on whether or not to accept a bid. Lastly, the Revised Notes were intended to prevent the companies involved from engaging in competitive bidding tactics that would benefit their own position. The statements of policy, however, were all quite general and applied only to listed companies and members of the London Stock Exchange. It was soon recognized that there was a need to expand the coverage of the Revised Notes. Consequently, the City Code on Take-Overs was drafted by a committee that included representatives from the Bank of England, the London Exchange, the Association of Investment Trusts, issuing houses and merchant banks. The Code was adopted in 1968, revised to strengthen its language, and republished in its present form in April, 1969. Although the Bank of England has taken a more active role in the recent revision of the Code, the general enforcement structure remains that of a self-regulatory group.

Earlier visions of the Code were not followed because the language was vague. Under the current draft, however, the language is quite specific in most areas, and it is difficult for offenders to argue a lack of understanding of the Code. Additionally, the current Code provides for a supervisory panel that has responsibility to supervise enforcement and to make interpretations in specific cases. Hopefully, the panel will make frequent reports in order to establish a body of case law covering the standards of practice.

Nothwithstanding these improvements, the current Code continues to lack effective sanctions. For example, if a company violates the Take-Over Code, the London Exchange, as an ultimate sanction, can withdraw its listing. This is likely, however, to be most harmful to the shareholders whom the Code is trying to protect. For other parties in take-over bid situations—issuing houses, banks and brokers—the only real sanction is that of adverse publicity. Additionally, there is the possibility that the Association of Issuing Houses might expel or otherwise sanction one of its members, but this has never happened. Finally, the Board of Trade might be willing to withdraw the exemption applicable to banks and issuing houses, but there is no indication that this sanction will ever be employed.

Nevertheless, the Code contains provisions controlling disclosure as well as direct regulations governing the procedure to be followed in take-over bid situations. The Code reaffirms the disclosure requirements mentioned above and designates other specific areas where disclosure is needed. In general, the disclosures required in the United Kingdom are similar to the disclosures required in the United States. In the United States, no tender offer for more than ten per cent of the equity securities in a company can be made without information being filed with the Securities and Exchange Commission. Furthermore, any person who has a ten per cent interest or more in one of the companies involved must disclose this to the company involved and to the S.E.C. In addition, target companies must abide by disclosure rules in communications with their own shareholders.

The direct regulations of the Take-Over Code, however, are more extensive than those that exist in the United States. Under the Code, the target company is provided protection against a surprise take-over since its board must be informed prior to the time an offer is made to its shareholders. Additionally, the Code provides protection for the offeror company. The target company must act in good faith in any rejection that it makes of a tender offer and, if it provides information to one offering company, it must provide similar data to all other offerors. Moreover, a target company must act in good faith in the transfer of stock certificates. Similarly, it is prohibited from issuing authorized but unissued shares, or from selling assets during the time that the tender offer is outstanding. None of these restrictions are present in the American legislation. Also, the Take-Over Bid Code goes further in direct shareholder protection since the terms of the offer itself are controlled and an offering company is restricted in declaring an offer unconditional unless it in fact has control. Additionally, there are specific provisions to prevent the sale of control stock that may prejudice minority shareholders, and an offering company cannot pay a higher price to some shareholders than it pays to others. United States legislation contains a few aspects of direct regulation, but it is not nearly as extensive as in the United Kingdom. In the U.S., if there is an increase in the offer price of a tender, the increase must be made to all. There is no prohibition, however, on a purchase of blocks of stock outside of the tender at a higher price.

In the United Kingdom, the financial press has been most critical of the failure to enforce the Take-Over Bid Code, and periodically there is an editorial suggesting the need for an S.E.C.-type organization to provide better enforcement. On the substantive aspects, however, the Code provisions in the United Kingdom provide more protection than their counterparts in the United States.