

INTERNATIONAL SECURITIES REGULATION: PACIFIC RIM

NEW ZEALAND

by

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Booklet 1: Commentary

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BOOKLET I: COMMENTARY

SECURITIES REGULATION IN NEW ZEALAND

by

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A. Legal System

New Zealand is a sovereign independent unitary State with a constitutional monarchy, responsible government and a unicameral legislature. Like the United Kingdom, New Zealand does not have a written constitution - there is no one document which embodies a national constitution. The sources of the constitution include Imperial legislation (principally the Imperial Laws Application Act 1988); New Zealand legislation (principally the Constitution Act 1986); the common law (customary common law, judicial precedent and statutory interpretation); customary international law; Letters Patent; the law and custom of Parliament and convention. The Constitution Act 1986 specifies the principal entities of the New Zealand Constitution, namely: the Sovereign (represented by the Governor-General); the Executive; the Legislature and the Cancellor of the Judiciary. In recent years, The Treaty of Waitangi, 1840 made between indigenous Maori and the Crown has assumed increased constitutional importance.¹ In

¹ See generally, P. Joseph, *Constitutional and Administrative Law in New Zealand*, 3rd ed. (2007); P. McHugh, *The Maori Magna Carta* (1991); A. Ward, *An Unsettled History: Treaty Claims in New Zealand Today* (1999).

November 1993, New Zealand adopted a proportional representation voting system.² Following a General Election in October 2005, New Zealand (as of October 2008) was governed by a minority coalition of the New Zealand Labour Party and the one-man Progressive Party holding 51 votes in a 121-seat parliament. Prime Minister Helen Clark from the Labour Party was Prime Minister for a three year term from October 19 2005. To ensure a working majority, the Prime Minister entered into agreements with two other minor parties – New Zealand First and United Future. A General Election was scheduled for November 2008. In the result, the National Party now governs New Zealand with support from the ACT Party.

New Zealand is a common law country. The legal system derives from British origins (like Australia, Hong Kong, Singapore and Malaysia). The court hierarchy comprises the District Court, the High Court, the Court of Appeal, and, the Supreme Court. The Supreme Court Act 2003 (NZ) established the Supreme Court of New Zealand. This Act established within New Zealand a new court of final appeal comprising New Zealand judges in order to recognize that New Zealand is an independent nation with its own history and traditions; to enable important legal matters - including legal matters relating to the Treaty of Waitangi - to be resolved with an understanding of New Zealand conditions, history and traditions, and, to improve access to justice. For appeals from New Zealand, the Supreme Court of New Zealand replaces the Judicial Committee of the Privy Council located in London. It came into being on 1 January 2004 and hearings commenced on 1 July 2004: see [2006] NZLJ 17-20 for a review of the operation of the Supreme Court.

Securities litigation usually commences in the High Court. The principal sources of New Zealand securities regulation law are statutes. The leading statutes are the Securities Act 1978 (the Act or the 78 Act) and the Securities Markets Act 1988 (the SMA). Case law (decisions of the courts interpreting the provisions of the Act) is another source of law. Rules of precedent apply - New Zealand courts are bound by decisions of higher courts in the appellate hierarchy. Decisions of courts in other common law jurisdictions are of persuasive authority. United States decisions are sometimes cited. For example, the decision in *SEC v. Ralston Purina Co* 346 US 119 (1935) is often referred to by New Zealand courts when considering the meaning of s. 3 of the Act (guide to construction of the “offer to the public” concept).

² K. Jackson and A. McRobie, *New Zealand Adopts Proportional Representation* (1998); J. Boston, S. Levine,

B. Securities Regulatory Scheme

1. History and Principal Legislation

There was no separate securities legislation in New Zealand until the Securities Act 1978. Before that time, the subject was embedded in company legislation such as the Companies Act 1955 and the common law. The collapse of the merchant banker, Securitibank, provided the impetus for the present legislation.³ Securitibank had attracted funds in a manner that avoided the prospectus provisions of the Companies Act 1955. The legislative response embodied in the Securities Act 1978 was designed to regulate the *activity* of fund raising generally thereby defeating technical avoidance of the pre-existing legislation.⁴

The principal legislation consists of:

- The Securities Act 1978 (the Act or the 78 Act) and
- The Securities Markets Act 1988 (the SMA).

The main regulations are:

- The Securities Regulations 1983;
- Securities Markets (Substantial Security Holders) Regulations 2007;
- Securities Markets (Market Manipulation) Regulations 2007, and,
- Securities Markets (Investment Advisers and Brokers) Regulations 2007.

The “Four Step” Reform Agenda

E. McLeay and N. Roberts, *Electoral and Constitutional Change in New Zealand: An MMP Sourcebook* (1999).

³ See generally, Frank Partnoy, “Why Markets Crash and What Law Can Do About It” (2000) 61 U. Pitt. L. Rev. 741.

⁴ For a full review of the history of securities regulation in New Zealand until 1998, see G. Walker, “Reinterpreting New Zealand Securities Regulation” in G. Walker, Gen. Ed., *Securities Regulation in Australia and New Zealand*, 2nd ed. (Sydney: LBC Information Services, 1998), 88-126.

In recent years, the New Zealand government has instituted a major “four-step programme” of reform of New Zealand’s securities regulation regime. As of 2008, the third step of that programme is complete.

The Reform Agenda in 2005-8

Further reform of the substantive legislation occurred in 2006 pursuant to the Securities Legislation Bill 2004. The Bill was the third step in the reform programme. This Bill was referred to the Commerce Committee on 14 December 2004 and that committee reported back in 2005. The Bill lapsed in 2005 (because of the General Election) but was subsequently reinstated. The Bill (as reported back with amendments) was split into four separate amending Acts in October 2006. The Acts were passed on 24 October 2006 but did not come into effect until February 2008. They were:

- The Securities Amendment Act 2006

- The Securities Markets Amendment Act 2006

- The Takeovers Amendment Act 2006, and,

- The Fair Trading Amendment Act 2006

The Commentary accompanying the Securities Legislation Bill as reported back from the Commerce Committee stated:

This bill is designed to ensure confidence in New Zealand’s capital markets by increasing the effectiveness of securities, securities trading, and takeover laws. The bill simplifies the current substantial security holders’ disclosure regime; introduces comprehensive prohibitions against practices involving the creation of a false impression of securities trading activity, price movement, or market information; strengthens the law relating to insider trading; improves the quality of advisor and broker disclosure and business practices across the advisory industry; and overhauls the penalties and remedies available under securities and takeover laws to deter illegal behavior and encourage compliance. This bill is an omnibus bill and amended the Securities Act 1978, the Securities Market Act 1988, the Takeovers Act 1993, and the Fair Trading Act 1986.

The Bill followed (in part) Australian legislative models pursuant to the earlier Memorandum of Understanding between the Government of New Zealand and the Government of Australia on Co-ordination of Business Law signed in August 2000: see also New Developments in this

Booklet.⁵ In summary, the main aspects of the 2008 reforms to securities regulation in New Zealand were:

- The introduction of a new insider trading regime following the Australian model
- New market manipulation laws
- Fine-tuning of the substantial shareholder disclosure requirements
- New rules for the regulation of investment advisers and brokers, and,
- Changes to the takeovers regime.
- A carve out of the application of the Fair Trading Act 1986 to conduct covered by securities and takeovers legislation.

As stated, these changes came into effect in February 2008.

Over view of the Co-regulatory Regime

The Ministry of Economic Development in New Zealand (the responsible Minister in 2008 is the Minister of Commerce, Lianne Dalziel) has general oversight of securities legislation and the Securities Commission (NZSC) performs regulatory, co-regulatory and day-to-day operational functions.

New Zealand operates a co-regulatory securities regulation regime. The New Zealand Exchange Limited (NZX) is the front-line regulator. The NZX operates New Zealand's main securities markets such as the New Zealand Stock Exchange (NZSX). The NZSC and the NZX (formerly the NZSE) co-operate with each other to regulate New Zealand's securities markets. The co-regulatory regime was formally established by legislation such as Part 2 of the SMA and the Memorandum of Understanding between the Securities Commission and the NZSE Limited (now the NZX) on Regulatory Co-operation signed on 27 February 2003. In overview, this MOU addresses operational issues relating to:

- Compulsory referrals from the NZX to the NZSC;

⁵ The 2000 MOU was eventually replaced by a revised Memorandum of Understanding on Coordination of Business Law between Australia and New Zealand signed on 22 February 2006.

- Discretionary referrals to the NZSC arising from NZX's oversight of trading activity via NZX's SMARTS electronic surveillance system;
- Referral of matters from the NZSC to NZX relating to the NZX's Conduct Rules and procedures for those referrals;
- Consultation on waivers from continuous disclosure;
- Procedures relating to the NZSC's powers to give directions to the NZSX, and,
- Procedures to consult on new Conduct Rules and amendments to those rules.

The Securities Act 1978 comprises five parts (the mixture of roman and Arabic numbering follows the legislation).

Part I of the Act establishes the Securities Commission (for convenience, usually called the "NZSC" in this Booklet), and describes its functions.

Part II, entitled "Restrictions on Offer and Allotment of Securities to the Public", creates the general restriction on offering securities to the public in New Zealand whether from within or from without New Zealand in the absence of a disclosure document such as a prospectus or an exemption under section 5 of the 78 Act.

Part 3 gives the NZSC powers of investigation and enforcement.

Part 4 deals with Regulations.

Part 5, Subparts 1-4 is entitled "Recognition and Application Regimes". The purpose of the Part 5 is fully stated in s 71 of the Act. For example, one purpose is to introduce recognition and application regimes that provide for exemptions from Part II of the Act and Regulations so that foreign issuers may offer securities in New Zealand in accordance with the laws of their home country.⁶ In this way, the 78 Act makes provision for mutual recognition regimes.⁷ Hence, on

⁶ For analysis, see N. Miller, "Cross-Border Co-Ordination of Securities Market Regulation – A New Zealand Perspective" (Paper presented in Sri Lanka, 24 January 2003). Available at www.sec-com.govt.nz/speeches/nms240103.shtml

⁷ See G. Walker and M. Fox, "Trans-Tasman Mutual Recognition of Securities Offerings" (2006) 24 C&SLJ 264. The U.S. literature on securities regulation is particularly rich on this subject. See Hal Scott, "Internationalisation of Primary Public Securities Markets" (2000) 63 (3) Law and Contemporary Problems 71 at 81ff for a discussion of various types of mutual recognition regimes.

22 February 2006, New Zealand and Australia entered into an agreement to facilitate a regime for mutual recognition of securities offerings between the two countries.⁸ In mid-2008, a new Mutual Recognition of Securities Offerings (MRSO) regime was in place between Australia and New Zealand.⁹

The Securities Markets Act 1988 is the new name for the former Securities Amendment Act 1988. The earlier Securities Amendment Act 1988 (SAA) came into effect in as a result of inquiries held after the share market crash of 1987. In its original form, the SAA dealt with insider trading, substantial shareholder disclosure and authorisation of dealers in futures contracts. The SAA was extensively amended by the Securities Markets Amendment Act 2002 and given the new title of the Securities Markets Act 1988 (the SMA). The SMA was further amended by the Securities Markets Amendment Act 2006 which came into effect on 29 February 2008. The SMA consists of the following parts:

Part 1 of the SMA is now entitled, “Dealing Misconduct” and contains a new insider trading regime and new market manipulation provisions based on the Australian model.

Part 2 of the SMA is entitled “Disclosure”. First, note that Part 2 and Part 2B of the SMA most clearly establish the co-regulatory regime of the NZSC and the NZX over securities regulation in New Zealand.

Part 2 Subpart 1 of the SMA contains provisions for continuous disclosure by public issuers of “material information” (as defined in section 3) that is not “generally available” (as defined in section 4) to the market. Continuous disclosure provisions are described in s. 19D of the SMA as provisions that require a public issuer that is a party to a listing agreement with a registered exchange (for example, with the New Zealand Exchange Limited or NZX) to notify information about events and matters as they arise for the purpose of that information being made available to participants in the registered exchange’s market. Under this Subpart, the Listing Rules of the NZX in respect of continuous disclosure (as contained in NZX Listing Rule 10.1.) are given

⁸ See V. Goldwasser and G. Walker, “Corporations Amendment (NZ Closer Economic Relations) Bill 2006” (2007) 25 (1) C&SLJ 69-76.

⁹ See Securities Commission, *Offering Securities in New Zealand and Australia Under Mutual Recognition* (2008). Available at <http://www.seccom.govt.nz/publications/documents/nz-aus/>

statutory force by section 19B of the SMA and the NZSC is given consequential enforcement powers.¹⁰

Part 2 Subpart 2 of the SMA makes provision for directors and officers of public issuers to make disclosure of relevant interests in securities.¹¹

Part 2 Subpart 3 of the SMA deals with the disclosure of interests of substantial security holders in public issuers.¹²

Part 2 B of the SMA is entitled, “Securities Exchanges”. Part 2 B, Subpart 1 makes provision for the registration, conduct and control of exchanges. The NZX Limited is a registered exchange under this subpart of the SMA. Only a registered exchange can operate a securities market such as the NZSX, the market operated by the NZX Limited.¹³ The NZSC is empowered to approve the listing, participant and discipline rules of a registered exchange.¹⁴

Part 2 B Subpart 2 of the SMA is entitled, “Monitoring of Securities Markets”. This subpart gives the NZSC a role in monitoring practices on securities markets by requiring, for example, the NZX to notify the NZSC of disciplinary actions and suspected contraventions of its discipline rules.¹⁵ Part 2 B of the SMA is a good example of the co-regulatory securities regime in New Zealand whereby the NZSC and the NZX each have a role in regulating the securities market.

Part III of the SMA is concerned with the authorisation of futures exchanges and dealers. The Sydney Futures Exchange (SFE) has traded a range of derivatives products on behalf of the NZX under the name NZFOX since 31 August 2004. The NZX acts as regulator of futures dealers in New Zealand. This subject is discussed further elsewhere in this Booklet.

¹⁰ The Australian equivalent is Chapter 6CA (Continuous Disclosure) of the *Corporations Act 2001*.

¹¹ For Australia, see section 205G of the *Corporations Act 2001*

¹² For Australia, see Chapter 6C of the *Corporations Act 2001*

¹³ However, under section 36C of the SMA, the Minister may declare that section 36B of the SMA (no operation of securities market unless registered) does not apply in respect of a securities market. In August 2005, the Minister of Commerce declared that the unregistered online securities market known as “Unlisted” would not be regulated. See Ministry of Economic Development (MED), Press Release, “Unlisted Not to be Regulated”, 1 August 2005 and MED Regulatory and Competition Branch, Decision under the Securities Markets Act in Respect of “Unlisted”, 1 August 2005 (available at MED website).

¹⁴ For Australia, see Chapter 7 (Financial Services and Markets) of the *Corporations Act 2001*.

¹⁵ Ibid

Part 4 of the SMA deals with the disclosure obligations of investment advisers and brokers.

Part 5 of the SMA is entitled, "Enforcement and Remedies". It deals with the enforcement powers of the Securities commission, the Court's enforcement powers, civil remedies, criminal offences and penalties and ancillary provisions.

Part 6 of the SMA contains ancillary provisions.

The Securities Regulations 1983 flesh out the prospectus provisions of the Act by specifying in detail the contents of prospectuses, advertisements, trust deeds and deeds of participation (generally with reference to the Companies Act 1993 and the Financial Reporting Act 1993). These regulations have been extensively amended over the years to reflect changes in the substantive legislation.

New Zealand company law legislation was comprehensively overhauled in 1993.¹⁶ The new legislation drew on Canadian and U.S. models.¹⁷ The package of legislation introduced in 1993 included: the Companies Act 1993; the Financial Reporting Act 1993; the Takeovers Act 1993; the Receiverships Act 1993 and the Companies Reregistration Act 1993. With the exception of the Takeovers Act 1993 (which came into full effect in 2001), all of these Acts came into force on 1 July, 1994 and all companies fell under this regime as of 30 June, 1997. Further, the distinction between private companies, public companies and public listed companies deriving from the Companies Act 1955 was finally abolished by the Companies Act 1993 on 30 June 1997. The only meaningful distinction between companies for our purposes is between companies and listed companies (that is, companies listed on NZX markets such as the NZSX).

Investment Statements as an alternative to the use of a Prospectus: In 1996, changes to the law relating to the offering of securities were made in New Zealand. The legislative package giving effect to the recommendations of the Working Group on Improved Investment Product and

¹⁶ G. Walker, Terry Reid, Pamela Hanrahan, Ian Ramsay and Geoff Stapledon, *Commercial Applications of Company Law in New Zealand*, 2nd ed. (Auckland: CCH New Zealand Ltd, 2005), 28-9. Hereafter, "CACL".

¹⁷ D. Oesterle, "Why have a Companies Act?" in G. Walker and B. Fisse, eds., *Securities Regulation in Australia and New Zealand*, 1st ed. (1994), 313.

Investment Adviser Disclosure was enacted on 2 September 1996. The legislation making up the new law comprised the Securities Amendment Act 1996, the Investment Advisers (Disclosure) Act 1996, the Financial Reporting Amendment (No. 2) Act 1996, the Superannuation Schemes Amendment Act 1996 and the Unit Trusts Amendment Act 1996. This legislation came into effect on 1 October 1997.¹⁸ In order to give effect to the new regime, the Securities Regulations 1983 were expanded and modified.

An important change to the 78 Act was the optional requirement for an investment statement rather than a prospectus to accompany an offer of securities: s. 33. As to the meaning of “investment statement”, see section 38C; as to its purpose, see section 38D, and, as to the form and content of an investment statement, see section 38E.¹⁹ The introduction of investment statements changed the logistics of public offerings in New Zealand. For this reason, we now turn to discuss this optional means of making a public offering.

New Zealand traditionally regulated the primary securities market under the 78 Act by requiring the registration of a prospectus when securities were offered to the public.²⁰ Each investor was required to receive a prospectus before subscribing for securities. The prospectus is required to contain extensive information (including financial information).²¹ Sometimes, the end result was a complex and lengthy document criticised for increasing regulatory costs without assisting the average New Zealander to determine whether or not to invest in a particular security or allow them to compare the merits of competing investment products.²² In New Zealand, these concerns became more urgent as successive governments considered how best to provide for the retirement needs of an ageing population especially given the absence of a compulsory government superannuation (pension) scheme for workers.

¹⁸ See L. Kavanagh and G. Dell, “Securities Law Reform in New Zealand” [1996] 11 JIBL 535.

¹⁹ See further P. Fitzsimons, “Investment Statements: Simplified Disclosure Documents for Public Offerings” (1999) 17 (2) C&SLJ 132.

²⁰ See P Fitzsimons, “Public Offerings of Securities in New Zealand” in G. Walker, Gen. Ed., *Securities Regulation in Australia and New Zealand*, 2nd ed. (Sydney: LBC Information Services Ltd, 1998), 352.

²¹ In passing note that there is considerable evidence that profit forecasts in New Zealand prospectuses are defective. See M. Ross, “Study shows profit projections are only for mugs” *The National Business Review*, September 15 2000, 56 (citing a study by Hsu, Weil and Hay on profit forecasts in New Zealand prospectuses in the period 1987-1994).

²² P Fitzsimons, “Play it [again], Sam: Capital Raisings in the New Zealand Context” [1995] Companies and Securities Law Bulletin, 63-72 and Working Group on Improved Product and Investment Advisor Disclosure, *Implementation of Part 4 of the 1993 Accord on Retirement Income Policies: Recommendations for Improved Product and Investment Advisor Disclosure: Final Report*, 21 December 1995 (“Working Group”), para 5.

In 1996, the Government amended the 78 Act and enacted the Investment Advisers (Disclosure) Act 1996 to put into effect recommendations made by the Working Group on Improved Product and Investment Adviser Disclosure.²³ The Working Group followed on from a Task Force on Private Provision for Retirement that had reported in 1991 and 1992.²⁴ The Task Force was concerned about the lack of comprehensibility, comparability and information that investors needed in order to make investment decisions. It also expressed concern about the limited information available about financial advisors.²⁵

The Working Group set out a number of essential policy principles:

- “*Disclosure philosophy*: The underlying regulatory policy is based on a philosophy that issuers which offer securities to the public should disclose to prospective investors in timely manner material information about the offer. The aim of the law is to enable investors to make their own decisions, not to insulate them from economic risk.”
- “*Cover public offerings*: Consistent with the current Securities Act, the disclosure requirements should cover all securities offered to the public.”
- “*Rules to be neutral and equivalent*: The disclosure requirements should be neutral and equivalent across that range of securities”
- “*Rules to be cost-effective*: The recommended disclosure requirements should achieve the Accord Parties policy objectives in a cost-effective manner.”²⁶

The Working Group’s principles translated into a number of changes in the securities regime including the introduction of investment statements.²⁷

2. Investment Statements

The aim of the investment statement is to set out:

²³ Working Group.

²⁴ Working Group, para. 6.

²⁵ Working Group, para. 11.

²⁶ E. Hickey, Letter to Minister of Commerce and others, 21 December 1995, page 2.

²⁷ Working Group, Summary of Recommendations. The new regime has not been without its critics - for example, see R. Kerr, “Compulsory Disclosure: Problems and Alternatives” [1998] C&SLB 11.

... briefly and clearly (in plain English) certain key features about a security offered to public, in manner which facilitates comparisons with other securities. The target user is the ‘prudent but non-expert investor’ referred to by the Todd Task Force.²⁸

Section 38D states the purpose of the investment statement is to provide certain key information that is likely to assist a "prudent but non-expert person" to decide whether or not to subscribe for securities and also to bring the attention of such a person the fact other important information can be obtained from other documents. Regulation 7A (1) requires the investment statements contain the information specified in Schedule 3D in a “succinct manner”. The NZSC was of the view that “as a short key features document, [the investment statement] is intended to provide information simply and easily at a low cost”.²⁹

Investment statements seek to achieve two policy goals. The first is to better inform investors. The second appears to be the lowering of the compliance burden placed on issuers by lowering costs. From the outset, it was unclear whether this second goal could be achieved in practice since issuers would seek extensive legal inputs into preparation of investment statements. On the face of it, issuers would always have to prepare two documents – the investment statement and the prospectus – and, without more, this would increase compliance costs. A prospectus has to be prepared because of the need to comply with section 54B (3) of the 78 Act – the “request disclosure” provision. On the other hand, print runs of the printed prospectus might be lowered by (say) 50 per cent. There are, however, serious doubts as to whether the investment statement regime is working as intended. In April 2000, one practitioner noted that investment statements were often more complicated than the prospectuses they were supposed to replace and expressed serious reservations about the new regime.³⁰

The content of the investment statement is set out in Schedule 3D. In addition to indicating it is an investment statement,³¹ an investment statement is required to set out certain information at the beginning of the investment statement as well as statements advising investors to choose their investment advisor carefully. The questions, which have to be answered in the investment statement (in plain English), are:³²

28 Working Group, 54.

29 See the NZSC website <<http://www.sec-com.govt.nz/speech/eas170298.htm>>.

30 S. Layburn, “Some observations about Investment Statements” (2000) C&SLB 44, 47.

31 Section 38C(b).

32 Schedule 3D Securities Regulations 1983 also provides more specific indications as to the type of information that should be provided for each of these questions.

- *What sort of investment is this?*
- *Who is involved in providing it for me?*
- *How much do I pay?*
- *What are the charges?*
- *What returns will I get?*
- *What are my risks?*
- *Can the investment be altered?*
- *How do I cash in my investment?*
- *Whom do I contact with enquiries about my investment?*
- *Is there anyone to whom I can complain if I have problems with the investment?*
- *What other information can I obtain about this investment?*

Regulation 7A makes it clear the investment statement may refer to additional information that is set out in the registered prospectus,³³ that where a matter required by Schedule 3D is not applicable to the particular securities then the investment statement neither has to refer to that matter nor state that the matter is inapplicable,³⁴ and that the information required under each of those questions has to be set out in that particular part which deals with that question.³⁵

There are a number of essential characteristics of investment statements. These include:

- An investment statement is the principal selling document of an offer. A prospectus is only required to be provided upon request;³⁶
- The form specified for the investment statement is to be used across all types of securities, although the Regulations do recognise that there will be some matters which are inappropriate for specific securities;³⁷

³³ Regulation 7A(2) Securities Regulation 1983.

³⁴ Regulation 7A(3).

- Investment statements are not required for all securities offerings. For example, under section 5 (2D), call debt securities, building society shares and bonus bonds do not require an investment statement.
- One important feature of the Regulations surrounding investment statements is that they allow a significant degree of flexibility in the presentation and utility of an investment statement. The Regulations do not limit the information, statements or the matters that can be contained in the investment statement.³⁸ This enables an investment statement to be included in other documents or be provided with additional information over and above that specified. An investment statement may also relate to one or more kinds of securities or one of more offers of subscriptions for securities of a particular kind;³⁹
- The investment statement itself is not registered. This means that, unlike the prospectus, there is no pre-vetting of the investment statement by the Registrar of Companies (ROC). The onus is on the issuer to ensure that the investment statement complies with the Regulations bearing in mind that the NZSC does have the ability to suspend or prohibit an investment statement under section 38F. Notwithstanding the absence of pre-vetting by the ROC, the NZX Listing Rules require that draft offering documents be supplied to the NZX (see NZX LR 5.2.2). In addition, the NZX retains the discretion to list or otherwise and has the power to refuse quotation if the 78 Act or other applicable legislation has not been complied with: see NZX LR 5.3.3).
- The investment statement, unlike the prospectus, does not have to contain or be accompanied by financial information, and can be changed at any time. This means that the investment statement does not “date”, as is the case for a prospectus, provided the information is current. However, if there was an adverse change in circumstances that

35 Regulation 7A(4).

36 Section 54B(3) of the 78 Act.

37 Regulation 7A.

38 Regulation 7A(5) and Section 38E(3).

39 Section 38E(2). The 78 Act also provides for flexibility for the form and content of prospectuses. Section 39(2) allows a prospectus to be combined with an annual return or other document required by an enactment and section 39(3) states that unless the Act or regulations provide otherwise, nothing in the Act or regulations limits the information that may be contained in a prospectus.

made the investment statement false or misleading in a material particular then the issuer could not proceed to allot securities without breaching the Act.⁴⁰

- Securities cannot be allotted unless the subscriber receives an investment statement relating to the security before subscribing.⁴¹ The failure to provide an investment statement means that the subscriber can avoid the allotment by giving notice in writing within the prescribed period.⁴² Two practical ways of ensuring that a subscriber receives an investment statement prior to signing up are to have the application form part of the investment statement so that an investor can only sign up for the security through an investment statement or to have each application form include an acknowledgement by the investor that he or she has received an investment statement. The first would appear to be the safer approach, although there is no requirement for the application form to be attached to the investment statement.

3. Investment Statements and Prospectuses

What is the linkage between the investment statement and the registered prospectus? While Schedule 3D sets out specific information to be included in the investment statement, Regulation 9 provides that an advertisement (which includes an investment statement) cannot be inconsistent with the registered prospectus. In general terms, one would have expected the investment statement to become the sales document while the prospectus would become the plain typed written document devoid of pictures and colours registered with the Registrar of Companies. The Working Group expected that only sophisticated investors or analysts would actually look at the information provided in the prospectus which can be acquired free “upon request” under section 54B (3).⁴³ In theory, one of the advantages of the new scheme was the ability to avoid distributing a significant number of large detailed prospectuses. While Section 54B (4) requires a prospectus to be sent within five working days of a request, sometimes no prospectus is forwarded. Section 60 (2) provides that it is an offence to fail to comply with section 54B.

40 Section 37A(1)(b).

41 Section 37A(1) (a).

42 Section 37A(3).

43 Working Group, para. 168.

The experience to date is that the prospectus has not become redundant.⁴⁴ A number of offers have been made primarily by way of an investment statement (such as the Sky City offering in 1997 and the Ameritech offer of shares in Telecom in 1998). However, for both offerings the documents were extensive - in both cases 36 pages long. For other offers, a request for an investment statement resulted in the prospectus being automatically forwarded as well (for example, Kiwi Development Trust where the prospectus was 86 pages long and the investment statement, including the application form, was 7 pages long). Other offers have gone to the extent of including the investment statement as a typed part of the large prospectus (such as AMP NZ Office Trust). Anecdotal evidence in May 2000 was that this practice had become the industry norm. Unless practice changes, the policy goal of a simple cost effective document will not be met. The problem is compounded by the practice of some issuers placing offer documents on a website given the costs associated with creating and maintaining a website.

One possible concern driving this approach is the potential liability attached to an investment statement as an advertisement.⁴⁵ The Working Group commented that:

An investment statement is intended to describe the key product features for a prudent but non-expert investor. It may also contain other information. If any statement in an investment statement is untrue, the product provider will be liable to any person who subscribed on the faith of the investment statement and sustained loss because of the untrue statement. Potential liability extends to any statement incorporated into an investment statement by reference.”⁴⁶

Under section 55(a) of the 78 Act, a statement included in an advertisement is deemed to be untrue if it is misleading in the form and context in which it is included or is misleading by reason of the omission of a particular which is a material statement in the form and context in which it is included. Section 56 imposes civil liabilities on the issuer, directors and promoters for untrue statements causing damage and section 58 imposes criminal liability upon directors of the issuer where an advertisement, which includes an untrue statement, is distributed.⁴⁷ The majority of actions for untrue statements in New Zealand have been in the form of criminal prosecution (which does not require proof of damage). Issuers are, therefore, concerned to ensure that an investment statement does not contain any untrue statements, particularly by “omission”. Regulation 8 of the Securities Regulations 1983 also prohibits any “advertisement” from

⁴⁴ G. Raymond, “Prospectuses still in demand” *The Press*, May 1 2000, 32 (strong investor demand for hard copies of investment statements and prospectuses).

⁴⁵ Section 2A (2)(b) of the 78 Act..

⁴⁶ Working Group, para 168.

⁴⁷ Section 58(1) of the 78 Act. See, eg, *van Nieukoop v Registrar of Companies* [2005] 1 NZLR 796.

containing information that is likely to deceive, mislead or confuse in regard to any particular that is material to the offer of the securities contained or referred to in the advertisement. Ensuring that an advertisement is not misleading, deceiving or confusing often requires additional information to clarify or qualify “simple, straightforward” statements. Generally speaking, issuers and advisers in New Zealand could not afford to ignore the Fair Trading Act 1986, which applies to such offerings,⁴⁸ particularly in the light of the Australian experience.⁴⁹ However, the application of the Fair Trading Act in relation to conduct involving securities was circumscribed in 2008: see section 63A of the 78 Act. Section 63A of the SMA states that a court hearing a proceeding brought against a person under the Fair Trading Act 1986 must not find that person liable for conduct that is regulated by [the 78 Act] if that person would not be liable for that conduct under [the 78 Act].

Issuers must balance the requirement to provide “succinct” and “key information” with the need to ensure that there are no material omissions and no misleading statements are made. Given this position, it is not surprising that issuers are using section 38E(3) and Regulation 7A(5) to include additional information.

Although the issuer’s directors do not have to sign an investment statement, they are required to complete a certificate under Regulation 17(2), as the investment statement is an advertisement.⁵⁰ This certificate requires them to certify that the advertisement is not misleading, not inconsistent with the registered prospectus and that it complies with the Act.⁵¹

4. The Value of an Investment Statement

In early 1999, the NZSC released the results of a survey on the usefulness of an investment statement for investors.⁵² Three hundred investors (ranging in age from 10 to 90 years) from three major floats (including the privatisation of government assets) in 1998 were questioned on a number of issues relating to their subscription for new shares. Of the 94 respondents, the

⁴⁸ *Fox v Douglas* (1988) 4 NZCLC 64,287. But see now s. 63A of the Securities Amendment Act 2006 (no liability under Fair Trading Act if not liable under the 78 Act).

⁴⁹ See now s. 728 of the Corporations Act 2001 (Cth.)

⁵⁰ Regulation 17(1).

⁵¹ See form of “Certificate in Respect of Advertisements” appearing in Fourth Schedule, Securities Regulations 1983.

majority subscribed for shares in order to obtain long term capital gains (which is usually not subject to tax in New Zealand), or for dividend payments. At least a third sought professional investment advice before subscribing.

The survey found that the average length of an investment statement was 50 pages in length, while the prospectus was on average 2.4 times longer than the investment statement. The crucial issue was the investors' view on the usefulness of an investment statement and prospectus. Around 60 per cent of respondents spent between 15 minutes and one hour reading the investment statement, while only 17 per cent spent more than an hour examining one, and 21 per cent spent less than 15 minutes. The investors were in the main impressed with the investment statement they received with 86 per cent finding it "understandable" and a further 8.6 per cent finding it "very understandable", so that over 90 per cent of investors felt they could understand the document. The key question was: how useful was the document for investors? The investment statement received a high level of support – 78.5 per cent found it "useful" and 12.9 per cent found it "very useful".

Overall, investors were clearly impressed with the investment statement. Another essential question was whether it was worth the cost of producing an additional document on top of the prospectus. Eighty-eight respondents believed they had received a prospectus. A substantial number invested time in reading the prospectus with 65.1 per cent spending between 15 minutes and an hour, and 9.1 per cent spending over an hour. Having read the prospectus (bearing in mind the prospectus was considerably longer than the investment statement) 80.7 per cent of investors found it "understandable" while 9.1 per cent found it "very understandable", so that approximately 90 per cent approved the documents "understandability", a figure close to the response for investment statements. What about the utility of the prospectus? 80.7 per cent found the prospectus "useful" while 12.5 per cent found it "very useful", responses that were slightly higher than the same question for investment statements.

Interestingly, a number of investors indicated that they thought the investment statements should be reduced in length, but conversely a number of investors appreciated the "comprehensiveness" of the prospectus. Further research is needed on these issues. If satisfaction with the "understandability" and utility of a prospectus is consistently similar to that for an investment

52 M. Wydeveld, "Investors' Opinions on Offer Documents", (18 January 1999) <www.sec-com.govt.nz/new/releases/1999/mw_survey180199.html> (visited 10 May 2000).

statement, this raises the issue of whether the expense and time involved in producing an additional offer document does advance investors' interests in a meaningful way or whether it merely imposes additional compliance costs on issuers.

5. Online Offerings of Securities

Since 1 October 1997 it has been possible to make an online offering of securities in New Zealand via the Internet.⁵³ This is because key definitions in section 2 of the Securities Act 1978 have been amended to include electronic communications.⁵⁴ Online offerings of securities offer the prospect of cost savings for issuers because investors can download investment statements and prospectuses. As a consequence, issuers could dispense with large print runs of prospectuses thereby saving printing costs (an incremental efficiency gain). The following sections consider how public and private offerings via the Internet can and might occur in New Zealand under existing legislation.

5.1 Primary Market Public Offerings via the Internet

Since the initial online public offering in the USA by Spring Street Brewing in 1996, there has been considerable interest in the use of a website as a means whereby investors can download an issuer's offering documents.⁵⁵ In the case of Spring Street, three salient advantages accrued to the issuer. First, Spring Street was able to dispense with the services of an investment banker (an underwriter in New Zealand). This represented a cost-saving in advice and underwriting fees to Spring Street although it seems unlikely that the company could have attracted the services of an investment banker in any event because the company was small and unproven. Second, Spring Street appears to have avoided the costs of printing and distributing a paper prospectus. Third, Spring Street was able to access 3,500 small investors at low-cost via the Web. The type of

⁵³ See G. Walker, "Net Trends in Securities Regulation Down Under" [1998] 13 JIBL 225.

⁵⁴ As of May 2000, the New Zealand government was considering the introduction of overarching legislation for electronic communication in an Electronic Transactions Bill. See Ministry of Economic Development, *Discussion Document: Electronic Transactions Bill* (May 2000). In the event, the Electronic Transactions Act 2002 came into effect on 21 November 2003.

⁵⁵ See J. Coffee, "Brave New World: The Impact(s) of the Internet on Modern Securities Regulation" (1997) 52 (4) *The Business Lawyer* 1195. For discussion of the present position in Australia, see H. Burrows, A. Ryding and C. Amhlaigh, *The e-company* (Sydney: Lawbook, 2002).

investor and quantum of investment attracted in Spring Street confirms the standard view of underwriters as “reputational intermediaries”. The flip side of this proposition, however, is that for an issuer like Spring Street, it is precisely this type of small investor and quantum of investment that is expected and desired.

In New Zealand, neither the Securities Act 1978 nor the NZSC (by way of a Policy Statement) make specific provision for electronic prospectuses. The ability to use an electronic prospectus (and other forms of electronic communication) arises from amendments to definitions in section 2 of the Act (see, for example, the definitions of “distribute”, “document”, “send” and “receive”). Until the NZSC promulgates guidelines on electronic prospectuses, issuers wishing to attract the cost-savings of an online *public* offering would appear to proceed as follows: first, issuer creates a Web site containing the information permitted by section 5 (2CA) of the Securities Act 1978. Section 5 (2CA) exempts from the application of Part II of the 78 Act an advertisement made by or on behalf of an issuer to the effect that:

- the issuer intends to make an offer of securities; no money is currently being sought; no applications for securities will be accepted or money received unless the subscriber has received an investment statement, and
- If the issuer wishes, a statement that the issuer is seeking preliminary indications of interest (“testing the waters” in the USA terminology), and
- contains certain factual statements (compare Rule 134 of the Securities Act 1933 (U.S.)).

The section 5 (2CA) statement should include a statement - see section 7 (4) - to the effect that the offering is made only to New Zealand residents, that sales will not be made to non-residents by other means, and, that no sales will be made in other jurisdictions, in order to avoid extraterritoriality problems. This suggestion follows Coffee’s view that the Pennsylvanian solution for exempting Internet offerings pursuant to its Blue Sky law can be applied at the international level to avoid problems with, for example, Regulation S.⁵⁶ The alternative view (also canvassed by Coffee), is that the very nature of the Internet means that it is beyond the jurisdictional reach of offshore jurisdictions in which case the issue is moot.

⁵⁶ See J. Coffee, *op. cit.*, 1231-2.

Second, after a period of time, issuer amends the Web site to include an investment statement containing the offer with a similar jurisdiction statement as discussed above: see the Americtech Investment Statement dated 13 March 1998 for the wording of an appropriate jurisdiction statement. Section 33 of the Securities Act 1978 is not infringed because that section provides that no offer shall be made to the public unless accompanied by an authorised advertisement that is an investment statement. Further, by this means, investors and prospective investors visiting the issuer's Web site can be notified that the prospectus is available in printed and electronic form and choose receipt of a prospectus in electronic form by email if appropriate.

Section 54B(3) of the Securities Act 1978 requires that a registered prospectus must be sent to a security holder or prospective investor upon request. Section 2 (1) defines "send" as including "send by electronic or other means that enables the recipient to readily store the matter in a permanent or legible form". Hence, a sending by email would satisfy these requirements. The definition implies that issuer cannot satisfy section 54B(3) by simply allowing access the website of the issuer in order for an investor to view or download the prospectus since there is no sending by issuer to investor. This can be avoided if, for example, prospective investor enters into a dialogue with the Web site so that the prospectus is sent from the Web site to the investor. Providing for prospectus delivery by email will better enable compliance with the request disclosure provisions of section 54B(3), which state that an issuer "shall send or cause to be sent" a copy of the registered prospectus "upon the request of a security holder or a prospective investor ... ". Thus, if a formal request for a prospectus is subsequently received, issuer can send the prospectus to the requester's email address. As of May 2000, a press report stated that strong demand still existed for hard copies of investment statements and prospectuses notwithstanding the ability to download it.⁵⁷ This suggests that desired incremental efficiency gains by use of the Internet have not been achieved. In fact, it may well be the case that compliance costs associated with public offerings have actually *increased* in that issuers must now create and maintain a website *and* provide hard copies of investment statements and prospectuses. One solution here is to amend section 54B(3) to provide explicitly that a sending by email will satisfy the request disclosure requirement. The resultant efficiency gain is that issuers could dispense with large print runs of prospectuses entirely.

⁵⁷ G. Raymond, "Prospectuses still in demand" *The Press*, May 1 2000, 32. Presumably, investors take the view that a free telephone call to issuers to request a prospectus is cheaper than downloading a prospectus.

5.2 Private Placements via the Internet

By use of the Web, the investor reaches the issuer. Prima facie, this appears to imply that the Web can never be used for a private placement. The use of email with a list server seems the most logical means of harnessing the new technology for a private placement because the issuer can precisely target the private investor. Thus, an issuer wishing to reach habitual investors within the meaning of section 3 (2)(a)(ii) of the Securities Act 1978 might email by list server readily identifiable habitual investors such as venture capital firms. However, one mistake in the selection process may result in the entire offer being tainted because an offer may be made to a member of the public: see section 3 (5) of the Act.

A private offering must fail if there is a general solicitation. Here, the New Zealand position is similar to that in the United States prior to 1996.⁵⁸ Further, in New Zealand there is no contracting out of the Securities Act 1978: see section 4 (2) of the Act. The burden of proof is on the issuer who wishes to claim the benefit of section 3 (2) of the Securities Act 1978 (non-public offers): see *Kiwi Co-operative Dairies v Securities Commission* [1995] 3 NZLR 26 (CA). Thus, issuer must point to evidence that shows the offeree or investor is a member of the exclusionary class. However, a section 5 (2CA) statement can now be used to construct an initial statement on a Web site seeking a preliminary statements of interest (see above).

5.3 Private placements via Section 5 Exemption for Eligible Persons

As of 15 April 2004, a new category of exemption from the operation of Part II of the 78 Act exists. Section 5 (2CB) states that nothing in Part II (except sections 38B and 58) applies in respect of as security if the only persons eligible to subscribe and who do subscribe are “eligible persons”. An “eligible person” is defined in sections 5 (2CC) through 5(2CE) of the 78 Act.

Section 5 (2CC) states that an eligible person is one or more of the following:

- wealthy;
- experienced in investing money;
- experienced in the industry or business to which the security relates.

⁵⁸ See J. Coffee, *op. cit.*, 1219-1222.

Section 5 (2CD) states that a “wealthy person” is one who is certified as having net assets of at least \$2 million or an annual gross income of at least \$200, 000 for the last two financial years. Section 5 (2CE) defines an “experienced person” as one whom an independent financial service provider is satisfied on reasonable grounds is able to assess the merits of the offer etc. In passing, note the overlap with section 3 (2)(a)(ii) and (iia) of the Act which state that certain offers (eg, offers to habitual investors and those who pay a minimum subscription price of at least \$0.5 million prior to allotment) do not constitute an offer of securities to the public. However, the section 5 exemption provides a safer route for an issuer and can be used on a webpage.

6. Organizations Involved in Securities Regulation

There are four main organizations involved in securities regulation in New Zealand. These organisations are discussed below.

6.1 The Securities Commission (NZSC): The NZSC is a creation of the Act and is the chief governmental agency with responsibility for securities regulation. The ultimate responsibility for the Act itself resides with the Ministry of Economic Development. The NZSC’s powers are discussed later in this Booklet. Total revenue of the NZSC for the year ended 30 June 2008 was \$10.059 million of which \$6.501 million comprised the annual government operating grant.

6.2 The New Zealand Exchange Limited (NZX): In late 2002, members of the New Zealand Stock Exchange (NZSE) voted in favour of the demutualisation of the former New Zealand Stock Exchange. Enabled by the New Zealand Stock Exchange Restructuring Act 2002, the NZSE became a limited liability company – NZSE Limited – with its own constitution on 1 January 2003. On 30 May 2003, NZSE Limited announced a further change of name to New Zealand Exchange Limited, trading as NZX, as part of a re-branding exercise. (Thus, the new website of the NZX is www.nzx.com and that website has a new format.) The NZX listed on its own stock market – the NZSX - on June 4 2003. This resulted in a series of name changes – for example, the former NZSE Listing Rules are now known as the NZX Listing Rules. The NZX provides the principal markets for securities trading in New Zealand. The NZX is largely a self-regulatory organization although the NZSC now has a role in regulating its activities. The relationship between listed companies and the NZX is primarily contractual and is governed by the NZX Listing Rules, which are incorporated into the Listing Agreement made between the

NZZ and listed companies. However, as of 1 December 2002, the NZSC has statutory power to enforce compliance by a listed company where the NZX's continuous disclosure listing rules apply to that listed company. The relevant listing rule is Listing Rule 10.1.(once listed issuer becomes aware of material information concerning itself, it must immediately release that information to the NZX)⁵⁹ and this rule is given statutory force by s 19B of the Securities Markets Act 1988. The equity market capitalization of the NZX in August 2008 was \$57.8 billion. At the same date, there were a total of 232 issuers quoted on all of NZX's markets.

6.3 The Companies Office and the Registrar of Companies

The Registrar of Companies (ROC) is charged with effecting the registration of prospectuses under the Act (s. 42) and has the power to refuse registration (s. 42 (2) and (3)). The Auckland Companies Office of the Ministry of Economic Development undertakes pre-registration checks of prospectuses for compliance with the Act.⁶⁰ The ROC does not vet investment statements.

In New Zealand, the Ministry of Economic Development has overall responsibility for companies via the Business Services Branch which is headed by a Deputy-Secretary. This responsibility is discharged by one of its business units, the Companies Office. The Registrar of Companies heads the Companies Office. The Registrar of Companies is a position created by statute. The Registrar is the principal regulator of companies in New Zealand. The role and powers of the Registrar are contained in Part XX of the Companies Act 1993.

⁵⁹ See Anon, "Tough disclosure regime wins investors' approval" *The Australian Financial Review*, 17 January 2003, 51 (New Zealand market players largely applaud new disclosure rules).

⁶⁰ The head office of the Ministry of Economic Development is at 33 Bowen Street, PO Box 1473, Wellington, New Zealand. Telephone: 64-4-472-0030; facsimile: 64-4-474-2814. The website is <<http://www.med.govt.nz>>. The Ministry publishes a newsletter called *Business Development News*. This newsletter is published 10 times annually and can be accessed free of charge by emailing deirdre.hains@med.govt.nz or by via the Internet at <www.med.govt.nz/gbl/bus_dev/news>. The address of the Companies Office in Auckland is Level 5, District Court Building, 3 Kingston Street, Private Bag 92-061, Wellesley Street, Auckland. Telephone: 64-9-912-7677; facsimile: 64-9-357-1765. As of 1999, New Zealand companies could be created via an Internet-based incorporation facility and by June 2000, about 70 per cent of companies were incorporated via the Internet. Online incorporation was followed in 2000 by an online service allowing companies to file their annual returns via the Internet. Sharply discounted fees are offered for businesses transacting with the Companies Office online. For details, see the Companies Office website at <<http://www.companies.govt.nz>>.

As stated, the Registrar of Companies heads the Companies Office. Immediately beneath the Registrar is the National Manager of Business Registries. There are five main operational units beneath the National Manager of Business Registries. These are:

- The National Enforcement Unit: The manager of the national enforcement unit has responsibility for prosecutions and the director prohibitions. This unit is based in Auckland.
- Central Region: The manager of this unit has responsibility for client services and the insurance and superannuation unit.
- Internet Support: The manager of this unit has responsibility for Internet support and online promotions.
- Contact Centre and Southern Region: The manager of this unit has responsibility for the contact centre, client services and quality control.
- Northern Region: The manager of this unit has responsibility for legal services, client services, compliance, other registers, document processing and document imaging.

Details of the organisational structure, functions and legislation administered by the Companies Office can be found at the website of the Companies Office: see (www.companies.govt.nz). One of the principal functions of the Companies Office is to maintain registers containing information about companies that can be accessed by members of the public. The following information about the function of the Companies Office is extracted from the Companies Office, *Online with New Zealand Business: Strategic Business Plan 2005-6*.

The Companies Office is responsible for the provision of services relating to the registration of companies and other corporate entities and public access to corporate and securities information. The Companies Office has compliance and enforcement functions under the Companies Act 1993, Securities Act 1978, Corporations (Investigation and Management) Act 1989, Financial Reporting Act 1993, and the Friendly Societies and Credit Unions Act 1982.

Corporate Body Registers maintained by the Companies Office: The Companies Office maintains and manages 17 registers including the following:

- New Zealand and overseas companies;

- Co-operative companies;
- Incorporated societies;
- Industrial and Provident societies;
- Charitable trusts;
- Unit trusts;
- Friendly societies;
- Credit unions; and
- Building Societies

Administration of the registries falls into four areas:

- New registrations;
- Maintenance of registered information;
- Removal of defunct entities; and
- Ensuring compliance with statutory disclosure obligations.

The Companies Office monitors compliance and time frames for filing changes to registered information, as prescribed by the associated legislation.

The information held on the registers is held available for public search. Searches can be conducted online via the Companies Office website or at the regional office where the company is registered.

As of May 2002, the Companies Office maintains the Personal Property Securities Register (the PPSR). The PPSR is a centralised, fully electronic register that creates a single procedure for the creation and registration of security interests in personal property. This register was provided for in the Personal Property Securities Act 1999.

The Registrar of Companies has a number of statutory responsibilities in relation to the supervision of corporate bodies and issuers of securities. The Securities and Corporate Compliance Unit of the Companies Office is based in Auckland and has three main functions:

- Market supervision: The unit analyses and vets financial statements, investment prospectuses and similar information to be disclosed under the Securities Act 1978, the Financial Reporting Act 1993 and related legislation. This means, for example, that it is the Companies Office that accepts lodgment of prospectuses and vets them, not the Securities Commission.
- Investigation: Where issues of non-compliance with the various statutory regimes arise from information disclosed, the unit may conduct investigations under the Companies Act 1993, the Securities Act 1978 or the Corporations (Investigation and Management) Act 1989.

- **Enforcement:** where investigations identify serious issues of non-compliance that remain unresolved, civil or criminal sanctions may be pursued. This can include prosecutions of companies or their directors, referrals to other agencies such as the Serious Fraud Office or commencement of director disqualification proceedings.

The remaining operational units of the Companies Office are the Insurance and Superannuation Unit, the Internet Support Advisory team, the National Compliance Unit and the Contact Centre.

6.4 The Overseas Investment Act 2005. This legislation is designed to consider proposals concerning investment in New Zealand from overseas. Under the previous legislation, this function was discharged by the Overseas Investment Commission (OIC). Section 63 of the 2005 Act abolishes the OIC and now decisions are made by the Treasurer and the relevant Minister. The guidelines are found in the Overseas Investment Regulations 2005. This legislation is relevant to proposals to acquire, for example, in excess of 25 per cent of a company where the value of that company exceeds NZD100 million: see section 13 of the Act. For a topical guide, see Bell Gully, *Overseas Investment Act 2005* (May 2008). Available at www.bellgully.com

7. Co-Regulation

There are two main co-regulatory organisations in New Zealand with statutory recognition for the purposes of securities regulation, the NZSC and the NZX. (The New Zealand Futures and Options Exchange - NZFOX - is regulated by the NZX.)

7.1 NZX

Some companies elect to have their securities listed for quotation on the securities market conducted by the New Zealand Exchange Limited (the NZX Limited). When they do so, they contract with the NZX Limited that they will comply with the NZX Listing Rules. The NZX Limited acts as co-regulator with the NZSC in the sense that it has a primary policing function for compliance by listed companies with those rules. However, the NZX is not a governmental or regulatory agency like the NZSC.

Historically, it was the Sharebrokers Amendment Act 1981 that enabled the Stock Exchange Association of New Zealand and each of the then four trading exchanges to form together as a statutory membership based entity, the New Zealand Stock Exchange (NZSE).

As stated earlier, in late 2002 members of the NZSE voted in favour of the demutualisation of the NZSE.⁶¹ Technological change and competitive pressures drove the change.⁶² Enabled by the *New Zealand Stock Exchange Restructuring Act 2002*, the NZSE became a limited liability company – NZSE Limited – with its own constitution on 1 January 2003.

On 30 May 2003, NZSE Limited announced a further change of name to New Zealand Exchange Limited, trading as NZX, as part of a re-branding exercise. (Thus, the website of the NZX is www.nzx.com). The NZX listed on its own stock market – the NZSX - on June 4 2003.⁶³ This resulted in a series of name changes – for example, the former NZSE Listing Rules are now known as the NZX Listing Rules. Note that the SMA defines “conduct rules” as the business rules and the listing rules of a securities exchange. Amongst others, the following rules are downloadable from the NZX website):

- NZX (including the Corporate Governance Best Practice Code as an Appendix to the Listing Rules) and NZDX Listing Rules;
- NZAX Listing Rules;
- NZX Discipline Rules (replacing the former NZX Business Rules, NZX Regulations and Code of Practice);

⁶¹ For a general discussion of the demutualisation process, see E. McKnight, R. Fraser, H. Gething, *Demutualisation* (London: FT Law and Tax, 1996). For a discussion of demutualisation of the Australian Stock Exchange in October 1998, see F. Donnan, “Self-Regulation and the Demutualisation of the Australian Stock Exchange” (1999) 10 *Australian Journal of Corporate Law*, 1. See also IOSCO, *Issues Paper on Exchange Demutualisation* (June 2001).

⁶² See NZSE, *Annual and Special Meeting Documentation* (16 October 2002). Thanks to Elaine Campbell, General Counsel of the NZX, for relevant documentation.

⁶³ J. Whyte, “NZ exchange sizes up the task ahead”, *The Australian Financial Review*, 31 January 2003, 73 (discussing listing of NZSE Limited in 2003; J. Whyte, “Full steam ahead for NZSE listing”, *The Australian Financial Review*, 29 May 2003, 19 (NZSE to list on its own market on June 4 2003); Anon, “NZSE to change name” *The Weekend Australian Financial Review*, May 31-June 1 2003, 11 (name change from NZSE to NZX ahead of NZX listing); J. Whyte, “NZX shares list at top of price range” *The Australian Financial Review*, 5 June 2003, 21 (NZX listed on its own market on 4 June 2003); R. Callick, “Exchange makes an impressive Mark”, *The Australian Financial Review*, 8 July 2003, 53 (longer review article describing the work of Mark Weldon as change agent and CEO of the NZX).

- NZX Participant Rules;
- NZX Futures and Options Rules

Note that these rules are updated on a regular basis. Check the NZX website to download the latest versions.

The main markets now operated by the NZX are as follows:

The NZSX Market: The New Zealand Stock Market (NZSX) is NZX's premier equities market. It features the securities of most of New Zealand's listed companies and a number of overseas companies. Companies on the NZSX have one of three listing types. The first type is primary listing where NZX is the home exchange and the company abides by NZX Listing rules. The second type is dual primary listing where the company abides with all NZX Listing Rules as well as its home exchange listing rules. The third type is overseas dual listing where the company abides by a limited number of NZX Listing Rules as well as those of its home exchange. Companies generally quote ordinary shares on the NZSX Market. They can also quote options, partly paid shares, warrants units, and notes and preference shares with equity-like characteristics. For a company to list on the NZSX Market, the securities being quoted must have a minimum anticipated market value on initial listing and a specific spread of shareholders. As of August 2008, there were 163 securities quoted on the NZSX market, which had a total market capitalisation of \$57.91 billion.

The NZDX Market: The New Zealand Debt Market (NZDX) offers a range of investment securities including corporate and government bonds and fixed income securities. As of August 2008, there were 54 securities listed on the NZDX, which had a total market capitalization of \$12.45 billion.

The NZAX Market: The New Zealand Alternative Market (NZAX) is a new initiative of the NZX, developed by the NZX to provide a market for the raising of capital and the trading of securities issued by companies that, because of their size or structure, may not be suited to the

NZSX Market. This market is now operative. As of August 2008, there were 29 securities listed on the NZAX, which had a total market capitalization of \$0.46 billion

The Listing Rules

The latest version of the NZX Listing Rules came into effect on 1 July 2006. The NZX Listing Rules form part of the Listing Agreement between the NZX Limited and the listed company. The Listing Agreement is a private contract with limited statutory force. In effect, it provides that the NZX may vary its Listing Rules as it sees fit (subject always to the approval process contained in section 360 of the Securities Markets Act 1988) and may act unilaterally in relation to exercising its powers to suspend or de-list a company.

The NZX Limited or a security holder – via the Contracts (Privity) Act 1982 - has the ability to enforce the Listing Rules: see NZX LR 2.1. The NZSC has a limited role in enforcing the Listing Rules relating to continuous disclosure: see sections 19B and 19G of the SMA. Also of relevance here is Part 2B, Subpart 2 of the SMA. As stated, this subpart is entitled, “Monitoring of securities markets”. It is this subpart that most clearly establishes the new co-regulatory regime for securities regulation in New Zealand. The subpart gives the NZSC powers of oversight that may have the effect of enforcing a listing rule.

By way of contrast, in Australia the Listing Rules of the Australian Stock Exchange (ASX) primarily operate as private law that is binding only as a matter of contract between the ASX and the listed company.⁶⁴ However, they do have general statutory force. This is because section 793C of the Corporations Act 2001 gives the courts the power, on the application of the Australian Securities and Investment Commission (ASIC), the ASX or a “person aggrieved”, to order any person obliged to comply with the Listing Rules to do so.

7.2 NZFOE and NZFOX

⁶⁴ See CCH Australia, *Annotated Listing Rules* (Sydney: CCH Australia).

The New Zealand Futures and Options Exchange (NZFOE) was owned and operated by the Sydney Futures Exchange (SFE). In 2003, the SFE confirmed its intention to move the SFE's operations to Australia. On 17 September 2003, the NZX and the SFE signed an agreement for the listing and trading of New Zealand equity derivative products on the SFE: NZX Press Release of 17 September 2003. The agreement gives the NZX the exclusive ability to create and list a set of futures and options products on the SFE based on equity products listed on NZX's markets for up to eight years. NZX takes full responsibility for branding the new futures and options products and for the marketing and promotion of those products under the name New Zealand Futures and Options Exchange (NZFOX). Greg Boland, SFE Regional Manager, New Zealand commented on the new arrangement.⁶⁵ He stated (personal communication to author, July 2004):

The responsibility for a regulatory structure to support the dealing of futures and options in New Zealand has smoothly transitioned from NZFOE to the NZX.

NZX's Futures and Options Rules came into force on 3 May 2004. Under these rules, NZX can provide the regulatory regime necessary for NZX Participants to advise and deal for clients. Non NZX Participants such as former NZFOE Dealers may apply, and to date, NZX has received applications from nearly all former New Zealand based NZFOE Participants. NZX Participants wishing to deal in NZFOX products (and other futures products traded on other markets) are expected to apply for coverage very soon. Regulatory coverage for existing NZX Participants is able to be provided quickly by NZX upon official application by the NZX Participant. The New Zealand Securities Commission has issued a class order which authorises NZX Participants who are bound by the Futures and Options Rules of NZX to deal in futures contracts generally, conditional upon their providing a copy of their annual audited financial statements to the Commission within three months of their balance date.

SFE Participants that have an Australian Financial Services Licence (AFSL) which authorises them to deal in futures contracts may conduct a futures business on behalf of New Zealand clients in respect of products listed on SFE. SFE Participants should note that Australian law also requires that, if they wish to deal in derivatives other than futures contracts (such as options over securities, which includes NZFOX equity options), their AFSL must authorise dealing in derivatives. Note that not all of the SFE Participants that have expressed an interest in the NZFOX equity option products currently have the appropriate AFSL and that appropriate endorsement to their AFSL is needed. SFE Participants should note that their authorisation to deal on behalf of New Zealand clients is also conditional upon their providing a copy of their annual audited financial statements to the Commission within three months of their balance date.

⁶⁵ Personal communication (July 2004) with Greg Boland, Regional Manager, New Zealand, SFE Corporation Limited.

Section 38 of the SMA requires dealers in futures contracts to be authorised. In late April 2004, various authorisations in respect of futures dealers were made by the NZSC: see, for example, The Authorised Futures Dealers Notice (No 3) 2004 (in effect as of 29 April 2004). The effect of these Notices is that all NZX Participants are authorised to deal futures on the NZFOX.

7.3 Other Self-Regulatory Bodies

Certain other self-regulatory bodies have a relationship with the NZSC. They are the Advertising Standards Authority, the Life Offices Association of New Zealand, the New Zealand Thoroughbred Breeders' Association Inc., and Harness Racing New Zealand, and, Local Authority and Other Venture Capital Schemes.⁶⁶ The NZSC has exempted these organizations and business entities registered with them from compliance with Part II of the 78 Act in respect of share offers to the public overseen by them subject to compliance with an approved Code of Practice.

C. Public Securities Markets

1. History⁶⁷

New Zealand's first stock exchanges were established during the gold boom of the late 1860s in Auckland, Thames, Dunedin and Reefton to trade shares in gold mining ventures. As gold mining declined, trading on the Reefton and Thames exchanges diminished but the Auckland, Dunedin, Wellington and Christchurch exchanges grew along with commercial development in those centres.

Information announcements to shareholders and interested parties were not a feature of these early exchanges. The situation changed in 1872 when twelve brokers formed the Auckland Sharebrokers' Association, which implemented a system facilitating the transfer of shares and announcements to clients throughout New Zealand.

⁶⁶ The relevant exemption Notice is The Securities Act (Local Authority and Other Venture Capital Schemes) Exemption Notice 2003 (effective 27 March 2003) which exempts the entities designated in the Schedule from requirements of the 78 Act in cash raisings of up to NZD5 million. Exempt entities include entities such as the Canterbury Development Corporation which administers schemes to promote equity investment in businesses based in the Canterbury district.

⁶⁷ For a detailed history, see D. Grant, *Bulls, Bears and Elephants: A History of the New Zealand Stock Exchange* (1997).

In 1897, the Auckland Sharebrokers' Association was re-named the Auckland Stock Exchange. In 1910, the local exchanges established common rules and, in 1915, the Stock Exchange Association of New Zealand was formed. This Association comprised the four main centres (Auckland, Wellington, Christchurch and Dunedin) and Thames and eventually developed into the NZSE, which operated under the authority of the Sharebrokers Act 1908 - 1981 (NZ). The NZSE operated regional exchanges in the four main centres until 1989 - each regional exchange had a trading floor and was responsible for its own operations. In 1989 significant changes took place: the NZSE made a comprehensive review of its management structure, members voted to dispense with separate regional exchanges, and, the management of the trading floors became the responsibility of the Board of the Exchange. As stated earlier, the NZSE demutualised and was renamed as the NZX in 2003. Subsequent to that event, the framework for regulating and monitoring the conduct of NZX market participants was changed. These changes involved a set of terminology changes that are summarised below:

- **NZX Firms** are firms which enter trades directly into the market place.
- **NZX Associate Firms** are firms which do not enter trades directly into the market place and hence the full set of inspection and compliance requirements that NZX firms are subject to do not apply to such firms.
- **NZX Participants** are trading organisations (eg a bank) and settlement organisations (eg, any clearing and settlement organisation).
- **NZX Advisor and NZX Associate Advisor** are the new terms for NZX Broker and Associate Broker.

Floor trading ceased on the Dunedin Exchange in 1990 and on the Wellington, Auckland and Christchurch Exchanges in 1991. Subsequently, electronic trading commenced via computer screens located in the offices of each member. Today, the NZX operates a continuous auction market during designated trading hours of 9:30 am to 3:30 pm (with an hour of pre-opening starting at 8:30 pm and half an hour of adjustment until 4 pm). The pre-opening session is used to establish opening prices for the day. Automatic trading was performed by the SEATS system. On September 10 1999, the SEATS system was replaced by a modern alternative system called

FASTER Trading.⁶⁸ By July 2000, an open interface feature (Application Programming Interface or API) on the new system allowed buy and sell orders received from investors over the Web to be automatically routed through broker computer systems to the NZSE as it then was (Straight through Processing or STP). At present, market information, clearing, settlement and registration on the NZX are performed within the FASTER (Fully Automated Screen Trading and Electronic Registration) system. FASTER interconnects the trading system, NZX Brokers office systems, and the share registry and payment systems. All NZX Firms must have their office systems permanently on-line to FASTER to receive advice of matched trades and perform settlements. The implementation of FASTER was made possible by s. 7 of the Securities Transfer Act 1991 (NZ), which enabled the approval of electronic systems for transfer of securities. Subsequently, The Securities Transfer (Approval of FASTER System) Order 1992 (SR 1992/215) was gazetted on 30 July 1992. The Schedule to this order contains a full description of the FASTER system.⁶⁹ FASTER enabled the NZSE to move to electronic scripless trading in May 1998.⁷⁰ In August 2004, the NZX announced that Direct Market Access (DMA) was now operational on New Zealand securities markets. DMA allows accredited DMA NZX Firms to trade directly into the New Zealand market.⁷¹ In January 2007, it was reported that the NZX planned to launch an electronic communication network (ECN) in Australia.⁷² The ECN, known as AXE ECN Pty Limited, is currently awaiting the outcome of an Australian Market Licence (AML) lodged in 2007 with the Australian Investments Commission (ASIC). Next, in July 2007, it was announced that the NZX had introduced a new trading system known as GlobalVision. GlobalVision now provides the infrastructure for all the NZX markets in New Zealand and will also provide the platform for the AXE ECN in Australia.

2. Functions and Objectives of the NZX

2.1 Overview

⁶⁸ Personal communication with Wayne Zander, IS Manager, NZSE, 23 May 2000.

⁶⁹ For an earlier description of trading systems worldwide, see *The Euroclear IFR Handbook of World Stock and Commodity Exchanges 1995* (1995), 865.

⁷⁰ G. Sheeran, "Confusion at paper war" *Sunday Star-Times*, May 31 1998, D2.

⁷¹ See J. Uly, "Direct Market Access Trading and Implications for Australian Securities Regulation" (2006) 24 C&SLJ 422.

⁷² Kate Perry, "ASX Beware: the Kiwis are coming" *The Australian Financial Review*, 19 January 2006, 77; Carole Comerton-Forde, "Benefits in Breaking ASX Hold" *The Australian Financial Review*, 12 March 2008, 71.

The NZSE (the predecessor to the NZX) was established by the Sharebrokers' Amendment Act 1981 (NZ) as the successor to the Stock Exchange Association of New Zealand. The Act empowered the NZSE to make rules regarding listing and trading on the NZSE, and, governing the conduct of its members and their businesses. The general functions and powers of the NZSE were contained in s. 4 of that Act:

- to operate a national stock exchange
- to promote and specify the conditions and terms for the listing and trading of securities on its exchange
- to regulate and promote uniformity in the conduct of its members and of business by its members
- to promote the interests of its members and members of the public in relation to the listing, underwriting and marketing of securities.

This law was repealed with the introduction of the Securities Markets Act 1988 (effective 2002). The present position is that Part 2 (entitled "Disclosure") and Part 2 B of the SMA (entitled "Securities Exchanges") provide the principal legislative basis for the external regulation of the NZX by the NZSC within the new co-regulatory scheme for New Zealand's securities markets.

The Securities Markets Act 1988 contains provisions regulating the establishment and on-going operating of securities exchanges. Under the SMA, a corporate body can not hold itself out as a securities exchange unless it is registered under the Act. Further, the SMA imposes restrictions on persons operating a securities exchange in certain circumstances. To become a registered securities exchange an organisation must, among other things, have its rules governing listed issuers and market participants approved by Order in Council by the Governor General on the recommendation of the Minister of Commerce.

The Act also includes provisions relating to the imposition of a control limit (which is the highest percentage of voting rights in the company that may be held or controlled by any person) on a registered exchange.

NZX is the only registered securities exchange in New Zealand. NZX has a 10 per cent control limit included in its constitution.

Once an exchange is registered it must operate its securities markets in accordance with its rules. Any changes to those rules go through a statutory approval or disallowance process, depending on the nature of the proposed rule changes.

As a registered exchange NZX also assumes a number of reporting obligations to the NZSC, established by the 78 Act. That Act prescribes its role (among other things) as to keep under review practices relating to activities on securities markets. The NZSC also has monitoring powers over NZX conferred by the SMA. The first oversight review of the NZX was undertaken in 2005.

Under the SMA, NZX must:

- notify the NZSC where it takes any disciplinary action for breach of its rules
- notify the NZSC where it knows or suspects that a person has committed, is committing or is likely to commit a significant contravention of NZX's conduct rules or certain laws
- give any material information disclosed to it under its listing rules to the NZSC
- provide information, assistance and access to its facilities to the NZSC or Takeovers Panel where such information, assistance and access is required to assist those bodies to discharge their functions.

In addition to the requirement for NZX to notify the NZSC of certain matters the SMA also confers on the NZSC the power to give directions to NZX to suspend trading in a listed issuer's securities or a class of securities in certain limited circumstances where it is satisfied that the direction is necessary in the public interest and where no more appropriate course of action is available.

In recognition of the special importance afforded to the continuous disclosure provisions in NZX's Listing Rules, NZX must consider any submissions that the NZSC may make in considering applications for determination of the Continuous Disclosure Listing Rules found in section 10 of the NZX Listing Rules. To facilitate this relationship between the NZSC and NZX, NZX has entered into a Memorandum of Understanding ("MOU") with the NZSC. The MOU states the shared goal of NZX and the NZSC is to ensure the optimum regulation of New Zealand's securities markets, to enhance the performance and reputation of NZX's stock markets as fair, efficient, deep, well informed and internationally competitive markets and to facilitate

appropriate levels and quality of disclosure. NZX and the NZSC have agreed a set of guiding principles to achieve this goal.

While NZX is regulated by the NZSC which has certain powers over NZX and its listed issuers, the MOU recognises NZX's role as the front-line regulator of its securities markets and details how NZX and the NZSC will work together in areas where they have overlapping responsibilities and where NZX has responsibilities to the NZSC. The MOU also details the framework to enhance information flow between NZX and the NZSC and to avoid duplication of work between the two bodies. These matters are now addressed in more detail with reference to the relevant statutory provisions.

Disclosure Provisions of the SMA

Part 2 Subpart 1 of the SMA contains provisions for continuous disclosure by public issuers of "material information" (as defined in section 3) that is not "generally available" (as defined in section 4) to the market. Continuous disclosure provisions are described in s. 19D of the SMA as provisions that require a public issuer that is a party to a listing agreement with a registered exchange (i.e., NZX) to notify information about events and matters as they arise for the purpose of that information being made available to participants in the registered exchange's market. Under this subpart, the Listing Rules of the NZX in respect of continuous disclosure (as contained in NZX Listing Rule 10.1.1) are given statutory force by section 19B of the SMA and the NZSC is given consequential enforcement powers.⁷³ Part 2 Subpart 2 of the SMA makes provision for directors and officers of public issuers to make disclosure of relevant interests in securities.⁷⁴ Part 2 Subpart 3 of the SMA deals with the disclosure of interests of substantial security holders in public issuers.⁷⁵

Registration, Conduct and Control of Securities Exchanges under the SMA

⁷³ The Australian equivalent is Chapter 6CA (Continuous Disclosure) of the *Corporations Act 2001*.

⁷⁴ For Australia, see section 205G of the *Corporations Act 2001*

⁷⁵ For Australia, see Chapter 6C of the *Corporations Act 2001*

Part 2 B, Subpart I of the SMA now regulates the registration, conduct and control of securities exchanges. Section 36F of the SMA makes provision for a body corporate to apply to become a registered exchange. The NZX is a registered exchange. Section 36G of the SMA states that a registered exchange must operate its securities markets with “conduct rules” (listing rules and business rules) that contain required matters and have been approved under section 36O of the SMA. In a similar fashion, new conduct rules and proposed changes to conduct rules must be supplied to the Minister of Commerce who may approve or disallow. In addition, control limits may be imposed on a registered exchange: see section 36S of the SMA.

Securities Exchange Monitoring Provisions of the SMA

Part 2B, Subpart 2 of the SMA is entitled “Monitoring of Securities Markets”. A first set of provisions require the NZX to notify the NZSC of disciplinary actions and contraventions. A second set of provisions require the NZX to give the NZSC any material information given to market participants. A third set of provisions impose general information and assistance obligations on the NZX in favour of the NZSC. A fourth set of provisions requires the NZX to give notice to the NZSC regarding continuous disclosure determinations. A fifth set of provisions empowers the NZSC to give directions to the NZX and such directions specifically include continuous disclosure directions. All five sets of provisions are backed by a general offence provision contained in section 36ZX of the SMA.

Comparison with former law

Former section 7 of the Sharebrokers Amendment Act 1981 (now repealed) stated that the NZSE shall make rules for the conduct of its members and for the conduct of business on its exchange. These rules were not subject to oversight by the NZSE. However, the position now is that the Minister of Commerce must approve conduct rules and proposed changes to conduct rules and, in so doing, must seek the advice of the NZSC: see section 36 (3) of the SMA.

The powers of the NZSE were examined by the Court of Appeal in *New Zealand Stock Exchange v. Listed Companies Association Inc.* [1984] 1 NZLR 699 (CA), where the Court of Appeal held that the NZSE was neither empowered or required to make statutory rules for listing companies. Hence, the relationship between the NZSE and listed companies was purely contractual. This meant that the NZSE had the ability to vary its Listing Rules as it saw fit and might act arbitrarily in relation to exercising its powers to suspend or delist a company. In the Court’s view, the NZSE was not subject to administrative law remedies under the Judicature

Amendment Act 1972 (NZ) since the relationship between the NZSE and the listed company lay in contract. In the result, the NZSE had contractual relationships with listed companies and statutory relationships with members under s. 7 of this Act. Because New Zealand made no provision for statutory control over the Listing Rules, the NZSC had no power to enforce them. The NZSE or a security holder - via the Contracts (Privity) Act 1982 (NZ) - had the ability to enforce the Listing Rules.⁷⁶

The changes introduced by the SMA necessarily imply that the *New Zealand Stock Exchange Case* is no longer good law. This is because: (a) the NZX is now required to seek approval for its Listing Rules and any proposed changes to them; (b) the relationship between the NZX and listed issuers is now regulated by contract (the Listing Agreement) and legislation (the SMA), and, (c) the NZSC now has the power to enforce listing rules relating to continuous disclosure. For guidance as to how New Zealand courts might interpret the new regime, see *Australian Corporations Law: Principles and Practice*, Vol 3 (Sydney: Butterworths) at paragraph 10.1.0940 under the heading “Enforcement of ASX Listing Rules”.

Economic function of securities market

The NZX operates a market where buyers and sellers exchange listed securities, and where a company requiring additional capital may issue newly listed securities to prospective buyers. The NZX provides and operates an efficient market for the raising of capital for listed companies and the trading of securities, including shares and fixed interest securities such as bonds and Government stock. These functions are aspects of the economic role of financial markets. Most microeconomists define an efficient market as one in which the costs of transactions are minimised. The function of the market is also to transfer financial resources from those with surplus funds to those who can use those assets more productively. This function also enhances the risk bearing capacity of the economy. In such wealth transfer (an aspect of allocative efficiency), two classifications of the sharemarket need to be considered - the primary and the secondary market.

⁷⁶ See P. Fitzsimons, “The New Zealand Stock Exchange: Rights and Powers” in G. Walker and B. Fisse, eds., *Securities Regulation in Australia and New Zealand*, 1st ed. (Auckland: OUP, 1994), 534.

2.2 The Primary Market

The primary or capital market is the market where companies sell new issues of securities in order to acquire new capital. Corporate issues include both fixed income (for example, debentures) and equity issues (common stock). This is the only market in which the issuer is directly involved in the transaction. By lowering information and transaction costs, the existence of such markets reduces the cost of raising funds for investment projects. Activity in the common stock primary market is usually considered in two main categories. The first and typically largest category is that of *seasoned* new issues offered by companies that already trade on the NZX. Here, a company has further need for capital, which it has decided to acquire by increasing the number of shares on issue. The typical mechanism here is a rights issue.

The second major category in the new issues market is generally referred to as the *initial public offerings (IPOs) market*. An IPO occurs when a company sells common stock to the public for the first time.⁷⁷ In most instances the company will previously have been privately held or, in more recent New Zealand history, may have been a state-owned organisation. The primary market is principally governed by the Securities Act 1978 and the NZX Listing Rules.

Both seasoned and IPO issues are typically underwritten by investment bankers. Underwriters also offer advice to the company on the general characteristics of the issue, pricing and timing of the offer. Underwriters may also accept responsibility for the sale of the issue, and hence, any shares that the underwriter cannot sell to the public will be acquired by the underwriter at the subscription price.

2.3 The Secondary Market

Secondary markets permit trading in existing issues. A secondary market exists where a stock has already been sold to the public and is traded between current and new owners. The proceeds from the sale of stock in the secondary market do not go to the issuing company but to the owner

⁷⁷ For a commercial and legal analysis of an IPO in New Zealand, see G. Walker, "Case Study of an IPO in New Zealand" in G. Walker, Gen. Ed., *Securities Regulation in Australia and New Zealand*, 2nd ed. (1998), 421-446.

of the security. In New Zealand, the secondary market is principally regulated by the Securities Markets Act 1988.⁷⁸

In combination, the primary and secondary markets form the markets of the NZX - markets where new funds can be raised as well as a market that provides facilities for trading existing shares. The secondary market provides *liquidity* for stock sold on the primary market. Individuals who have acquired stock in the primary market will at some stage wish to sell. Companies would have great difficulties in selling stock on the primary market if investors were not able to resell in the secondary market.

The secondary equity markets in New Zealand may be broken down into two categories - the organised exchange of the NZX and *over-the-counter* (OTC) markets. The OTC markets in New Zealand are negligible and are not discussed in this Booklet. Securities traded on the NZX are sold on an auction basis with investors placing buy and sell orders through brokers and the NZX matching up these orders.

2.4 Efficiency of the Market

It is generally accepted that financial markets exhibit both operational and allocative efficiency. *Operational efficiency* refers principally to the cost-effectiveness of various intermediaries (including brokers) in channelling funds between buyers and sellers. The FASTER system (now replaced by GlobalVision) increased operational efficiency in New Zealand because trading, settlements and registry functions have been integrated. Transaction costs incurred by investors range from 0.5 to 1.5 per cent, depending on the amount of the investment.

Allocative efficiency requires that new information should be available to all investors so that informed and rational decisions can be made. An allocatively efficient market will ensure the immediate and widespread dissemination of accurate information. Furthermore, in an allocatively efficient market all ascertainable information is reflected in securities prices. Maurice Kendall proposed this concept of efficient markets in 1953 when he was unable to find regular price cycles in stock prices. Each series appeared random, whence the introduction of

⁷⁸ See further, T. Shreves, "Secondary Market Regulation in New Zealand" in G. Walker and B. Fisse, eds., *Securities Regulation in Australia and New Zealand*, 1st ed., (1994), 504.

the term “random walk” which merely implies that price changes in a stock are as independent of each other as tosses of a coin.⁷⁹

Subsequent to Kendall’s discovery there have been refinements to the concepts of efficient markets, with three different levels of efficiency being proposed by Harry Roberts - weak-form, semi-strong form and strong-form efficiency.⁸⁰ *Weak-form efficiency* assumes that the price of a security will reflect all information contained in the record of past prices. In essence, this concept implies no relationship between past and future price changes.

The second level of efficiency, *semi-strong form*, is where prices reflect not only past prices, but also all other published information. Thus, as new public information, including stock earnings, mergers news and economic news becomes available, stock prices rapidly adjust. The opportunity to take advantage of any such adjustment is minimal - Patell and Wolfson found that most price adjustment occurs within 5 to 10 minutes of the announcement.⁸¹

Finally, *strong-form efficiency* holds that prices reflect not just public information but all information including private information. Hence, no group of investors could have monopolistic access to information relevant to the formation of share prices. Any painstaking analysis of companies and the economy would not render a fund manager or investor any additional information. Under strong-form efficiency no group would be able to consistently obtain above-average returns. The NZX is generally accepted by investment analysts to be semi-strong form efficient. This view, however, is challenged by the proponents of behavioural finance.⁸²

D. DISCUSSION OF REGULATIONS REGARDING SUBSTANTIVE SECURITIES MATTERS

⁷⁹ See, B. Malkiel, *A Random Walk Down Wall Street* (6th ed., 1996).

⁸⁰ See H. Roberts, “Statistical versus Clinical Prediction of the Stock Market” (unpub. paper presented to the Seminar on the Analysis of Security Prices, University of Chicago, 1967). For further formalisation of the concepts see E. Fama, “Efficient Capital Markets: A Review of Theory and Empirical Work” (1970) 25 (2) *Journal of Finance* 383.

⁸¹ See J. Patell and M. Wolfson, “Intraday Speed of Adjustment of Stock Prices to Earnings and Dividend Announcements” (1984) 13 *Journal of Financial Economics* 223.

⁸² See generally, G. Walker, “Securities Regulation, Efficient Markets and Behavioural Finance: Reclaiming the Legal Genealogy” (2006) 36 (3) *HKLJ* 481-517.

1. Establishment, Regulation, and Organization of Securities Regulating Organizations

1.1 The Securities Commission

The Securities Commission (NZSC) is a creation of the Act.⁸³ It consists of 5-10 members appointed by the Governor-General on the recommendation of the responsible Minister. The Chairperson is a barrister and solicitor of not less than 7 years standing. He or she serves on a full-time basis. The remaining members serve on a part-time basis. The day-to-day work of the NZSC is performed by an office of full-time staff headed by the Director: see further *Securities Commission Annual Report 2006* available at the NZSC's website.

Section 10 of the Act sets out the functions of the NZSC as follows; these are:

- to perform the functions and duties conferred or imposed on it by or under this Act or any other enactment; and
- to keep under review the law relating to bodies corporate, securities and unincorporated issuers of securities, and to recommend to the Minister any changes that it considers necessary; and
- to keep under review practices relating to securities, and to comment thereon to any appropriate body; and
- to co-operate with any overseas regulator and for that purpose, but without limiting this function, to communicate ... information obtained by the Commission ... to that overseas regulator ...
- to keep under review activities on securities markets, and to comment on those activities to the appropriate body; and
- on the Minister's request, to advise the Minister on the conduct rules ... proposed by securities exchanges; and
- to promote public understanding of the law and practice relating to securities; and
- By agreement with the Takeovers Panel, to provide administrative and support services to the Panel.

In the past, the functions of the NZSC were described as twofold – those of law reform and watchdog: see *City Realties Limited v. Securities Commission* [1982] NZLR 74 (CA). However, amendments to New Zealand's securities regulation regime effective 1 December

⁸³ See generally, P. Fitzsimons, "The New Zealand Securities Commission: The Rise and Fall of a Law Reform Body" (1994) 2 Waikato LR 87; P. McKenzie, "Reflections on a Decade with the Securities Commission" (1996) 6 (2) *Canta LR* 215.

2002 expanded the functions of the NZSC. For example, the NZSC now has the role of keeping under review activities on securities markets. Significantly, the Securities Markets Act 1988 established a new co-regulatory framework under which the NZSC and the NZX each have responsibilities to regulate activity in the securities markets. In addition, the NZSC and the NZX signed a Memorandum of Understanding (MOU) on 27 February 2003 that sets out how each party will co-operate to effectively regulate the NZX's securities markets.⁸⁴ An operations group manages the implementation and day-to-day dealings between the parties under the MOU.

As stated, the functions of the NZSC were usually described as twofold - those of law reform and watchdog. In striking contrast to other comparable bodies, the NZSC initially had few independent powers. For example, it did not have the power to launch insider trading actions of its own volition. However, in 2002, the NZSC was empowered to bring a public issuer's right of action against an insider if it considered that it was in the public interest to do so: see section 18A of the SMA. This section of the SMA has now been repealed and the NZSC now has various powers to bring actions including actions for insider conduct: see below.

Statutory powers under the 78 Act

The statutory powers of the NZSC were overhauled and expanded in 2002 and again in 2008.

The general grant of power in section 10: The most significant statutory powers appear in the 1978 Act and the SMA. Part 1, section 10 of the Act (discussed above) contains the general grant of power and gives the NZSC the power to perform the functions and duties imposed by the Act and other legislation such as the SMA. Section 17 of the Act then proceeds to grant the NZSC all such consequential powers as are necessary or expedient to carry out these functions and duties.

The following make up the NZSC's specific powers under the Securities Act 1978.

Exemption powers: Part I, Section 5 of the Act enables the NZSC to grant exemptions from Part II of the Act. Part II of the Act contains the general prohibition on offering securities to the public without a prospectus. The exemption power can be specific or discretionary. The power to grant discretionary exemptions on application is contained in section 5 (5). This power cannot

⁸⁴ See NZX Press Release dated 18 March 2003 available at www.NZX.co.nz/exchange/news/Prs_Rlse_March_2003.html

be exercised retrospectively: *Westpac Financial Services Ltd v. Securities Commission* (1996) 7 NZCLC 261, 106. In 2004, the section 5 exemption power was expanded to include certain advertisements – see section 5 (2CA) of the 78 Act - and a class of wealthy and experienced investors: see section 5 (2CB) of the 78 Act.

Privilege: Proceedings of the NZSC are privileged. Section 28 of the Act states that no proceedings, civil or criminal, shall lie against the NZSC for anything it may do or fail to do in the course of the exercise or intended exercise of its functions, unless it is shown that it acted in bad faith or without reasonable care. In the *City Realties Case*, the Court of Appeal said that while this protection is wide, the liability for negligence is a safeguard for persons affected by the NZSC's activities. In *Fleming v. NZSC* [1995] 2 NZLR 514 (CA), the question before the Court was whether the NZSC owed any duty to members of the public to take reasonable care to prevent the publication of advertisements which did not comply with the 78 Act and which might cause loss to individual investors. The NZSC had been alerted to advertisements in a newspaper offering high interest securities in breach of the Act. The newspaper concerned advised the NZSC that there would be no repetition of the advertisements but similar advertisements appeared and investors lost money. An action by the investors against the NZSC for breach of duty of care to potential investors was dismissed by the Court of Appeal. Cooke P considered that the existence of a duty was arguable on the basis that the defendants had been put on notice of non-complying advertisements and had an express power to prohibit them. Cooke P thus considered that s. 28 did not preclude tortious liability on the part of the NZSC but held the weightiest factor to the contrary was the floodgates argument (potential liability to an indeterminate number of claimants). Richardson J thought that the imposition of a tortious duty would interfere with the discretion of the NZSC. His Honour noted that the NZSC was not intended to be an omniscient guarantor of investors but rather a supervisory agency with a limited role – that role made it inappropriate to impose specific duties of care to all members of the investing public. It had not involved itself in the affairs of individual investors, nor was there any specific reliance by the plaintiffs. Casey J was of the view that policy considerations (potential liability to every adult New Zealand investor), afforded a conclusive reason against the imposition of a duty of care.⁸⁵

⁸⁵ See also *Yuen Kun Yeu v A-G of Hong Kong* [1988] AC 175 (PC); *Minorities Finance Ltd v Arthur Young* [1989] 2 All ER 105; *Birchard v Alberta Securities Commission* (1987) 42 DLR (4th) 300; *Davis v Radcliffe* [1990] 1 WLR 821 (PC); *Kripps v Touche Ross & Co* (1992) 94 DLR (4th) 284; *Schilling v Certified General Accountants Assn of British Columbia* (1996) 135 DLR (4th) 669 (BCCA).

Power to Suspend and Cancel the Registration of a Prospectus: Prospectuses are delivered to the Registrar of Companies in Auckland for registration: s. 41. The NZSC has the power to suspend or cancel the registration of a prospectus if it is of the opinion that the prospectus is false or misleading as to a material particular or does not comply with the Act: s. 44.

Prohibition of Advertisements: The NZSC may make prohibition orders in respect of advertisements (eg, in relation to an offer of equity securities): s. 38B.

Suspension and Prohibition of Investment Statements: The NZSC has the power to suspend or prohibit an investment statement: s. 38F.

Powers in relation to offers of securities: Part II of the Act contains the general restriction on offering securities to the public in the absence of a disclosure document such as a prospectus or an “authorised advertisement”. The NZSC is granted various supplementary powers to enforce this part of the Act. Thus, section 38B provides that the NZSC may prohibit the distribution of an advertisement that is likely to mislead and section 38F states that the NZSC can suspend an investment statement that is likely to mislead. Under section 44, the NZSC can suspend or cancel the registration of a prospectus previously registered with the Registrar of Companies in Auckland.

General investigation and enforcement powers: Part 3 of the Act was inserted by the Securities Amendment Act 2002. It greatly expanded the NZSC’s investigation and enforcement powers. Part 3 also contains provisions dealing with proceedings and evidence.

- ***Powers of inspection:*** Under sections 67-68 of the Act, the NZSC has the power to inspect documents and no privilege against self-incrimination applies: see s. 69T. The NZSC is protected from liability in exercising its powers of inspection unless acting in bad faith: see s. 68F. However, there is a right of appeal against the exercise of the inspection power: see s. 68G.
- ***Powers for receiving evidence:*** Under s. 69B of the Act, the NZSC has the power to hear evidence, which would not otherwise be admissible. It has the power to summon witnesses: see s. 69B.
- ***Exercise of inspection and evidence powers for overseas regulators:*** Under s. 69F, an overseas regulator may request the NZSC to inquire into any matter related to its functions and the NZSC has the power to comply with such request.

- **Power to accept undertakings:** Under ss. 69J and 69K of the Act, the NZSC has the power to accept enforceable undertakings.
- **Proceedings before the NZSC:** This subpart of the Act deals with the right to be heard and represented at proceedings before the NZSC. Proceedings may be heard in private and the NZSC may make confidentiality orders. Under s 69O, the NZSC may state a case for the opinion of the High Court at any time.
- **Miscellaneous provisions:** These provisions relate to evidentiary matters and include s. 69T, which takes away the privilege against self-incrimination.

Appeal Powers: A general right of appeal to the High Court appears in section 68G. Under section 69, the NZSC has the power to hear an appeal from any person aggrieved by the refusal of the Registrar of Companies to register any prospectus, deed, memorandum of amendments to a registered prospectus, instrument amending a deed or any other refusal, act or decision of the Registrar under any provision of the Act (other than s. 76 or s. 67A), or regulations made under the Act: s. 69. Any determination by the NZSC is final and binding: s. 69 (2).

Statutory Powers under the SMA

The powers of the NZSC under the Securities Markets Act 1988 (the SMA) were extensively overhauled pursuant to the 2006 amending legislation (effective 29 February 2008). The NZSC has published a guide to the new requirements under the SMA: see NZSC, *New Securities Law for Investment Advisers and Market Participants 2008 - A guide to new requirements under the Securities Markets Act 1988* (2008). This guide is available on the NZSC website. The enforcement powers of the NZSC are now largely grouped in Part 5 of the SMA entitled, “Enforcement and Remedies”. The main powers of the NZSC under the SMA can be summarized now as follows:

Power of the NZSC to seek injunctions: Under Part Five, Subpart 2, the NZSC has the power to apply for an injunction restraining a person from engaging in conduct that constitutes or would constitute a contravention of a provision of the SMA: see section 42K.

Power of the NZSC in relation to Insider Conduct: Under Part 1, Subpart 1 of the SMA, insider conduct is subject to criminal liability. However, pursuant to Part 5, Subpart 3, the NZSC has the power to seek a pecuniary penalty order and a declaration of contravention: see section 42R and 42S of the SMA. The maximum amount of the pecuniary penalty is described in section 42W.

Power of the NZSC in relation to Market Manipulation: Under Part 1, Subpart 1 of the SMA, various forms of market manipulation (such as false or misleading statements or information and false or misleading appearance of trading) are subject to criminal liability. Note, however, that pursuant to the true of the Securities Markets (Market Manipulation) Regulations 2007, there are carve outs for market stabilization, short selling and the crossing of trades. However, pursuant to Part Five, Subpart 1, the NZSC has the power to make prohibition and corrective orders: see section 42. Next, pursuant to Part 5, Subpart 3, the NZSC has the power to seek a pecuniary penalty order and a declaration of contravention in relation to this activity: see section 42R and 42S of the SMA.

Power of the NZSC in relation to the General Dealing Misconduct prohibition: Under Part 1, Subpart 2 of the SMA, a new general dealing misconduct prohibition is introduced in section 13. The section has extraterritorial scope (see section 18) but there are a set of carve-outs in sections 14-17.. The section follows section 1041H of the Australian Corporations Act 2001 and the case law on the cognate the Australian section is directly relevant. The prohibition is in addition to the general prohibition on misleading or deceptive conduct in trade in the Fair Trading Act 1986. No criminal sanction attaches to this prohibition. However, pursuant to Part Five, Subpart 1, the NZSC has the power to make prohibition and corrective orders: see section 42. Next, pursuant to Part 5, Subpart 3, the NZSC has the power to seek a pecuniary penalty order and a declaration of contravention in relation to this activity: see section 42R and 42S of the SMA.

Power of the NZSC to enforce Continuous Disclosure Regime: Part 2 of the SMA contains two subparts. Subpart 1 deals with continuous disclosure by public issuers. Under the NZX Listing Rule 10.1.1, a listed company is required to notify the NZX immediately as soon as it becomes aware of any “material information” concerning itself. The Listing Rules are part of the Listing Agreement between the listed company and the NZX and are a private contract. However, NZX LR 10.1.1 now has an added statutory force because section 19B of the SMA states that public issuers must disclose in accordance with listing rules if continuous disclosure listing rules apply. Under Part Five, Subpart 1, the NZSC has the power to make a disclosure order where a continuous disclosure obligation or exemption has been contravened: see section 42B. Failure to comply with an order made by the NZSC under section 42B is an offence: see section 42J. Next, pursuant to section 42R, the NZSC may seek a pecuniary penalty order and declaration of contravention.

Power of NZSC to make disclosure order regarding relevant interests by directors and officers of public issuers: Part 2, Subpart 2 of the SMA requires directors and officers of public issuers to disclose a relevant interest within a period of 5 trading days. Disclosure must be made to the registered exchange with which the public issuer is listed and in the interests register of the public issuer. Failure to comply is an offence: see sections 19ZD and section 19ZF. Under section 42B (b) of the SMA, the NZSC has the power to make a disclosure order.

Power of the NZSC to apply for order where substantial security holder disclosure provisions have been breached: Part 2, Subpart 3 of the SMA requires that (subject to certain carve-outs), substantial security holders (persons who have a relevant interest in 5% or more of the voting securities of a public issuer) must make disclosure to the issuer and the registered exchange. Under section 34 of the SMA, the NZSC has the power to require disclosure of all relevant interests (by way of “tracing notices”). Failure to comply is an offence: see section 35BA. Under Part 5, Subpart 1 of the SMA, the NZSC may make a disclosure order: see section 42B (c). The NZSC may seek a pecuniary penalty order and declaration of contravention in respect of a breach of a substantial holding disclosure obligation or exemption: see section 42R and section 42S.

Powers of the NZSC in relation to new co-regulatory securities regulation regime: Part 2B of the SMA is entitled “Securities Exchanges”. Part 2B, Subpart 1 deals with the registration, conduct and control of exchanges (such as the market operated by the NZX). Part 2B, Subpart 2 deals with the monitoring of securities markets. As a result of Part 2B, and for the first time, the NZSC now has a role in the administration of the NZX. The way in which the new regime operates is described below.

- ***Part 2B, Subpart 1 of the SMA:*** Securities markets can only be operated by a “registered exchange” although a securities market may be exempted from the provisions of Part 2B. Registration of exchanges is governed by section 36F. The NZX is a registered exchange. Under section 36G, a registered exchange must operate its securities market in accordance with “conduct rules” (listing rules and business rules) that include the matters described in section 36H. Any proposed new conduct rules must be approved: see section 36O. In determining whether to or not to recommend approval, the Minister must seek the advice of the NZSC: see section 36N(3).

- ***Part 2B, Subpart 2 of the SMA:*** As stated, this subpart is entitled, “Monitoring of securities markets”. It is this subpart that most clearly establishes the new co-regulatory regime for securities regulation in New Zealand. First, a registered exchange must notify the NZSC of disciplinary actions and suspected contravention of its conduct rules: section 36ZD. Second, a registered exchange must give the NZSC material information given to market participants: section 36ZG. Third, a registered exchange must give the NZSC or the Takeovers Panel information or assistance on request: section 36ZK. Fourth, a registered exchange must give the NZSC notice on continuous disclosure determinations: section 36ZM. Fifth, the NZSC may give directions to registered exchange. The direction may require the exchange to suspend trading in a particular security: section 36ZO. Sixth, the NZSC may give a continuous disclosure direction to a registered exchange: section 36ZP. These powers of the NZSC are backed by the criminal sanction contained in section 36ZX.

Under Part 5, Subpart 1 of the SMA, the NZSC has the power to make a prohibition or corrective order in relation to section 36A (1) which states that there must be no holding out as a securities exchange unless registered. Failure to comply with an order made by the NZSC is an offence: see section 42J.

Powers in relation to futures exchange: Part 3 of the SMA is entitled, “Dealing in Futures Contracts”. It introduced a regime for registering a futures exchange in New Zealand. The NZSC has the power to make a prohibition order or a correction order in relation to section 37A (1) which states that there must be no holding out as a futures exchange unless authorized. Failure to comply with an order made by the NZSC is an offence: see section 42J.

Powers in relation to investment advisers and investment brokers: Part 4 of the SMA replaces the Investment Advisers (Disclosure) Act 1996 which is now repealed. An investment adviser is a person who gives investment advice about securities to members of the public as part of their job or business. An investment broker is a person, including the company who receives investment of money or investment property from members of the public as part of the job or

business. Such persons must disclose before giving investment advice to a member of the public. The adviser's disclosure must be made by giving the investor a disclosure statement. Advisers must disclose five types of information in a disclosure statement: experience and qualifications; criminal convictions; fees; other relevant interests and relationships, and, types of investments that the adviser advises on. Brokers must disclose to types of information in a disclosure statement: criminal convictions, insolvency and disciplinary proceedings; and procedures for dealing with investment money and investment property. The NZSC is given wide powers to enforce the obligations of investment advisers and brokers. The NZSC may make prohibition, corrective or disclosure orders. It can also make temporary banning orders. The NZSC may also seek a pecuniary penalty order and declaration of contravention in respect of an investment advisers' or brokers' obligation or exemption: see section 42R and section 42S.

2. Statutory Interpretation in New Zealand

The purpose of this section is to outline the purposive approach to statutory interpretation in New Zealand and to show how that approach applies to the Securities Act 1978. This is important for three reasons. First, the correct approach to the legislation can be demonstrated by application of established principles of law. Second, again as a matter of law, the purposive approach to interpreting the legislation provides the solution to problematic cases. Third, this approach enables a coherent reading of the bulk of the legislation and solves the aberrant application of judicial discretion. As we shall see, remaining difficulties can then be attributed to legislative maladaptation.

The traditional mode of statutory interpretation in New Zealand, and other common law countries generally, was the literal approach. Thus, judicial interpretation of legislation was, "to give ... a strict and narrow interpretation, holding it down rightly to those cases which it covered expressly."⁸⁶ The literal approach has obvious limitations. An over-literal approach might mean that, where parliament has not clearly expressed its intention in statutory language, courts might refuse to give effect to the obvious purpose of the legislation.⁸⁷ Nonetheless, New Zealand courts were prepared to look at the mischief that an Act was intended to remedy if the statutory

⁸⁶ R. Pound, "Common Law and Legislation" (1907) 21 Harvard LR 383, 385. See also H. Stone, "The Common Law in the United States" (1936) 50 Harvard LR 4; M. Amos, "The Interpretation of Statutes" (1934) 5 Cambridge LJ 163.

⁸⁷ *Ex parte Hill* (1827) 3 C and P 225 (KB); *Whiteley v. Chappell* (1868) LR 4 QB 147.

words were unclear as they stood (but not if the words had clear meaning).⁸⁸ What if clear meaning was at variance with intended purpose? In such cases, as Professor John Burrows points out, “the approach could lead to decisions which were out of line with the overall scheme and purpose of the legislation, and, which were stricter and more literal than any ordinary reader would arrive at.”⁸⁹

The modern New Zealand judicial mode of statutory interpretation is the purposive approach - the court looks for the purpose of the legislation with the intention of giving effect to that purpose. Here, the New Zealand practice accords with that in the United Kingdom. In 1975, Lord Diplock said “If one looks back to the actual decisions of this House on questions of statutory construction over the past 10 years one cannot fail to be struck by the evidence of a trend away from the purely literal towards the purposive construction of statutory provisions.”⁹⁰ This reflects the judiciary’s desire that legislation should apply as parliament intended.⁹¹ In New Zealand, there has been legislative direction for over a century in favour of the purposive approach.⁹² Prior to 1 November 1999, such legislative guidance was contained in s. 5 (j) of the Acts Interpretation Act 1924 (NZ). That section stated:

Every Act, and every provision or enactment thereof, shall be deemed remedial, whether its immediate purport is to direct the doing of anything parliament deems to be for the public good, or to prevent or punish the doing of anything it deems contrary to the public good, and shall accordingly receive such fair, large, and liberal construction and interpretation as will best ensure the attainment of the object of the

⁸⁸ For an expression of this view, see *Johnstone v. Police* [1962] NZLR 673, 674 (SC), per Turner J.

⁸⁹ J. Burrows, *Statute Law in New Zealand*, 3rd ed. (Wellington: LexisNexis, 2003), 129. Hereafter, Burrows 3rd ed.

⁹⁰ *Carter v. Bradbeer* [1975] WLR 1204, 1206 (HL).

⁹¹ See Burrows, 3rd ed., 129-30. Here, Professor Burrows sets out several reasons why the judiciary traditionally favoured the literal approach to statutory interpretation rather than an approach which gave effect to the intent of the legislature.

⁹² For analysis, see J. Burrows, “The Cardinal Rule of Statutory Interpretation in New Zealand” (1969) 3 NZULR 253; R. Glover, “The Acts Interpretation Act, Section 5(j)” (1981) 1 (2) *Canta LR* 300; J. Burrows, “Statutory Interpretation in New Zealand” (1984) 11 NZULR 1, and, R. Glover, *Acts Interpretation* (1991) where the recent case law is exhaustively reviewed. Legislative direction requiring a purposive approach to interpretation first appeared in s. 5 (7) of the Interpretation Act 1888 (NZ). The words of that provision were identical to the legislative direction embodied in s. 5 (j) of the Acts Interpretation Act 1924 (NZ). The 1888 provision was preceded by Provision 3 of the Interpretation Ordinance 1851 (NZ) which stated that the language of every ordinance was to be, “construed according to its plain import, and where it is doubtful, according to the purpose thereof”. Thus, the approach under the 1851 Ordinance was to interpret legislation literally, an approach discarded in the 1888 Act.

Act and of such provision or enactment according to its true intent, meaning and spirit.

The provision requires that *every* Act should be interpreted liberally to give effect to its object or purpose. In *CIR v. Challenge Corporation*,⁹³ Richardson J. emphasised the point:

... the twin pillars on which the approach to statutes mandated by section 5(j) rests are the scheme of the legislation and the relevant objects of the legislation. Consideration of the scheme of the legislation requires a careful reading in its historical context of the whole statute, analysing its structure and examining the relationships between the various provisions and recognising any discernible themes and patterns and underlying policy considerations.⁹⁴

On 1 November 1999, the Acts Interpretation Act 1924 was repealed and replaced by The Interpretation Act 1999. Section 5(j) of the 1924 was replaced by a new section 5, which reads as follows:

5. Ascertaining the meaning of legislation – (1) The meaning of an enactment must be ascertained from its text and in light of its purpose.

(2) The matters that may be considered in ascertaining the meaning of an enactment include the indications provided in the enactment.

(3) Examples of those indications are preambles, the analysis, a table of contents, headings to Parts and sections, marginal notes, diagrams, graphics, examples and explanatory material, and the organisation and format of the enactment.

Commenting on new section 5(1) in 2003, Professor Burrows thought there was “no indication in the judgments of the Courts that the judges are treating s 5 (1) any differently from its predecessor.”⁹⁵ An early decision on the new section 5 (1) confirmed this view. In *Jack v. Manakau CC* (an unreported decision of Randerson J, High Court, Auckland: M1698/99), Randerson J said that he was satisfied that the approach taken in the *Challenge Corporation Case* (above) remained applicable under the new Act. A decision of Thomas J is to a similar effect: see *R v Rongonui* [2000] 2 NZLR 385 at 431. This implies that much of the judicial commentary on the former section 5 (j) remains the guide for the courts in relation to the new

⁹³ [1986] 8 NZTC 5,001 (CA).

⁹⁴ *Id.*, 5020. The Privy Council affirmed the Court of Appeal’s application of the purpose rule in *The New Zealand Stock Exchange v. The Commissioner of Inland Revenue* [1990] 2 NZLR 120 (HC); [1990] 3 NZLR 333 (CA); [1991] 2 AC 464 at 472 (PC).

⁹⁵ Burrows, 3rd ed., 137.

section.⁹⁶ In subsequent paragraphs, we consider the case law on section 5 (j) of the Acts Interpretation Act 1924.

2.1 Case Law prior to The Interpretation Act 1999

Judgments of the New Zealand courts make frequent reference to the “object” or “purpose” of the legislation in question.⁹⁷ In *Northland Milk Vendors Association Inc. v. Northern Milk Limited*,⁹⁸ Cooke P. stated:

The responsibility falling on the Courts ... is to work out a practical interpretation appearing to accord best with the general intention of Parliament as embodied in the Act - that is to say, the spirit of the Act ... the Courts must try to make the Act work while taking care not themselves to usurp the policy-making function which rightly belongs to Parliament. The Courts can in a sense fill in gaps but only in order to make the Act work as Parliament must have intended.⁹⁹

In *Marac Life Assurance Limited v. CIR*,¹⁰⁰ the Court of Appeal had to determine whether Marac life bonds were taxable under the Income Tax Act 1976. In deciding that the life bonds were not taxable, Cooke P. stated:

I recognise that, taken literally, the wording of the ... legislation may perhaps be wide enough to cover the Marac life bonds ... But ... on considering the relevant history and scheme of New Zealand statute law and the mischief at which the 1983 income tax amendments were aimed, I am sure that Parliament cannot have meant them to change the law and traditional practice regarding life insurance taxation.¹⁰¹

There are numerous references in New Zealand cases to “making an Act work as Parliament intended”,¹⁰² to “purposive” construction,¹⁰³ the “broad statutory goal”¹⁰⁴ and to the “spirit of

⁹⁶ See further, P. McNamara, “Interpretation Act 1999” [2000] NZLJ 48; S. McAnally, “Extrinsic Guides to Statutory Interpretation” [2000] NZLJ 51.

⁹⁷ See, for example, *Pacific Industrial Corporation v. Bank of New Zealand* [1991] 1 NZLR 368, 374 (HC), per Thomas J; *New Zealand Society of Physiotherapists v. Accident Compensation Corporation* [1988] 1 NZLR 346, 353 (HC), per Quilliam J.

⁹⁸ [1988] 1 NZLR 530 (CA).

⁹⁹ *Id.*, 537.

¹⁰⁰ (1986) 9 TRNZ 331 (CA).

¹⁰¹ *Id.*, 337 per Cooke P.

¹⁰² *Auckland City Council v. Minister of Transport* [1990] 1 NZLR 264, 289 (CA), per Cooke P.

¹⁰³ For example, *Police v. B* [1990] 2 NZLR 504, 507 (HC), per Tompkins J (affirmed [1991] 2 NZLR 527); *Wahrlich v. Bate* [1990] 3 NZLR 97, 111 (HC), per McGechan J.

¹⁰⁴ *Re AIC Merchant Finance Ltd* [1990] 2 NZLR 385, 391 (CA), per Richardson J.

the legislation”.¹⁰⁵ A similar trend toward the purposive approach to statutory interpretation is evident in Australia. In *Kingston v. Keprose Pty Ltd*,¹⁰⁶ McHugh JA said that:

In most cases the grammatical meaning of a provision will give effect to the purpose of the legislation ... But if the grammatical meaning of a provision does not give effect to the purpose of the legislation the grammatical meaning cannot prevail. It must give way to the construction which will promote the purpose or object of the Act.¹⁰⁷

In short, the New Zealand Court of Appeal has endorsed a purposive approach to statutory interpretation.

Discovering the purpose of an Act is not free from difficulty.¹⁰⁸ Sometimes the most natural grammatical meaning of the provision in question gives effect to the purpose of the legislation.

Where grammatical meaning and purpose are congruent there is no problem. But if a purely grammatical construction does not give effect to the purpose of a provision then the Court should look for an interpretation that gives effect to the purpose.¹⁰⁹ Logically, this means that even where the meaning of a provision appears to be clear, interpretation must involve an examination of the underlying purpose of the legislation to ensure that meaning and purpose are congruent. Where a purposive approach to interpretation is used it will never suffice to simply look at the words of a provision in order to determine legislative intent or purpose.

A purposive approach to statutory interpretation involves consideration of the particular provision in its context. In turn, this requires examination of a number of factors. First, the purpose of the Act may refer to the overall “theme” of the Act. It may be possible to discern a theme running through the main provisions of an Act. New Zealand courts, particularly the

¹⁰⁵ *R v. Lewis* [1991] 1 NZLR 409, 411 (CA), per Cooke P; *Northland Milk Vendors Association Inc v. Northern Milk Ltd* [1988] 1 NZLR 530, 537 (CA), per Cooke P.

¹⁰⁶ (1987) 11 NSWLR 404 (CA).

¹⁰⁷ *Id.*, 423.

¹⁰⁸ “The significations of the words ‘object’ and ‘purposive’ are so various in different collocations and in relation to different aspects, that the utmost care is necessary to avoid slipping into egregious error. For instance, the ‘object’ of a statute for one purpose may be properly defined as the end to which its provisions or their true construction appear to be directed. For another purpose it may properly be regarded simply as the legal effect produced by its operative provisions...”. *James v. Cowan* (1930) 43 CLR 386, 408 (HC) per Isaacs J.

¹⁰⁹ *Kingston v. Keprose Pty Ltd* (1987) 11 NSWLR 404, 423 (CA), per McHugh JA. Note the injunction that grammatical meaning is still the starting point, and that the task remains one of construction. See also comments of Lord Diplock, “The Courts as Legislators”, in B. Harvey, ed., *The Lawyer and Justice: A Collection of Addresses by Judges and Jurists to the Holdsworth Club of the University of Birmingham*

Court of Appeal, continually emphasise the “scheme of the Act”.¹¹⁰ An examination of the main provisions of the Securities Act 1978 shows that the predominant theme running through this Act is investor protection. The judiciary agrees. In *Re AIC Merchant Finance*,¹¹¹ Richardson J. said:

The pattern of the Securities Act and the sanctions it imposes make it plain that the broad statutory goal is to facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers for securities. In that way the Act is aimed at the protection of investors.¹¹²

Second, many Acts of Parliament state their purpose in the Long Title.¹¹³ The Long Title of the Securities Act 1978 reads as follows:

An Act to establish a Securities Commission; and to consolidate and amend the law relating to the offering of securities to the public, and to extend the application thereof.

The new section 5 (2) makes reference to the use of indications provided in the enactment (which must include Long Titles) as an aid to statutory interpretation. In the past, courts frequently referred to the Long Title when applying a purposive approach to statutory interpretation,¹¹⁴ notwithstanding that the Long Title might sometimes not accurately cover the whole scope of the Act and individual provisions may go beyond it.¹¹⁵

It is clear from the words of the Long Title of the Securities Act 1978 that the Act was meant to *extend* the law relating to the *offering* of securities to the public.¹¹⁶ This amounts to a very broad statement of intent. If the reference to extending the law means anything, it must reflect an intention to regulate the *activity* of fund raising generally (rather than fund raising by specific entities such as companies), thereby furthering the purpose of the Act - investor protection.

- (1978), 274: “If ... the Courts can identify the target of parliamentary legislation their proper function is to see that it is hit; not merely to record that it has been missed.”
- 110 See, for example, *Callender v. Wellington City Council* [1980] 2 NZLR 55 at 63-64 (CA), per Richardson J; *Brown v. Minister of Education* [1985] 2 NZLR 356 at 361-364 (CA), per Richardson J; *Commissioner of Inland Revenue v. Grover* [1987] 2 NZLR 736 at 737-739 (CA), per Cooke P.
- 111 [1990] 2 NZLR 385 (CA).
- 112 *Id.*, 391.
- 113 See, for example, the Milk Act 1988 (NZ) and the Matrimonial Property Act 1976 (NZ).
- 114 *Northland Milk Vendors Association Inc v. Northern Milk Ltd* [1988] 1 NZLR 530, 537 (CA), per Cooke P. See also *Z v. Z* [1989] 3 NZLR 413, 418 (CA), per Bisson J; *Nealon v. Public Trustee* [1949] NZLR 148, 159 (CA), per Finlay J.
- 115 *Dominion Airlines Ltd v. Strand* [1933] NZLR 1, 45 (SC), per Ostler J.

While some Acts have a separate purpose section, the Securities Act 1978 does not. In passing, it is submitted that the Act should be amended to include a clear statement of its purpose.

Third, it is permissible when determining the purpose of a particular piece of legislation to refer to extrinsic sources, or material outside the Act, in order to ascertain the mischief which Parliament was hoping to remedy by the Act and the ends which the Act was intended to achieve.¹¹⁷ Professor Burrows states:

It has long been regarded as permissible to have regard to the social and economic factors which existed at the time the Act was passed ... Such an examination may clarify the ‘mischief’ which the Act was passed to remedy. It may sometimes also immediately clarify the meaning of a provision to see the circumstances which the framers of the Act had in mind when they prepared the legislation: the abstract words of legislation can take on a new clarity when one discovers the exact situation which the legislators were addressing.¹¹⁸

This raises two questions. What were the relevant social and economic factors during the period prior to the enactment of the Securities Act 1978 and what was the mischief that Parliament hoped to remedy? There are limits to the usefulness of such inquiry. Even where a mischief can be identified it is not always the case that the provisions enacted are capable of remedying such mischief.¹¹⁹ It is, however, a logical presumption that Parliament intended to get rid of the particular mischief as effectively as possible and the statute should be given a liberal interpretation to achieve that end. In the case of the Securities Act 1978, there are two main external sources providing insight into the relevant social and economic factors prevailing at the time the Act was passed. These sources support the proposition that the intention of parliament was to provide greater investor protection where securities are offered to the public.

The first main external source is *The Report of the Working Party on Negotiable Instruments*.¹²⁰ It is permissible and common for courts to look at the reports of committees and commissions that recommended legislation.¹²¹ Reports produced by committees may be of particular use in

¹¹⁶ *Barclays NZ Ltd. v. Gillies* (1990) 5 NZCLC 66,659 at 66,680 (HC) per Master Williams: “The Long Title to the Securities Act 1978 speaks of ‘extending the application of the law relating to offer of securities to the public’”.

¹¹⁷ New Zealand Law Commission, *A New Interpretation Act*, Report No. 17 (1990), 41 ff.

¹¹⁸ Burrows, 3rd ed., 172.

¹¹⁹ *Donselaar v. Donselaar* [1982] 1 NZLR 97, 115 (CA), per Somers J; *Maunsell v. Olins* [1975] AC 373, 393-394 (HL), per Lord Simon.

¹²⁰ Report of the Working Party on Negotiable Instruments (1977). Hereafter, “Working Party”.

¹²¹ See now section 5 (3) of The Interpretation Act 1999. For example, the report of the English Royal Commission of 1879 recommending the 1879 Criminal Code Bill (on which the Crimes Act 1961 (NZ) was

establishing the manner by which the reform sought to change the existing law and the ends it was trying to achieve.¹²² Before the passing of the Securities Act 1978, a Working Party of the Justice Department produced a report on negotiable instruments following the collapse of the Securitibank.¹²³ The *Working Party* recommended that:

The whole body of law relating to the raising of funds from the public be reviewed on a broad basis of policy as well as in the detail of its application. This body of law has become very complex, and we fear that the ‘loop-holes’ exposed by the Securitibank Group’s dealings with ‘in-house’ bills are only an example of deficiencies in the law.¹²⁴

The *Working Party* considered that law reform should be concerned, inter alia, with the following matters:¹²⁵

- (a) Providing for the furnishing of appropriate information to the investing public, not only in respect of offers or invitations to invest, but also in relation to the continuing state of affairs of the entity which has raised funds from the public.
- (b) Considering the need for the surveillance of the application of funds raised from the public, and the state of affairs of fund-raising entities on a continuing basis. We favour the establishment of an independent Commission of Commercial Affairs, charged with the responsibility of reviewing and investigating the affairs of entities which have raised funds from the public.

These recommendations were aimed at protecting investors by ensuring that they were entitled to and did in fact receive sufficient information about the entity offering securities to the public.

The second main external source from which the purpose of the Securities Act 1978 can be gleaned is New Zealand parliamentary debates. Courts traditionally took a restrictive approach to material of this kind - it could not be referred to at all.¹²⁶ Today, in England,¹²⁷ and New

based), has often been referred to as providing direct assistance in interpreting provisions of the Crimes Act 1961. See, for example, *Downey v. R* [1971] NZLR 97, 100 (CA); *R v. Bennett* [1981] 1 NZLR 519 at 521 (CA). Another example is the report of the commissioners who recommended the 1908 consolidation statute which was sometimes referred to in order to determine whether a consolidated Act was intended to change the law: see, for example, *Hughes v. Hanna* (1909) 29 NZLR 16 at 22-23 (CA); *Black v. Shaw* (1914) 33 NZLR 194 at 196 (SC).

¹²² See *Warsdale v. Polgase* [1981] 1 NZLR 722 (HC), where the Contract and Commercial Law Reform Committee Report which gave rise to the passing of the Contractual Remedies Act 1979 (NZ) was specifically referred to in adopting a particular interpretation.

¹²³ Working Party.

¹²⁴ Working Party, 78.

¹²⁵ Id., 79.

¹²⁶ *Black-Clawson International Ltd v. Papierwerke Waldhof-Aschaffenburg A/G* [1975] AC 591 (HL); *Davis v. Johnson* [1979] AC 264 (HL); *Hadmore Productions Ltd v. Hamilton* [1983] 1 AC 191 (HL); *R v. Allen*

Zealand,¹²⁸ it is clear that courts have discretion to admit and use parliamentary history and parliamentary debates as an aid to statutory interpretation.¹²⁹ Statements in parliament following the Securitibank collapse provide a clear indication of the purpose of the legislation. For example, the Securities Advertisement Bill, adopting the thrust of the recommendations of the *Working Party*, was introduced into parliament in 1977. In his introductory speech on the Bill, the Minister for Justice, Hon D. Thomson MP stated:

The Bill follows a series of financial collapses in recent years, which have drawn attention to the need for legislation to give a greater degree of protection to the public. Commercial entities have usual types of securities, such as shares and debentures, the public has been asked to invest in contributory mortgages, hire-purchase paper, bills of exchange and a number of quasi-syndicates. Collapses have occurred mainly in investment in these less usual types of securities - investment that has not yet given rise to similar duties and responsibilities as apply to the usual type of investment.

The Bill will repeal those enactments and provisions that deal with particular types of entities, and instead will constitute a virtually comprehensive source of the statute law on the duties and responsibilities that arise when an entity offers securities to the public. Put another way, the Bill represents activity-based legislation that will deal with this area of the law as a whole, so there are no inconsistencies in its regulation and development, and, more importantly it will remove the present opportunity for disreputable promoters to operate in less well regulated areas.

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- [1985] 1 AC 1029 (HL). See Burrows, *op. cit.*, for reasons for and against the inclusion and exclusion of parliamentary debates in statutory interpretation.
- 127 *Pepper v. Hart* [1993] 1 ALL ER 42 (HL). But see now *Robinson v Secretary of State for Northern Ireland* [2002] UK HL 32 at 35.
- 128 The first case was *Marac Life Assurance Ltd v. CIR* [1986] 1 NZLR 694, 701 (CA) per Cooke J. “A governmental statement in the House could not be allowed to alter the meaning of an Act of Parliament in plain conflict with it; but in my view it would be unduly technical to ignore such an aid as supporting a provisional interpretation of the words of the Act, or as helping to identify the mischief aimed at or to clarify some ambiguity in the Act.” In *New Zealand Maori Council v. Attorney-General* [1987] 1 NZLR 641, 658 (CA), the Court of Appeal said that it would be irresponsible not to look to the parliamentary proceedings when interpreting some Acts.
- 129 *Devonport v. Local Government Commission* [1989] 2 NZLR 203 (CA), illustrates the view of the courts on the use of parliamentary debates. There, Cooke P. said, “This court has accepted that reference to the *New Zealand Parliamentary Debates (Hansard)* may be appropriate if, for instance, significant help can be obtained thereby to resolve an ambiguity or to provide really useful background, but we have stressed that it is clearly not appropriate as a matter of course. ... The Courts have little patience with references to *Hansard* which are of little help or relevance and simply add to the volume of information which they have to sift through.” *Id.*, 208. In *A-G v. Whangarei City Council* [1987] 2 NZLR 151 (CA), Cooke P. said, “We take this occasion to say that, while we have been prepared to look at reports of parliamentary debates in some cases, this development is certainly not intended to encourage constant references to *Hansard* and indirect arguments therefrom. Only material of obvious and direct importance is at all likely to be considered; and the Court will not allow such references to be imported into and lengthen arguments as a matter of course.” *Id.*, 152. See further, Burrows, 3rd ed., Chapter 9.

I emphasise that risk is an inseparable part of investment, and the Bill in no way purports to alter that. But I do not regard as legitimate that part of risk attributable to irresponsibility or mismanagement. The Bill is aimed at redressing the balance in favour of the investor who, in many of the financial collapses in recent years, has had little or no way of ensuring that his investment has been responsibly and properly managed.¹³⁰

During the second reading of the Bill in the House the Minister for Justice reiterated his view on the investor protection rationale of the proposed legislation.¹³¹ Emphasising that the Bill represented activity-based legislation, he stated:

Accordingly the Bill is drafted in wide terms, and so the definition of what constitutes a security is drawn widely and encompasses items that would not readily be regarded commercially as securities.¹³²

This statement provides evidence that the term “security” was intended by parliament to be interpreted widely and extend beyond the conventional definition of a security. Thus, the statements of the Minister of Justice in parliamentary debates provide support for the proposition that the Act was directed at the *activity* of fund raising by the *offering* of securities; that the term “security” was to be read widely to encompass items that would not be conventionally regarded as securities (ie. the meaning of a security extends beyond conventional legal categorization), and, that the purpose of Act is investor protection.

There is no dispute that the judiciary supports this reading of the legislation. In *Re AIC Merchant Finance*,¹³³ Richardson J stated, obiter, that:

The pattern of the Securities Act and the sanctions it imposes make it plain that the broad statutory goal is to facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers for securities. In that way the Act is aimed at the protection of investors ... the premise underlying the Securities Act ... is that the best protection of the public lies in full disclosure of the company’s affairs and of the security it is offering. That then allows the investor to make an informed investment decision, which in turn facilitates the functioning of the financial markets.¹³⁴

130 *NZPD*, Vol. 416, 1977, 5339.

131 Second reading of the Securities Advertising Bill by the Minister for Justice, Hon D Thomson MP, *NZPD*, Vol. 421, 1978, 3934-3935.

132 *Id.*, 3935.

133 [1990] 2 NZLR 385 (CA).

134 *Id.*, 391-2.

Richardson J.'s approach was affirmed in the High Court in *DFC v. Abel*,¹³⁵ and by the full Court of Appeal in *Securities Commission v. Kiwi Co-operative Dairies Ltd.*¹³⁶

In sum, well-established principles of statutory interpretation and existing case law provide clear guidance on the correct approach to securities legislation in New Zealand as a matter of *law*. Thus, in New Zealand (unlike North America), there is little need to refer to the body of theoretical literature aimed at revitalising approaches to statutory interpretation.¹³⁷ This is simply because in New Zealand (and in Australia),¹³⁸ there is explicit statutory direction to the courts via The Interpretation Act 1999 as to how Acts should be interpreted. Hence, at least superficially, the work of Edward Rubin has less application in New Zealand than it might in North America.¹³⁹ Rubin argues that legislation is a deliberate act of social policy,¹⁴⁰ a statement delivered to a court or "implementation mechanism".¹⁴¹ The statement may be transitive (an explicit instruction) or intransitive (loose instructions to administrative agencies).¹⁴² It seems plain, however, that the modern doctrine of statutory interpretation in New Zealand is premised on the notion that legislation is an act of social policy and, in the case of the securities regime, the legislation is highly transitive.

A problem here is that judicial discretion resides in apparently highly transitive provisions. Judicial discretion is one tenet of Hartian positivism and may be defined as the constrained authority of judges to appeal to standards other than those legally binding on them to resolve controversial disputes. Judicial discretion is unavoidable where the rule of recognition is

135 [1991] 2 NZLR 619 at 629 (HC) per Fisher J.

136 [1995] 3 NZLR 26 at 31 (CA); (1995) 7 NZCLC 260,828 at 260,832 (CA) per Blanchard J.

137 As to North America, see: G. Calabresi, *A Common Law for the Age of Statutes* (1982); R. Posner, "Statutory Interpretation - in the Classroom and in the Courtroom" (1983) 50 U. Chi. LR 800; M. Posner, "Interpreting Texts: Some New Directions" (1985) 58 S. Cal. LR 15; W. Eskridge, "Dynamic Statutory Interpretation" (1987) 135 U. Penn. LR 15; C. Sunstein, "Interpreting Statutes in the Regulatory State" (1989) 103 Harvard LR 405; W. Eskridge, "Gadamer/Statutory Interpretation" (1990) Columbia LR 609; W. Eskridge and P. Frickey, "Statutory Interpretation as Practical Reasoning" (1992) 42 Stanford LR 321; P. Frickey, "From the Big Sleep to the Big Heat: The Revival of Theory in Statutory Interpretation" (1992) 77 Minn. LR 241; W. Eskridge, *Dynamic Statutory Interpretation* (1994)

138 See s. 15 AA of the Acts Interpretation Act 1901 (Cth) and its mirror image in s. 109H, Corporations Law (Cth).

139 E. Rubin, "Law and Legislation in the Administrative State" (1989) 89 Columbia LR 369; E. Rubin, *Legislative Methodology: Some Lessons from the Truth-in-Lending Act* (1991) 80 Georgetown LJ 233; E. Rubin, "Modern Statutes, Loose Cannons and the Limits of Practical Legal Reason" (1992) 45 Vanderbilt LR 579; E. Rubin, "The New Legal Process, the Synthesis of Discourse, and the Microanalysis of Institutions" (1996) 109 Harvard LR 1393.

140 E. Rubin, "Law and Legislation in the Administrative State" (1989) 89 Columbia LR 369, 373.

141 *Id.*, 380.

142 *Id.*, 381.

inapplicable or where the open texture of language demands the exercise of discretion. As to the latter point, Hart draws a distinction between the core and penumbra of a term.¹⁴³ Hart's notion is that there is a distinction between easy and hard cases that parallels the distinction between the core and penumbra of a concept. Thus, legal rules are binding with respect to their core instances, however, with respect to the penumbra of a concept, rational disagreement is possible and the law dictates no particular answer. Hence, a judge must exercise discretion and, in effect, legislate meaning.¹⁴⁴ The exercise of judicial discretion is one reason why the securities regime might lack coherency. If the New Zealand scheme of securities regulation is to operate in an optimal fashion, judges must advert to the purposes and policies underlying the scheme when exercising their discretion. If they do not, then an explicit direction should be inserted in the legislation. Here, it is to be welcomed that the amendments to the SMA effective 29 February 2008 introduced new sections that contain statements of the purpose of the relevant subparts: see ss. 19A, 19SA and 20.

3. Definition of a Security

3.1 Introduction

The Securities Act 1978 controls the primary market. Section 33 of the Act prohibits, *inter alia*, the offering of a security to the public in the absence of a registered prospectus or investment statement or authorised advertisement.¹⁴⁵ Where an investment statement is provided, a security holder or prospective investor may request a copy of the registered prospectus (“request disclosure”).¹⁴⁶

The term “security” was previously defined in section 2(1) of the Act. It stated that a security:

means any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person; and includes –

(a) Any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property); and

¹⁴³ Hart, *op. cit.*, 124-6. See further, J. Black, *Rules and Regulators* (1997), 10ff.

¹⁴⁴ For a discussion, see The Hon. Justice M. H. McHugh, “The Judicial Method” (1999) 73 (1) ALJ 37, 48.

¹⁴⁵ Section 33 of the 78 Act.

¹⁴⁶ Section 54B (3) of the 78 Act.

(b) Any renewal or variation of the terms or conditions of any existing security.

Since October 1 1997, the definition for the term “security” is found in section 2D(1).¹⁴⁷ The section 2D(1) definition is the same as the former section 2(1) with three exceptions. First, the term “security” for the purposes of the Act is as defined in section 2D(1) “unless the context otherwise requires”.¹⁴⁸ The significance of these words should not be discounted; they may be used in the future to facilitate a more purposive interpretation of the term. Second, the definition of “security” explicitly refers to the terms “equity” and “debt” securities, which are defined in section 2(1). Third, in what can be regarded as an attempt to extend the original purpose or coherency of the Act by bringing all investment products under a common statutory regime, the definition has been amended to include unit trusts, superannuation schemes, and life insurance policies (section 2D(1)(c)-(e)).

The term “unit trust” is defined in section 2 as having the meaning given to that term in section 2(1) of the Unit Trusts Act 1960 (NZ). “Superannuation scheme” is defined in section 2(1) as a registered superannuation scheme within the meaning of section 2(1) of the Superannuation Schemes Act 1989 (NZ). A “life insurance policy” is defined as a “policy of life or endowment insurance, or a policy securing an annuity” and a policy of insurance declared to be so by the regulations.¹⁴⁹ The definition also provides for interests to be declared to be securities under the regulations (section 2D(1)(f)) and also for interests to be declared not to be a security (section 2D(1)).

Section 2(1) also defines the terms “debt security”, “equity security” and “participatory security”. The main purpose of separating these securities into three classes is for classification. The importance of the classification of a security goes to whether independent supervision is needed (a trustee for an offer of debt securities,¹⁵⁰ or a statutory supervisor for an offering of participatory securities),¹⁵¹ what documentation has to be registered, and the relevant

¹⁴⁷ Securities Amendment Act 1996, ss. 3 (18) and 4.

¹⁴⁸ Compare the opening words of s. 2, Securities Act 1933 (US), “unless the context otherwise requires”. As Cox, Hillman, Langevoort, *Securities Regulation: Cases and Materials* (2nd ed., 1997), 117 comment, these words provide “an important basis for the exercise of judicial discretion concerning the proper scope of the securities laws.”

¹⁴⁹ Section 2(1). See *Marac Life Assurance Ltd v. Commissioner of Inland Revenue* [1986] 1 NZLR 694 (CA) for a discussion of the meaning of the terms “life insurance” and “endowment”.

¹⁵⁰ Section 33 (2).

¹⁵¹ Section 33 (3).

information that needs to be disclosed (as set out in the schedules to the Securities Regulations).¹⁵²

Section 33(1) prohibits the offering for subscription of a "security" in the absence of a registered prospectus or investment statement and the term "security" as defined encompasses the specific definitions of "debt", "equity" and "participatory" securities. "Debt security" refers, in general terms, to schemes where money is lent and later repaid, while "equity security" refers in general terms to interests in the share capital of a company. A "participatory security" is the default definition. Any scheme that falls within the definition of the term "security" under section 2D, but is not an equity or debt security, or is not an interest a unit trust, an interest in a superannuation scheme, or a life insurance policy is a "participatory security". Examples of participatory securities include interests in horticulture schemes, forestry or horse syndicates.

Apart from unit trusts, superannuation schemes, and life insurance schemes, section 2D(1) contemplates four types of interests that may qualify as a "security". They are:

- an interest in any capital, assets, earnings, royalties, or other property of any person; or
- a right to participate in any capital, assets, earnings, royalties, or other property of any person; or
- Any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property); or
- Any renewal or variation of the terms or conditions of any existing security.

In order to trigger the prospectus provisions of the Act that which is offered must come within the s. 2(1) definition of security. In this way, the definition of a security is the gateway to the Act. Section 2 requires that there be "any interest *or* right to participate". Reading this section disjunctively, there are two limbs to the s. 2 definition.¹⁵³ It will be possible to prove either an interest, or, a right to participate. Because the Act provides no further guidance on the meanings of "interest" or "right to participate", the first interpretive step is to look at the ordinary meanings of these terms.¹⁵⁴

¹⁵² Sections 33 (2) and (3). The Securities Regulations 1983 were extensively amended by the Securities Amendment Regulations 1997 (in force as of 7 August 1997).

¹⁵³ See *R v. Smith* [1991] 3 NZLR 740 at 748 (HC), where Wylie J. considered "right to participate" separately from "interest".

¹⁵⁴ See, for instance, *Commissioner of Inland Revenue v. Haenge* [1986] 1 NZLR 119 at 122 (CA) per Cooke P; *Kingston v. Keoprose Pty Ltd* (1987) 11 NSWLR 404 at 423 (CA), per McHugh J. See also the strong reliance

The term “interest” is not novel. An “interest” has been defined to mean, “a right, or title to, or estate in, any real or personal property”.¹⁵⁵ Further defined, “a right” means “a lawful title or claim to anything”,¹⁵⁶ and “a title” means “title to land or goods, signifying (a) a party’s right to the enjoyment thereof; or (b) the means whereby such right has accrued, and by which it is evidenced”.¹⁵⁷ Judicially, the term “interest” has often been defined.¹⁵⁸ For example, “‘any interest’ must include an equitable interest”¹⁵⁹ and “interest” is not to be cut down to “interest in possession”.¹⁶⁰ Thus, a life policy is an “interest”.¹⁶¹ Further, an “interest” has been denoted as giving the possessor a right or expectation to share in a company’s profits even though that might arise via liquidation.¹⁶²

As we have seen, “a right” means a lawful title or claim to anything”.¹⁶³ This is very broad.¹⁶⁴ However, the second limb of the definition of security is more limited since it requires an element of participation. The *Collins Concise Dictionary of English* defines “participate” as “to take part, be or become actively involved, or share in.”¹⁶⁵ Judicially, it has been said that, “the word ‘participate’ clearly implied a sharing or division”.¹⁶⁶

As a consequence, on a literal interpretation, it can be seen that the words “interest” or “right to participate” are *prima facie* broad. Hence, the definition of security must also be wide; especially when one considers that the definition is predicated on, “an interest or right to participate in ... *property of any person*”.¹⁶⁷ Even if read down, *ejusdem generis*, so that security relates to “capital, assets, earnings, royalties...”, the definition will still be exceptionally broad. Hence, the Act should apply to offers of interests in existing property and contingent interests in future property. Otherwise, the application of the Act would be limited as promoters of

on “natural and ordinary meaning” in *Accident Compensation Commission v. Kivi* [1980] 2 NZLR 385, 389 (CA), per Richmond P.

155 P. Spiller, *Butterworths New Zealand Law Dictionary* (4th ed., 1995), 151.

156 *Id.*, 260.

157 *Id.*, 297.

158 J. James, *Stroud’s Judicial Dictionary of Words and Phrases* (5th ed., 1986), 1328-1333.

159 *Re Casey* [1892] 1 Ch. 104.

160 *A-G v. Wood* [1987] 2 Q.B. 102, per Williams J. when considering the Finance Act 1894 (UK).

161 *A-G v. Murray* [1904] 1 K.B. 165.

162 *I.R.C. v. Woolf* [1962] 1 Ch. 35.

163 P. Spiller, *op. cit.*, 151.

164 See *Stroud’s Judicial Dictionary of Words and Phrases* (5th ed., 1986), 2291 - 2299 for extensive judicial definitions of the term “right”.

165 *Collins Concise Dictionary of English* (1992) 974.

166 *Robertson v. Fraser* 6 Ch. 696.

167 Emphasis added.

investments often promote them in advance of the purchase of the relevant asset. This proposition is supported by dicta of Fisher J. in *DFC v. Abel*.¹⁶⁸

Early commentators on the Securities Act 1978 believed that the definition of security was very wide. Matthew Dunning thought that the “definition in the New Zealand statute is wide enough to encompass almost all investment activity.”¹⁶⁹ Peter Ratner discussed the width of the definition and suggested that in most cases it would be safe to assume that the instrument offered is a security that will be covered by the Act unless one of the exemptions applies.¹⁷⁰ Similarly, early judicial dicta indicated that the Courts would give the definition of security a wide interpretation. In *City Realities Ltd v. Securities Commission*,¹⁷¹ Cooke J. commented on the, “extremely wide definition of security”, contained in s. 2. of the Act, the width of which is complemented by the various exemptions in s. 5.”¹⁷²

The wide definition of the term “security” reflects Parliament’s intention to provide greater investor protection,¹⁷³ and, *prima facie*, appears to cover almost every type of investment.¹⁷⁴

Thus, there is enough scope in the definition of “security” to enable the judiciary to interpret the term in a broad and purposive manner so as to give effect to the intent of parliament - investor protection.¹⁷⁵ Nonetheless, two early cases on the Securities Act held otherwise.

¹⁶⁸ [1991] 2 NZLR 619, 626 (HC) per Fisher J. who stated that “Broadly speaking, the expression ‘security’ seems intended to embrace any interest in, or right to participate in, present or future property, including the existing or future debts owed by others”.

¹⁶⁹ M. Dunning, “The definition of ‘security’ for purposes of a Securities Act” [1984] NZLJ 71, 74.

¹⁷⁰ P. Ratner, “The Securities Act 1978 and the Securities Regulations” (1983) 5 Otago LR 471, 477-478. See also, R. Darvell and R. Clarke, *Securities Law in New Zealand* (1983), 41.

¹⁷¹ [1982] 1 NZLR 74 (CA).

¹⁷² *Id.*, 76 - 77.

¹⁷³ See the statement on second reading of the Securities Advertising Bill by the Minister for Justice, Hon D Thomson MP, *NZPD*, Vol. 421, 1978, 3935: “... the Bill represents activity-based legislation. Accordingly, the Bill is drawn in wide terms, and so the definition of what constitutes a security is drawn widely and encompasses items that would not readily be regarded commercially as securities. However, the wide definition of security must be read subject to the fact that the Bill deals only with securities offered to the public, and subject to the new clause 5(1).”

¹⁷⁴ However, a range of exemptions is provided in section. 5 of the Act. See, for example, the numerous exemption notices issued by the NZSC pursuant to its discretionary power to exclude transactions from the regime. In some cases, the exemptions are from the whole of Part II of the Act; in others, from specific sections.

¹⁷⁵ In many cases the ordinary meaning of words is in fact reinforced when the purpose, context and other factors are examined. See, for example, *Police v. Matheson* [1989] 3 NZLR 682 (HC); *R v. Pekapo* [1989] 2 NZLR 229 (HC); *Diet Tea Co Ltd v. A-G* [1986] 2 NZLR 693 (HC); *Commodore Pty Ltd v. Perpetual Trustees Ltd* [1984] 1 NZLR 324 at 333-334 (CA) per Cooke J.; *Rural Banking and Finance Corporation of NZ v. Official Assignee* [1991] 2 NZLR 351 at 355 (HC) per Fisher J.

3.2 Two Problem Cases: *Marac* and *Smith*

In *Marac Life Assurance Ltd v. CIR*¹⁷⁶ the question arose as to whether certain “Life Bonds” marketed by Marac amounted to policies of life insurance for the purposes of the Life Insurance Act 1908 (NZ), the Income Tax Act 1976 (NZ), and the exemption from Part II of the Securities Act 1978.¹⁷⁷ The essential feature of the bonds was a promise by Marac to pay to the insured an amount, described as the “sum assured”, on the happening of an event defined in the policy.¹⁷⁸ In short, the bond was a debt security with the addition of the minuscule portion of the premium costs that went to insurance risk.¹⁷⁹

In the High Court the availability of the exemption in the Securities Act 1978 turned on the element of life insurance present in the bonds. The High Court thought this to be sufficient to justify the arrangement being regarded as life insurance. The Court of Appeal agreed but on different grounds. So long as the bonds were not shams¹⁸⁰ and there was an element of life insurance in the bonds - albeit a minimal element - the exemption from Part II of the Act could apply.

Despite the fact that both Richardson J. and Cooke P. noted the importance of the purpose of the tax and insurance legislation,¹⁸¹ a purposive approach was not applied to the securities legislation. At the time when the Securities Act 1978 was passed, products such as the insurance

¹⁷⁶ (1985) 9 NZTC 201 (HC); [1986] 1 NZLR 694 (CA).

¹⁷⁷ Former section 5(1)(a) (now repealed).

¹⁷⁸ The event was the survival of the insured to the maturity date, or the death of the insured within the term. The sum assured was the single premium plus a ‘bonus’ calculated at a percentage rate per annum, which matched the current interest rate offered on term deposits. If a purchaser of a bond died before the end of the term, Marac would pay out the sum assured, even though some months or years of that bonus was unearned. The unearned bonus represented the insurance element of the bond.

¹⁷⁹ The mortality costs of the premium for all of the bonds were calculated as 0.5 per cent, (the actuarial calculation of the insurance risk that the assured would die before the maturity date). *Id.*, 697.

¹⁸⁰ *Id.*, 706 per Richardson J. The doctrine of the sham referred to by the Court broadly states that, at common law, the true nature of a transaction can only be determined by an examination of the legal arrangements between the parties and not by any assessment of the broad substance of the transaction measured by the results intended or achieved or of the overall economic consequences. Unless the documentation is a sham that hides the true agreement or unless there is a statutory provision mandating a broader or different approach, the nature of a transaction will be determined by the legal rights and duties actually created by the agreement between the parties. See also *Re Securitibank Ltd (No2)* [1978] 2 NZLR 136 (CA); *Marac Finance Ltd v. Virtue* [1981] 1 NZLR 586 (CA). This approach contrasts sharply with that of the U.S. Supreme Court in *United Housing Foundation, Inc. v. Forman* 421 U.S. 837 (1975) where the economic realities underlying the transaction were dispositive.

¹⁸¹ *Id.*, at 703 and 700 respectively.

life bonds did not exist in New Zealand. Given that the purpose of the Act is investor protection,¹⁸² it is unlikely that Parliament intended the exclusion for insurance products to apply to products marketed as “insurance products” where the insurance element present in them was minimal. Teresa Shreves catches the problem in this passage:

The broad definition of ‘security’ prevents the use of fine legal distinctions to avoid the disclosure regime considered necessary for investor protection ... Marac, by the addition of a very small insurance element, was able to offer the product with no accompanying Securities Act disclosure. In refusing to even examine and weigh the various elements in the bonds, the court signalled that fine legal distinctions still could be utilised to avoid regulation under the Act.¹⁸³

The decision in *Marac* can be usefully contrasted with the United States Supreme Court decision in *United Housing Foundation, Inc. v. Forman*.¹⁸⁴ In *Forman*, stock entitling a purchaser to lease an apartment in a state subsidised nonprofit housing cooperative was held not to be a security despite the fact that the definition of a security in the Securities Act 1933 (US) included the words “any ... stock”. The Supreme Court’s analysis is distinguished by its purposive approach to the legislation:

The primary purpose of the Acts of 1933 and 1934 was to eliminate serious abuses in a largely unregulated securities market. The focus of the Acts is on the capital market of the enterprise system ... Because securities transactions are economic in character Congress intended the application of these statutes to turn on the economic realities underlying a transaction, and not on the name appended thereto ...¹⁸⁵

The application of a purposive approach in *Forman* led inexorably to the economic characterisation of the legislation and a focus on economic reality. Thus, when considering whether the requisite stock constituted a security, “...we must again examine the substance - the economic realities of the transaction - rather than the names that have been employed by the parties.”¹⁸⁶ The *economic reality* of the transaction in *Marac* was that the bond was a debt security as defined dressed up as an insurance bond. The *substance* of the transaction was that the bond was a debt security. Failure to consider the purpose of the securities legislation and apply a substance over form analysis led to an incorrect characterisation of the instrument. Further, this result ignores the specific words of section 4(1) of the Securities Act, which directs

182 NZPD, Vol. 416, 1977, 5339.

183 T. Shreves, “Implementation and Enforcement of Disclosure Regulation in the Securities Act 1978” (unpub. LLM thesis, Victoria University of Wellington, 1995), 74-75.

184 421 U.S. 837 (1975).

185 Cited in Cox, Hillman, Langevoort, *Securities Regulation: Cases and Materials* (2nd ed., 1997), 151.

186 Ibid.

that the provisions of the Act “shall have effect notwithstanding anything to the contrary in any other enactment ...”.

The decision in *Marac* prompted piecemeal reform. The Securities Act was amended to repeal the blanket exemption for insurance products.¹⁸⁷ In order to obtain exemption from the prospectus requirements of the Act, an insurance company had to be authorised by the NZSC. The NZSC would only grant authorisation to an insurance company that complied with a regime, which provided investors with some of the protection available under the Securities Act.¹⁸⁸ The fact that Parliament thought it necessary to legislate to amend the law shortly after the decision strongly suggests that the Court in *Marac* was wrong in failing to apply a purposive approach.

In late 1996, further reform occurred when the Securities Amendment Act 1996 was passed. The 1996 Act came into force on 1 October 1997. The extensive exemption granted to life insurance companies under s. 7A of the 1978 Act was repealed. A definition of “life insurance policy” has been created which enables a disclosure regime specific to life insurance policies outside the general regime for debt securities and participatory securities.¹⁸⁹ If the Court of Appeal in *Marac* had given the term “security” a wide reading, however, it would have provided an early endorsement of a purposive approach to the legislation and a clear signal that the Act was not to be avoided by technical devices.

A second problematic case on the scope of the section 2(1) definition of “security” is *R v. Smith*.¹⁹⁰ *Smith* concerned criminal charges laid under section 58(1) of the Securities Act 1978 against the directors of Goldcorp Exchange Ltd. The directors were charged with making misstatements in advertisements inviting the public to purchase gold or other bullion. One method of purchase was described as the purchase of “non-allocated metal”. The purchaser would agree to buy the metal and would receive an invoice verifying ownership. The company undertook to store and insure the bullion on behalf of the purchasers who could take physical delivery if they so desired. It was alleged by the Crown that this constituted a criminal

¹⁸⁷ Section 43(1) of the Securities Amendment Act 1988, which became section 7A of the Securities Act 1978 (now repealed).

¹⁸⁸ Section 7B of the Act (now repealed) empowered the Commission to put in place the regime developed in conjunction with the Life Offices Association of New Zealand. Together, they developed a Code of Business Practice for Life Insurance companies, which covered matters such as disclosure, marketing, insurance intermediaries, and complaints procedures. As a result of this reform, investors in life insurance products received some of the protection provided by the Act.

¹⁸⁹ See Schedule 3B of the Securities Amendment Regulations 1997.

¹⁹⁰ [1991] 3 NZLR 740 (HC) per Wylie J.

misstatement under section 58(1) of the Securities Act 1978, as Goldcorp did not in fact maintain physical stocks of gold equal to the quantity it had sold on an unallocated basis. However, section 58(1) only applies to advertisements that refer or relate to an offer of a “security”. Hence, the key issue was whether the rights granted to investors could be subsumed under the definition of “security”, that is, as any “interest or right to participate ... in property” of Goldcorp.¹⁹¹

Adopting a sale of goods analysis (as Thorp J. had in earlier civil proceedings),¹⁹² Wylie J. concluded that the purchasers of non-allocated metal acquired contractual rights only and no legal or equitable title to the gold.¹⁹³ The question then became whether or not an interest less than a legal or equitable interest would suffice under the Act. Wylie J. came to the conclusion that the purchasers of the non-allocated metal acquired no “interest ... in ... property” within the meaning of the definition of “security” under the Securities Act 1978.¹⁹⁴ In reaching this conclusion, Wylie J. considered the Australian legislation, which contains an extended definition of the term “prescribed interest”.¹⁹⁵ The Crown argued that the court should adopt the Australian interpretation of “prescribed interest”. On this interpretation, contractual rights and interests would comprise an interest within the definition of “security” in the Securities Act 1978.

¹⁹¹ Id., 749.

¹⁹² Unreported judgment delivered 17 October 1990, High Court (Auckland Registry M1450/88 and Christchurch Registry CP 498/89).

¹⁹³ Id., 743 per Wylie J. “Whatever the investors may have thought they were getting by buying bullion on an unallocated basis, the contract entered into between the investors and the company was an agreement for the sale of unascertained goods for future delivery. As a consequence, the provisions of section 18 of the Sale of Goods Act 1908 were applicable. That section provides that, in those circumstances, no property in the goods is transferred to the buyer unless and until the goods are ascertained. Where there is a contract for the sale of unascertained goods, no property in the goods is transferred to the buyer unless and until the goods are ascertained: section 18, Sale of Goods Act 1908 (NZ). The rule is absolute and prevails over any expressed intention of the parties: *Re Goldcorp Exchange* [1994] 3 NZLR 385 (PC). There, the Privy Council advised that because the bullion was unascertained at the time of the contract it followed that the customers of Goldcorp had no title to the bullion.

¹⁹⁴ Wylie J.’s reliance on the earlier finding of Thorp J. that the non-allocated purchasers had no present proprietary interest in the bullion stocks is at least questionable in light of the subsequent decision in *Liggett v. Kensington* [1993] 1 NZLR 257 (CA). There, a majority of the Court of Appeal decided that Goldcorp stood in a fiduciary relationship to the non-allocated investors and that a constructive trust existed based on their equitable proprietary interest. Because the investors had enough of a proprietary interest in Goldcorp’s property to found the equitable remedy of a constructive trust, it is difficult to see why this was not considered as sufficient to amount to an equitable interest under the Act. However, the Court of Appeal ruling was overturned by the Privy Council: see *Re Goldcorp Exchange* [1994] 3 NZLR 385 (PC).

¹⁹⁵ Section 4 of the Australian Securities Industry Act 1980 defined “prescribed interest” as, “... any right to participate or any interest, whether enforceable or not and whether actual, prospective or contingent ... whether or not the right or interest is evidenced by a formal document and whether or not the right or interest relates to a physical asset ...”.

Wylie J. concluded that that the extended definition given to “prescribed interest” in the Australian legislation did not support attributing the undefined term in the New Zealand Act any wider construction than its ordinary legal meaning in the absence of any expanded definition.¹⁹⁶ His Honour considered, (arguably incorrectly),¹⁹⁷ that the Australian cases held those contractual rights alone would be insufficient to found an interest in property.¹⁹⁸ This comparison of the New Zealand and Australian legislation does not take into account the width of the definition of “security” in the Securities Act. Hence, while His Honour was correct in saying that the definition of “prescribed interest” in the Australian legislation was wide, he failed to recognise the arguably broader definition of “security” and “participatory security” in the New Zealand legislation. As Matthew Dunning has commented:

In the New Zealand definition of “security” the word “interest” is used simpliciter: there is no qualification of it being required to be legal, equitable, actual, prospective or contingent ... the absence of qualification suggests that none is meant and since the whole comprises its parts, all interests are caught.¹⁹⁹

Given the width in the definition of “security”, it was open for Wylie J. to find that a contractual interest (the right to call for delivery) was sufficient to amount to an “interest” for the purposes of the definition of “security”.

In *Smith*, the Crown also argued that the sale of non-allocated metal might fall within the second limb of the section 2 definition of “security” as constituting a “right to participate”. Wylie J. held that the concept of participation involves some form of sharing with others even if only the promoter of the scheme. His Honour did not regard the right of a purchaser to call for delivery of the gold as a right to participate in the property of the Exchange. The call for delivery was merely the exercise of the investor’s contractual rights. Andrew Simmonds questions this conclusion:

¹⁹⁶ Id., 748.

¹⁹⁷ See R. Baxt, H. Ford and A. Black, *Securities Industry Law* (5th ed., 1996), 29, which states: “There is an infinite variety of rights under contracts that could be prescribed interests. For example, life insurance, superannuation funds, options. Because these things could all amount to prescribed interests under the legislation it has been necessary to specifically exclude them from the definition of prescribed interest.”

¹⁹⁸ Id., 745; A. Simmonds, “‘Security’ of Gold: *R. v. Smith*” [1992] NZLJ 58, questions this conclusion. Simmonds analyses a number of Australian decisions where contractual rights (granted in, for example, franchise agreements), were held to be “prescribed interests” and concludes that “it is difficult to reconcile these cases with Wylie J’s conclusion that contractual rights alone do not give rise to an interest in property sufficient to amount to a ‘security’”. Id., 60.

¹⁹⁹ M. Dunning, “The definition of ‘security’ for the purposes of a Securities Act” [1984] NZLJ 71, 72.

It is unclear whether Wylie J. thought contractual rights alone could amount to a “right to participate” within the definition of “security”; although it appears that he did not. However, it is clear from the Australian cases that in some circumstances contractual rights can give rise to a right to participate²⁰⁰... In the writer’s view, having regard to the Australian case law and the general scheme of the Act, it would be incorrect to take an overly strict approach to the interpretation of the term “right to participate”.²⁰¹

Smith can be regarded as another case where failure to consider the purpose of the statute led the court into error. The application of the Sale of Goods Act 1908 (NZ) as a means for determining whether an “interest ... in ... property” existed under the Securities Act seems quite wrong when considering a criminal count under the latter Act. The Sale of Goods Act analysis failed to take into account the purpose of the Securities Act, investor protection. It was necessary to apply that statute in civil proceedings to determine where property in the bullion lay (thereby enabling the receivers to determine the priority of payment of debts). But as Teresa Shreves points out:

In cases such as *R v. Smith*, which turn on the definition of security, there is no question about competing claims to property. Rather, the issue concerns whether an interest exists for the purpose of securities regulation, which is designed to protect investors through mandated information disclosure.²⁰²

Section 4(1) of the Securities Act further militates against the use of a Sale of Goods Act analysis. It is the function of section 4(1)²⁰³ to protect the provisions of the Securities Act from derogation by provisions in other statutes by ensuring that the provisions of the Act will prevail where provisions in other statutes might encroach.²⁰⁴ Because the purpose of the Securities Act is investor protection (and the rules for determining the passage of title under the Sale of Goods Act obviously take no account of that purpose), the use of the Sale of Goods Act to determine whether an interest exists pursuant to the definition of security under the Securities Act is wrong at law, contrary to the overall scheme of the Act and precluded by section 4(1).²⁰⁵

200 See the judgments of Gray J. in *Commissioner for Corporate Affairs v. A Home Away Pty Ltd* [1980] CLC 34 at 321-322 (SC) and *Commissioner for Corporate Affairs v. Lake Eildon Country Club* [1980] ACLC 34,358 at 34,364 (SC) where Gray J. stated that purchasers’ advertised entitlement to use the facilities of timeshare resorts affiliated to the Lake Eildon Country Club at below normal cost was a “right to participate” in an asset of the respondent’s undertaking.

201 A. Simmonds, “Security of Gold: *R v Smith*” [1992] NZLJ 58, 61.

202 Shreves, *op. cit.*, 89.

203 Section 4(1) states that, “The provisions of this Act shall have effect notwithstanding anything to the contrary in any other enactment or in any deed, agreement, application, prospectus, registered prospectus, or advertisement.”

204 *Re AIC Merchant Finance* [1990] 2 NZLR 385 at 390 (CA) per Richardson J.

205 In terms of the test laid down in *Re AIC Merchant Finance* [1990] 2 NZLR 385 per Richardson J.

There is one final problem with *Smith*. Wylie J found that investors believed (on the basis of advertisements), they were buying bullion and would receive a property interest which would readily meet the definition of “security”. Nonetheless, His Honour held that the advertising was not determinative of whether investors received an interest in property. The fundamental rule in section 33(1) of the Act provides that, “no security shall be offered ...” and it is clear that the expanded definition of “offer” in the Act encompasses invitations to treat including advertisements.²⁰⁶ Hence, irrespective of the interest that the investors actually received, they were clearly *offered* securities, which could fall within the ambit of the Act. As noted earlier, the legislation is directed at the activity of offering securities, regardless of what is eventually provided. The problem is that if the *Smith* interpretation of a security is adopted, the disclosure obligations in Part II of the Act will not apply unless the transaction offered ultimately falls within the strict legal definition of an “interest”. The result gives an “unduly narrow” interpretation of the definition of a security that circumscribes the width of the definition.²⁰⁷ The directors of Goldcorp escaped criminal liability and the investors who had been misled by the advertising soliciting investment funds were left to bear the loss. This is precisely the type of situation that the Act was designed to prevent.

3.3 The 1990’s Case Law

Marac and *Smith* were two early cases on the Act. The decision in *Marac* has been rendered redundant by legislative amendment. The interpretation of a security in *Smith* was subsequently questioned in *DFC Financial Services Ltd v. Abel*.²⁰⁸ The mid-1990’s case law showed a more mature approach to the definition. This trend will continue given the redefinition of s. 2D (1) and the inclusion of the words, “unless the context otherwise requires”.²⁰⁹ Significantly, in the later case law, the courts have reaffirmed the intention of the legislature that the definition was intended to cover a broad range of transactions. In the 1982 Court of Appeal decision in *City Realities*, Cooke P. had noted that the definition of security was an extremely wide definition, well capable of covering company shares but going far beyond them. There are now dicta to a

²⁰⁶ See the s. 2(1) definition of “Offer”.

²⁰⁷ A. Simmonds, “‘Security’ of Gold: *R v. Smith*” [1992] NZLJ 58 at 63.

²⁰⁸ [1991] 2 NZLR 619 (HC).

²⁰⁹ Although query whether the inclusion of these words would have made any difference to the decision in *Marac*.

similar effect in the 1997 advice of the Privy Council in *Culverden*,²¹⁰ a case that involved the sale of retirement units with a “buy back” right. As we shall see, however, some problems remain. It is submitted (recalling the earlier discussion on statutory interpretation and the decision in *Forman*), that the key to solving these problems is to focus closely on the purpose and economic character of the legislation.

3.3.1 The Form of the Transaction

It sometimes appears that the courts’ first step in determining if a security exists is to ascertain the form of the transaction. Often it will not be difficult to determine if a security has been offered - for example, where a company offers shares. Complex transactions may need closer analysis. The courts have held that it is necessary to examine the transaction as a whole in order to determine whether or not a security is being offered and that particular parts of a transaction should not be isolated from their legal and factual context. An early expression of this view appears in *Marac* where Richardson J stated:

The true nature of a transaction can only be ascertained by careful consideration of the legal arrangements actually entered into and carried out: not on an assessment of the broad substance of the transaction measured by the results intended and achieved or of the overall economic consequences. The nomenclature used by the parties is not decisive and what is crucial is the ascertainment of the legal rights and duties which are actually created by the transaction into which the parties entered. The surrounding circumstances may be taken into account in characterising the transaction. Not to deny or contradict the written agreement but in order to understand the setting in which it was made and to construe it against that factual background having regard to the genesis and objectively the aim of the transaction.²¹¹

Where the transaction is alleged to arise from agreements contained in separate documents, Richardson J, in *The Society of Lloyd’s v. Hyslop*, stated:

In each case it is crucial to keep in mind that the true character of the legal arrangement actually entered into and carried out and the forms adopted cannot be dismissed as mere machinery for effecting other purposes. Interrelated documents

²¹⁰ *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,303.

²¹¹ *Marac Life Assurance Ltd v. Cmmr. of Inland Revenue* [1986] 1 NZLR 694 (CA), 706.

may be considered together but the legal rights and obligations of particular parties turn on the terms of their agreements.²¹²

Now it is important to note that both of the above quotations repeat (practically verbatim), earlier dicta of Richardson J in *Mills v. Dowdall*.²¹³ There, His Honour stated:

The legal principles governing the ascertainment of the true legal character of a transaction are now well settled ... It frequently happens that the same result in a business sense can be attained by two different legal transactions. The parties are free to choose whatever lawful arrangements will suit their purposes. The true nature of their transaction can only be ascertained by careful consideration of the legal arrangement actually entered into and carried out. Not on an assessment of the broad substance of the transaction measured by the results intended and achieved; or of the overall economic consequences to the parties; or of the legal consequences that would follow from an alternative course ... The forms adopted cannot be dismissed as mere machinery for effecting the purposes of the parties. It is the legal character of the transaction that is actually entered into and the legal steps which are followed which are decisive.²¹⁴

Richardson J recognised two exceptions to this proposition which elevates the form of a transaction over its substance. The first is where the transaction is a sham; the second is where there is a statutory provision mandating a broader or different approach.²¹⁵ As a practical matter, it will only rarely be the case that the legal documents created by the parties in a securities transaction are a sham.²¹⁶ Thus, only a statutory provision mandating a different approach will negate the form over substance doctrine enunciated by Richardson J. In the case of the Securities Act, it can be argued that section 4(1) mandates such an approach since it requires that the “provisions of this Act shall have effect notwithstanding anything to the contrary ... in any deed, agreement...” More generally, it is submitted that section 5(j) of the Acts Interpretation Act provides a general direction supporting the elevation of substance over form. For the avoidance of doubt, however, the Act should be amended by rephrasing section 4(1) to achieve this effect since the form of the transaction doctrine strikes at the heart of the investor protection rationale of the Act. In any event, it is submitted that the advice of the Privy

212 *The Society of Lloyd's v. Hyslop; Oxford Members Agency Ltd v. Hyslop* [1993] 3 NZLR 135, 141.

213 [1983] 1 NZLR 154, 159.

214 *Ibid.*

215 *Ibid.*

216 For an analysis of the case law on shams, see Commission of Inquiry into Certain Matters relating to Taxation, *Report of the Winebox Inquiry, Vol. II* (1997), 2.2.22 and A. Hargovan, “Piercing the corporate veil on sham transactions and companies” (2006) 24 C&SLJ 436.

Council in *Culverden Retirement Village v. Registrar of Companies*²¹⁷ has eroded this doctrine in cases involving the Securities Act 1978.

3.3.2 The Substance of the Transaction and Ancillary Rights

In *Culverden*, the Court of Appeal held that it was not necessary that a security be the subject of a discrete contract, and that it could be offered as part of a package.²¹⁸ On appeal, the Privy Council noted that financial transactions may be simple or complex, frequently involving “a bundle of mutual rights and obligations, some to be performed at once and others years later”.²¹⁹ Its view (following the reasoning of the High Court and the Court of Appeal),²²⁰ was that the existence of a bundle of rights does not mean that the Act could only apply to the transaction as a whole or not at all. It stated:

The Act applies to offers of interests or rights which are securities as defined. A single offer may lead to a single transaction containing several components, one or more of which may be within the statutory definition of securities and others not. Separate and quite different securities may be comprised in one contract. The offer of one right in conjunction with other rights and obligations cannot of itself exempt that right from being tested against the statutory definitions.²²¹

Accordingly, a single transaction may contain more than one type of security (for example, a debt security and a participatory security).

In determining whether a transaction or part of a transaction constitutes a security, the courts have considered whether the right is “ancillary” or a “cardinal feature of the transaction”.²²² In *DFC v. Abel*²²³ the subscribers in a bloodstock scheme argued that a loan from DFC, which was invested in the scheme, constituted a security and should be void in the absence of a registered prospectus. Fisher J held those securities, in the form of an interest in the bloodstock syndicate had been offered, but that the loan was merely ancillary to the other rights acquired. This meant

217 (1997) 8 NZCLC 261,301 (PC).

218 *Culverden Retirement Village v. Registrar of Companies* (1996) 1 BCSLR 162 (CA), 167.

219 *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,304.

220 See P. Fitzsimons, “The Securities Act 1978 and Offers of ‘Securities’” [1996] C&SLB 96, 99.

221 *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,304.

222 Ibid.

223 *DFC Financial Services Ltd (in statutory management) v. Abel* [1991] 2 NZLR 619, 630.

that the subscribers were investors in the bloodstock scheme but in relation to DFC they were “purely borrowers”.²²⁴

In *Culverden*, the Privy Council considered the “ancillary right” point. The Privy Council held that in deciding whether one right is ancillary to another involves a determination of the *substance* of the overall transaction.²²⁵ This partially erodes the form over substance doctrine advanced by Richardson J in *Marac* and *Hyslop*.²²⁶ The Privy Council described the *Culverden* arrangement in the following terms:

When the unit is sold the buyer enters into a sale and purchase agreement, with seven schedules of terms and ancillary agreements covering 40 pages ... The appellant agrees to manage the village for the benefit of the residents for a weekly fee. The buyer agrees that he will sell his unit back to the appellant when he ceases to occupy it. Thus the latest date for resale will be the death of the buyer.

The resale is at the original purchase price less a capital replacement and care charge, calculated at the rate of \$6,000 for each year the buyer has been in occupation, up to a maximum of \$30,000, and less also the cost of renovating the unit to the same condition as when acquired, plus an inflation adjustment, the amount of which depends on the chosen inflation adjustment factor and the movement of the market. If the inflation adjustment factor in the particular agreement is nil, nothing will be added under this head however much market prices may have risen. Thus, in some instances the formula is bound to yield a price lower than the price paid on the original purchase.

It was common ground between the parties in *Culverden* that the buy back obligation was not merely an option which the appellant may or may not choose to enforce. When the triggering event of ceasing to occupy occurs, the unit owner is bound to re-sell and the appellant is bound to re-purchase.²²⁷

Referring to the buy back provision agreed to at the time of the original sale and purchase agreement between the two parties, the Privy Council stated:

Here the unit holder is unable to sell the land of which he has bought the freehold. He needs the appellant’s consent to let the property. He may use it, that is, he may occupy the townhouse. Indeed, he is required to occupy it, because if he ceases to do so the buy back provision is triggered automatically. Moreover, the buy back provision can be triggered by failure to pay the weekly fees or observe the rules of the village. In practical terms the substance of this transaction is that in return for a lump sum payment, a buyer acquires two rights: the right to acquire a unit and the right, when his occupation ends, to be repaid the price he paid, adjusted downwards

²²⁴ Ibid.

²²⁵ *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,302-261,303.

²²⁶ Partially, because strictly speaking the ruling only applies where there is more than one right to consider.

²²⁷ *Id.*, 261,303.

or upwards according to the length of his occupation, the state of the property, the factors built into the inflation adjustment in his particular case, and the movement of the market. The repayment right, far from being ancillary, is a cardinal feature of the transaction. This being so, the repayment right cannot be sheltered behind the section 5(1)(b) exemption as an unexceptional term ancillary to the purchase of an interest in land.²²⁸

The Privy Council clarifies two points. First, a “merely ancillary” right will not convert an otherwise exempt transaction (for example, the purchase of an interest in land) into a security. Second, the determination of whether a right is ancillary or separate requires an examination of *the substance of the transaction as a whole* in order to ascertain whether or not the right is “a cardinal feature of the transaction”. Here, the right was linked to the original right - property was transferred to the purchaser and the agreement provided for it to be re-transferred. The Privy Council stated:

The right acquired under the buy back provision was not granted in isolation. It cannot be equated with the right of a seller under an ordinary contract for the sale of land. It was a right granted to those who signed the sale and purchase agreement.²²⁹

In addition, the right acquired in the first place was subject to certain constraints which would lead to the second right (the right to repurchase) being activated.

The difficulty is to determine whether the “right” is ancillary or a cardinal feature. In determining whether or not a “right” or aspect of a transaction is merely ancillary or a cardinal feature of a transaction, the Privy Council’s approach requires the following analysis:

- (1) An examination of the substance of the transaction to see whether it contains more than one right or component (and it appears that the courts will take a broad view of the substance of a transaction);
- (2) If there is more than one right then, an examination of whether or not each right is merely ancillary or a cardinal feature of the transaction. Elements that will assist in determining this issue are:
 - (a) The setting in which the rights arose: who are the relevant parties to the agreement and what is the subject of the transaction?

²²⁸ Ibid.

²²⁹ Id., 261,304.

In *Culverden* land was transferred and required to be retransferred under the buy back provision between the same parties, whereas in *DFC v. Abel* the loan was provided by a third party financier who was not a party to the bloodstock partnership. In *Hyslop*, one of the factors the Court of Appeal took into account in holding that no security had been offered was that the “total package” said to constitute the alleged securities in fact consisted of two agreements between the investor and two separate parties.

(b) The connection between the rights:

In *Culverden* the transaction was contained in a single package comprising one document, and the formulation for the price for the buyback was contained in the document and was based upon the original purchase price. In addition, the buyback provision was triggered by a failure to comply with certain conditions attached to the title, which was originally conveyed or on the occurrence of certain conditions, and the unitholder was prevented from reselling the title to anyone except the vendor. By contrast, in *DFC v. Abel*, the loan, although it was provided for investment in the bloodstock scheme, was repayable irrespective of the outcome of the scheme. In *Hyslop*, the investor signed two separate agreements with two separate parties, and although the agreements were interrelated (since membership of Lloyd's was a precondition to joining a syndicate) the court treated them as being separate.

If the right is determined to be ancillary then only the original or “main” right has to be considered for the purposes of whether or not a security exists. However, if the right is found to be a “cardinal feature of the transaction” then the transaction as a whole has to be considered in determining whether or not the statutory definition of security applies. It is submitted that this logic can be taken a step further: following the analysis in *Forman* (and irrespective of whether or not there are two rights), the courts should examine the substance of all transactions with a view to ascertaining the economic reality underlying the transaction.

3.3.3 Four Types of Security

We now turn to consider more closely the four types of schemes contemplated by section 2D(1).

3.3.3.1 Interest in Another's Property

The first scheme within section 2D(1) is an interest in the capital, assets, earnings, royalties, or other property of any person. The issue that normally arises here is whether a person has acquired the requisite "interest". In the normal course of events, an interest in existing or present property will be a security. For example, in *Culverden* purchasers were offered a freehold title in land contained within a retirement village. In the High Court, Morris J held that this was a security since the purchaser obtained an interest in the property of another person.²³⁰ Once a security has been found the next stage is to consider whether or not one of the exemptions applies.²³¹ This issue will be considered elsewhere.

The Court of Appeal in *Hyslop* was faced with an argument that membership of Lloyd's and membership of an insurance syndicate were each securities. The court held that mere membership in an association was not an interest in any capital, assets, earnings, royalties, or other property of any other person.²³² Nor did the court accept that a right to share in the surplus on the winding up of an association would be such an interest where the right, although an obvious consequence, was "neither sought" by the investor nor offered by the other party.²³³ Richardson J commented that "[t]he remote possibility that kind of benefit might accrue to a member cannot fairly be characterised as part of the offer of membership".²³⁴ The court appeared to place significance on what is sought by the investor in determining whether or not an interest is being offered when it stated that:

Nothing in the material in the case suggests that winding up was in the contemplation of [the offeror] or the respondent at the time she was elected an underwriting member.²³⁵

In relation to the syndicate, Richardson J held that a "Name" (a member of an underwriting syndicate) trades as a sole trader since the insurance contracts would be entered on behalf of the Name personally who would have the earnings, obligations and property to herself, although he did raise (but did not decide) the issue as to whether or not a syndicate could be an

²³⁰ *Registrar of Companies v. Culverden Retirement Village Ltd* (1995) NZCLC 260,850, 260,854.

²³¹ *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,303.

²³² *The Society of Lloyd's v. Hyslop; Oxford Members Agency Ltd v. Hyslop* [1993] 3 NZLR 135, 141.

²³³ *Id.*, 141, 152.

²³⁴ *Id.*, 141.

unincorporated body of persons which would mean that the Name would have a property interest in the property of that “person”.²³⁶ However, McKay J commented that as a name, Hyslop:

would arguably acquire same beneficial interest in the premiums to be received by her syndicates until the closure of the accounting period and the determination of each member's individual profit, but otherwise her trading would be entirely on her own behalf.²³⁷

It would appear that if the funds or property arising from a contract are pooled in some way then a beneficial interest could constitute "an interest in the property of any person". However, a mere contractual right to be paid money will not be sufficient, even if other persons are to be paid money under similar contracts.

3.3.3.2 Interest in Future Property

A more difficult issue is whether or not the term “interest” includes interests in future property. It will be recalled that in *Smith* the term was given a legal meaning and hence contractual rights to property did not qualify as a security. A dictum of Fisher J in *Abel* casts serious doubt on that finding.

In *DFC v. Abel*²³⁸ investors in a bloodstock scheme attempted to avoid liability to the third party financier of their venture, DFC Financial Services Ltd. In early 1987, the promoter of the scheme, Curtin Farms Limited, had offered the investors ownership of the horses as well as a management contract. The promoter also obtained from the investors a power of attorney that enabled it to obtain a loan from DFC on behalf of each investor for the purposes of the scheme. For the investors, the benefit of this scheme included the ability to invest without any initial cash outlay and the hope of being able to obtain tax deductions for their payments under the scheme with the long-term prospects of income and capital gain from the horses. Unfortunately for the investors, the bloodstock market collapsed in the aftermath of the stockmarket crash of 1987. They eventually stopped repaying DFC. When faced with DFC’s summary judgment application they argued that the loan was a “security” for the purposes of the Act and in the absence of a

235 Ibid.

236 Ibid.

237 Id., 152. Emphasis added.

238 *DFC Financial Services Ltd (in statutory management) v. Abel* [1991] 2 NZLR 619.

registered prospectus was void. Fisher J, unlike Wylie J, took a broader view of the term “security”. He stated:

Broadly speaking, the expression “security” seems intended to embrace any interest in, or right to participate in, present or future property, including the existing or future debts owed by others. Section 37(1) therefore appears to be concerned, at least principally, with contracts or dispositions conferring a right to, or interest in, some form of present or future property.²³⁹

Fisher J found that the promoter had offered a security in the form of part ownership of the horses together with the right to management services.²⁴⁰ In relation to the loan, however, it was not until after the promoter had offered an interest in the horse syndicate to the investors that DFC agreed to provide the loans. Hence, when the offer was made to the public:

... there existed no legal rights or liabilities as between [DFC] on the one hand and [Curtin Farms Ltd] or its nominees on the other. All that existed on that topic was the expectation, based upon an informal understanding, that finance would be forthcoming in the future. It follows that the expectation of a loan did not represent an existing “security” in the sense referred to above.²⁴¹

Consequently, all the promoter, Curtin Farms Ltd, was in a position to offer at the time the offer was made:

... was an introduction to the plaintiff for the purpose of consummating a loan which had already been negotiated in principle. But at that stage the arrangement as to a proposed loan did not amount to either a contractual right or a proprietary interest in the hands of either [Curtin Farms Ltd] or the subscribers. On the face of it the prospect of a future loan did not amount to a “security” which [Curtin Farms Ltd] was in a position to offer the public ...²⁴²

Fisher J was clearly of the view that a contractual right to future property or proprietary interest would be a security but that a mere expectation of an interest arising in the future would not be sufficient. His Honour commented that, in addition to the securities consisting of the two horses and the management services, “[a]rguably they also included the expectation of future earnings and capital profits to be derived from the partnership activities”.²⁴³ In this case, however, the expectation would not be based on an “informal understanding” but would arise from the very nature of that which was offered to the investors.

239 Id., 626.

240 Id., 627.

241 Ibid.

242 Ibid.

243 Id., 628.

In determining whether a scheme constituted a security, Fisher J stated:

I think that the item offered to the public must amount to a security when viewed from the subscriber's viewpoint. In the case of a loan offered to the public, this would mean that what was offered by the creditor would have to constitute a "security", when seen from the borrower's viewpoint.²⁴⁴

Approaching the question of whether a security has been offered from the investor's viewpoint is consistent with the investor protection rationale of the Act.²⁴⁵ If such an approach had been used in *Smith* then it is likely that a security would have been found to have been offered, since those persons who did not take immediate possession of the bullion would have been of the view that they had gained some form of right (contractual or proprietary) in the bullion.

Fisher J's analysis is to be preferred to that of Wylie J's on a number of grounds. First, Wylie J was faced with persons who were facing criminal charges over the company's offerings. For this reason alone, a more restrictive approach to the definition of a security was likely. Fisher J, by contrast, was faced with borrowers seeking to avoid civil liability for loans that had been obtained on their behalf. Second, it is arguable that Wylie J's analysis of the equivalent Australian provisions was incorrect and that the Australian cases encompass a broad view of the term "interest". The third ground is that Wylie J relied upon the earlier civil case, which involved the issue of what rights investors actually had in the bullion, rather than focusing upon what was offered to the investors and whether that came within the statutory definition of security. By contrast, Fisher J examined what was offered from the view of the potential investor. This is consistent with the Court of Appeal's decision in *Hyslop*.²⁴⁶ Fourth, a broad approach would be consistent with the Court of Appeal's view in *City Realities* that the term "security" was "extremely wide",²⁴⁷ and the rationale of the Act is investor protection.²⁴⁸ Thus, it is arguable that *Smith* should be confined to its facts and Fisher J's view preferred.

Hence, the term "interest" clearly includes legal interests in the "property of another person" and must apply when the property of one person is transferred to another or a beneficial interest is

²⁴⁴ Id., 629.

²⁴⁵ *Re AIC Merchant Finance Ltd (in rec); National Mutual Life Nominees Ltd v. Watson* [1990] 2 NZLR 385, 391.

²⁴⁶ *The Society of Lloyd's v. Hyslop; Oxford Members Agency Ltd v. Hyslop* [1993] 3 NZLR 135, 141.

²⁴⁷ *City Realities Ltd v. Securities Commission* [1982] 1 NZLR 74, 77.

²⁴⁸ *Re AIC Merchant Finance Ltd (in rec); National Mutual Life Nominees Ltd v. Watson* [1990] 2 NZLR 385, 391; and *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,305.

obtained in the other person's property. It is also arguable that the term includes an interest in future property and contractual rights that relate to property.

3.3.3.3 Right to Participate in the Property of Another

The second scheme under section 2D(1) is where a person acquires the right to "participate" in the property of another person. In *Smith*, Wylie J held that "the concept of 'participation'" involved two elements.²⁴⁹ The first is "some form of sharing with others even if only with the promoter of the scheme".²⁵⁰ The second is "some form of continuing activity shared by a number of persons".²⁵¹ On the facts of *Smith*, Wylie J found that "an eventual right or expectation" to obtain the gold bullion was not a right to participate. Similarly, neither was a right to storage, insurance or the right to call for delivery, since these were merely contractual rights.²⁵²

The Court of Appeal in *Hyslop* was of the view that membership of an association was not a right to participate in the property of another person. The remote possibility of sharing in any surplus on the winding up of the association, when not in the contemplation of the parties, was not sufficient to create this right.

3.3.3.4 The Right to Be Paid Money

The third type of security within section 2D(1) is:

Any interest in or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing by, any person (whether or not the interest or right is secured by a charge over any property).

This wording is the same as used in section 2(1) to define a debt security. Consequently, this portion of the definition of a security is referred to in recent cases as a "debt security".

²⁴⁹ *R v. Smith* [1991] 3 NZLR 740, 748-749.

²⁵⁰ *Id.*, 748.

²⁵¹ *Id.*, 749.

²⁵² *Id.*, 748.

In *DFC v. Abel*, the subscribers argued that this paragraph extended to persons who were borrowers since they gained “the right to be paid money that ... is to be ... lent to ... any person”.²⁵³ Fisher J rejected this argument and commented:

It seems to me that in this context, the “security” envisaged in the words “right to be paid money that ... is to be ... lent to ... any person” in s2 (1) was intended to be the creditors’ right to repayment, not any antecedent contractual right which the borrower might have to enforce the initial advance. The phrase is intended to protect those members of the public who agree to invest money in the form of loans to others. Loans to subscribers are the reverse of that situation ... But I do not think that in themselves, loans to subscribers, or the right to such loans, were intended to fall within the expression “securities”. The Act is there to protect investors, not borrowers.²⁵⁴

The courts, however, have recently taken the view that the term “debt security” can include transactions that are wider than loans or deposits. Morris J in the High Court in *Culverden* stated:

It seems to me the words “or otherwise owing” clearly contemplate wider circumstances than simply loans and deposits from the public. The section makes it plain the money need not be immediately owing. The definition covers a future payment which in my view can be triggered by date or event. In this case the owner of a unit (or their estate) has an entitlement to be paid money within 60 days of ceasing to occupy the unit and transferring it to the defendant (or its successor in title). This is a right to be paid money that is to be owing by any person, and is therefore a debt security.²⁵⁵

The Court of Appeal agreed with Morris J that the appropriate approach (given the wide definition of securities and that the phrase “or otherwise owing” was of the “widest ambit”), was that the Act covered transactions which would not normally be considered a security.²⁵⁶ In the Court’s view, the wide ambit of the Act was balanced by the specific exclusions under section 5, which limited its scope.²⁵⁷ The Court of Appeal in *Culverden* appeared to accept that the words “moneys otherwise owing” could create a debt security where the contract is entered into on one date and the settlement monies are paid on a subsequent date.²⁵⁸ In this situation, the vendor “is owed money” between the two dates. Prima facie, this means that *any* contract where there is a time period between execution of the contract and performance by the payment of money would be a debt security. The Court of Appeal then stated that in an *ordinary* sale and purchase

²⁵³ [1991] 2 NZLR 619, 629.

²⁵⁴ *Ibid.*

²⁵⁵ *Registrar of Companies v. Culverden Retirement Village Ltd* (1995) NZCLC 260,850, 260,857.

²⁵⁶ *Culverden Retirement Village v. Registrar of Companies* (1996) 1 BCSLR 162 (CA), 166.

²⁵⁷ *Ibid.*

agreement the section 5(1)(b) exemption could be relied upon to exclude the application of the Act.²⁵⁹ The Privy Council in *Culverden* implicitly rejected such a wide application of the definition since it found the buy back provision to be a debt security which “cannot be equated with the right of a seller under an ordinary contract for the sale of land”.²⁶⁰

The Privy Council was of the view that a debt security was wider than “a transaction whereby the consideration on both sides is an obligation to pay or repay money”.²⁶¹ It also included arrangements where the rights granted were such that moneys paid by one party to a second party were required to be repaid by the second party notwithstanding they were accompanied by transfers of property. Further, the Privy Council characterised a transaction as a debt security where the repayment of moneys previously paid by the investor to the vendor occurs even if the repayment involved an adjustment up or down.²⁶² Thus:

The right granted to the unit holder under the buy back provision is a debt security. The appellant is the issuer of that security: the buy back right is granted by the appellant in consideration of the original price paid to the appellant.²⁶³

The Privy Council’s focus was on the connection between the two “rights” and the resulting exchange of money. The fact that money was exchanged on each occasion for land, and might be paid back a number of years later did not detract from this concern. What the unit holder was paying was a certain sum to the vendor which sum would be repaid in the future subject to a readjustment. While this necessarily will exclude an ordinary sale and purchase agreement where land is conveyed by the vendor to the purchaser with no provision for reconveyance, agreements whereby the substance of the transaction can be viewed as involving the flow of money by one party to the other and back again at a future time could be defined as a debt security.

The Privy Council in *Culverden* was clearly concerned that the failure to find a debt security would leave unit holders at risk and saw here a role for the protective provisions of the Act (such as information disclosure and the appointment of a trustee). The Privy Council discounted the fact that the unit holders would have the freehold title on the basis that the statutory definition of

258 Id., 166-167. See L. Kavanagh and M. Deane, "Offering Securities to the Public in New Zealand: What Exactly is a Debt Security?" [1996] 8 JIBL 341, 342.

259 Id., 166.

260 *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,304.

261 Id., 261,305.

262 Ibid.

263 Ibid.

“debt security recognises that the existence of protective security over property does not negate the application of the Act”.²⁶⁴

In the High Court in *Culverden*, Morris J had stated that the debt security definition extended to “future payments ... triggered by date or event”.²⁶⁵ This would appear to include options that are exercisable upon a certain date or event (for example, a notice from the purchaser to the vendor) provided the option is part of a transaction.²⁶⁶ The Privy Council decision, however, appears to narrow the instances where there are future payments to those instances where the issuer is repaying “money previously paid to the [issuer] by the [investor]”.²⁶⁷ An option or right of first refusal for the repurchase (with price to be calculated by reference to the prevailing market price or by arbitration but not by reference to the original purchase price) would not appear to constitute the repayment of “moneys previously paid”.

It is possible that an agreement which provided either that the resident would sell the unit title upon ceasing occupation to a third party nominated by the vendor or, alternatively, allowed the resident to transfer the unit title to a proposed purchaser (subject to the approval of the vendor and the obligation to first enter into a management agreement with the vendor), is outside the definition of debt security. Here, the third party would not have executed the original agreement nor would they have received moneys from the resident. Hence, such third party would not be under an obligation to repay moneys to that resident and, therefore, would not “otherwise owe money”. Thus, they could not be issuing debt securities and would not be caught by the terms of the Act. If the nominated third party was an associated company of the vendor then it is possible that the court may take a “substance” approach and categorise the vendor and proposed purchaser as one. This would involve ignoring the corporate veil, which is not unknown in the context of the Securities Act,²⁶⁸ despite recent reaffirmation of separate corporate personality in the Court of Appeal.²⁶⁹ But the Privy Council decision does not appear to catch such an agreement since it focuses on the payment of money and the *repayment* of that *same* money.

²⁶⁴ *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,305.

²⁶⁵ *Registrar of Companies v. Culverden Retirement Village Ltd* (1995) NZCLC 260,850, 260,857.

²⁶⁶ P. Fitzsimons, “The Securities Act 1978 and Offers of ‘Securities’” [1996] *Company and Securities Law Bulletin* 96, 99.

²⁶⁷ *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,305.

²⁶⁸ See *R v. Reid* (1990) 5 NZCLC 66,483 and G. Walker, “Lifting the Corporate Veil to Avoid Criminal Liability for Misstatements in Registered Prospectus” (1993) 11 *Companies and Securities Law Journal* 5.

²⁶⁹ *Attorney-General v. Equiticorp Industries Group Ltd (in statutory management)* [1996] 1 NZLR 528 (CA), 538-541.

The Privy Council in *Culverden* confirmed Morris J's finding in the High Court that a debt security encompasses not only the typical lending arrangement but also any arrangement where money is repaid with, or without, a return of interest or income. Morris J had noted that most purchasers of units in a retirement village would be "financially at least, considerably worse off at the end of the association". Most purchasers would be receiving less, not more, than they had originally paid. This has implications for any arrangement that provides for the repayment of funds to an "investor" no matter how little that money happens to be. If a transaction requires the (re)payment of moneys by one party to another party at a future time then there is a strong chance that the Act could apply. As the *Culverden* decision shows, it is not necessary that the moneys (re)paid are equal to or greater than the original moneys paid (which would be the situation in most loan transactions), provided that, in the context of a transaction as a whole, some moneys are (re)paid.

All three courts in *Culverden* took into account the investor protection rationale of the Act and considered whether or not there was a security from the perspective of the investor. This is especially true of the Privy Council, which stated:

Unit holders are at risk that, having paid the original price to the [issuer], the [issuer] may not be able to honour its repayment commitment ... [Sections 33(1) and (2) and 37A are] intended to afford protection to members of the public who are invited to pay, and do pay, substantial sums of money to the [issuer] against, in part, its promise to repay all or a large part of it in due course.²⁷⁰

The Privy Council's analysis is consistent with that of Fisher J in *DFC v. Abel*.²⁷¹ By contrast, Wylie J did not take this approach in *Smith* (which involved, inter alia, a claim that investors had acquired participatory securities).²⁷² *Culverden* also affirms the principle that not only may there be more than one type of security involved in a transaction, but in addition, part of the transaction may amount to a security.²⁷³ This effectively erodes the form over substance doctrine enunciated by Richardson J in *Marac*.

Overall, the broadening of the term "debt security" coupled with the wide application of section 3(1) (which defines what is meant by an "offer to the public") and the uncertain scope of section

²⁷⁰ *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,305.

²⁷¹ *DFC Financial Services Ltd (in statutory management) v. Abel* [1991] 2 NZLR 619.

²⁷² *R v. Smith* [1991] 3 NZLR 740.

²⁷³ *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,304.

3(2) (which defines the exceptions to section 3(1))²⁷⁴ may result in unsatisfied parties to transactions invoking failure to comply with Part II of the Act as a ground to either avoid liability,²⁷⁵ or to recover funds already paid.²⁷⁶ In addition, persons who enter transactions where they may be characterised as an issuer (or a director of an issuer) must bear in mind the potential for personal liability under section 37(6).

The most important implication of the *Culverden* decision is the extension of the potential reach (and query, overreach) of Part II of the Act. The term “debt securities” now has a much wider application than may have been considered earlier. If money flows between parties can be characterised as payments and then repayments, the definition of security applies irrespective of the property or rights being transferred between the parties or whether the “investor” makes a profit or loss. The application of the term is highlighted by the refusal of the courts to read down the meaning of “debt securities” by reference to items such as loans which are expressly included in the definition.²⁷⁷ The reach of Part II of the Act is further broadened by the Privy Council’s expansion of the meaning of the term “investment” which has the consequence of narrowing the application of the exemptions available under sections 5(1)(b) and (c) (considered below).

3.4 Section 5 Exemptions

If a security is present as a matter of law, the next question is whether the offering of that security is exempt from Part II of the Act by virtue of sections 5, 6 and 7A. In brief, section 6 exempts previously allotted securities from Part II under certain conditions and will be considered later. Section 7A temporarily exempts superannuation in certain circumstances. Section 5 is the provision that gives the broadest exemptions, both complete and partial, including the discretionary exemptions granted by the NZSC under sections 5 (5). The complete exemptions from Part II include specific interests such as shares in flat or office owning

²⁷⁴ For a detailed discussion of section 3 cases see P. Fitzsimons, “Capital Raising and Offers to the Public” [1995] Companies and Securities Law Bulletin 4 and P. Fitzsimons, “‘Play it [again], Sam: Offers to the Public in the New Zealand Context” [1995] Companies and Securities Law Bulletin 63.

²⁷⁵ For example, see *Robert Jones Investment Limited v. Gardner* (1988) 4 NZCLC 64,412; *Barclay’s New Zealand Limited v. Gillies* (1990) 5 NZCLC 66,659; and *International Standardbred Partnership v. Garland* (1992) 6 NZCLC 67,812.

²⁷⁶ For example see *Ferguson v. RJI Ltd* (1995) 7 NZCLC 260,668.

²⁷⁷ See L. Kavanagh and M. Deane, “Offering Securities to the Public in New Zealand: What Exactly is a Debt Security?” [1996] 8 JIBL 341, 343.

companies,²⁷⁸ interests in professional partnerships and certain businesses,²⁷⁹ mortgages of land other than contributory mortgages,²⁸⁰ an employee share purchase scheme,²⁸¹ and interests in government superannuation funds.²⁸² Interests in entities such as registered banks,²⁸³ call debt securities, building society shares, bonus bonds,²⁸⁴ the Crown,²⁸⁵ and specifically gazetted exemptions are given partial exemption.²⁸⁶ Note that section 5 (5) of the 78 Act was amended effective 15 April 2004 so that “any transaction or class of transactions” may be exempted.. An exemption for employer superannuation schemes was also added in April 2004: see sections 5A and 5B of the 78 Act.

There is now a new category of exemptions in section 5 of the Act. As noted earlier, these exemptions are for wealthy or experienced investors: see section 5 (2CB) of the Act. These exemptions are best viewed as providing a significant addition to the exclusionary provisions of section 3 (2) of the Act. These exemptions came into force on 15 April 2004. Note that a distinct certification procedure for claiming exempt status is provided in these sections.

Two exemptions which provide a complete exemption from compliance with Part II are interests in land and chattels that come within sections 5(1) (b) and (c). This subdivision will consider these two exemptions.

Section 5 provides in part:

- (1) Nothing in Part II of this Act shall apply in respect of–
 - (b) Any estate or interest in land for which a separate certificate of title can be issued under the Land Transfer Act 1952 or the Unit Titles Act 1972, other than any such estate or interest that–
 - (i) Forms part of a contributory scheme; and
 - (ii) Does not entitle the holder to a right in respect of a specified part of the land for which a separate certificate of title can be so issued;

278 Section 5(1)(d).
 279 Section 5(1)(e).
 280 Section 5(1)(f).
 281 Section 5(1)(h).
 282 Section 5(1)(i).
 283 Section 5(2C).
 284 Section 5(2D).

(c) Any proprietary right to chattels (other than any such right that forms part of a contributory scheme).

The section 5(1)(b) exemption applies to interests in land. This exemption does not apply where the interest forms part of a “contributory scheme” and there is no right to a specified part of the land for which a separate certificate of title could be issued. Contributory scheme is defined under section 2 as:

... any scheme or arrangement that, in substance and irrespective of the form thereof, involves the investment of money in such circumstances that—

(a) The investor acquires or may acquire an interest in or right in respect of property; and

(b) Pursuant to the terms of investment that interest or right will or may be used or exercised in conjunction with any other interest or right in respect of property acquired in like circumstances, whether at the same time or not; –

but does not include such a scheme or arrangement if the number of investors therein does not exceed 5 and neither the manager of the scheme nor any associated person is a manager of any other such scheme or arrangement.

In *Culverden*, Morris J summarised the essential requirements of the definition of "contributory scheme" as fourfold:

1. The scheme involves the investment of money;
2. The investor acquires an interest in property;
3. That interest will or may be used in conjunction with any other interest in property acquired (at any time) in like circumstances; and
4. The number of investors in the scheme is more than five; or

[the manager or associated person is a manager of another such scheme or arrangement]²⁸⁷

The first requirement demands an analysis of the term “investment”. In *Culverden*, the High Court and the Court of Appeal held that the term “investment” involved investing moneys for profit or to earn interest and, in the instant case, unit holders would not receive a profit or interest

285 Section 5(3).

286 Section 5(5).

287 *Registrar of Companies v. Culverden Retirement Village Ltd* (1995) NZCLC 260,850, 260,855. The last requirement was not noted by Morris J.

on money in return for their investment.²⁸⁸ The Court of Appeal analysed the definition of “contributory scheme” and held that:

... the context points towards the profit oriented meaning [of “investment”]. One may speak of having an investment in one’s home, but one is less likely in that context to describe oneself, or to be described by others, as an “investor”. A reference to a number of investors is immediately suggestive of a group of persons subscribing to some acquisition or venture in the hope or expectation of profit.²⁸⁹

The Privy Council disagreed. After noting that an investor may obtain a return by way of income or capital growth and that it “may be in cash, or it may be in kind such as the provision of services”, the Privy Council considered that the unitholders in *Culverden* would:

... say they have invested their money in buying a townhouse in Culverden Retirement Village on terms that they will occupy this, with necessary services provided, for so long as they wish and that they will then get back all or a large part of their outlay. *The return from their outlay is to be found in the totality of these benefits, not just the financial payment at the end.*

Their Lordships can see nothing in the context of the definition of contributory scheme to suggest that the undefined words “investment” and “investor” were intended to bear a more restricted meaning excluding this type of transaction from the scope of the definition. Broadly stated, and subject to the somewhat obscure paragraph (ii) in section 5(1)(b), the effect of the contributory scheme exception is to take outside the exemption and leave within the scope of the Act interests in land forming part of a joint enterprise involving more than five investors. Their Lordships cannot see any compelling reason for distinguishing between schemes under which the sole return is money and schemes under which the return comes partly as money and partly from the use of the land.²⁹⁰

The Privy Council’s dictum effects a broader definition of “investment” than the lower courts. Hence, provided there is some monetary return (which may be less than the original investment), a monetary return in combination with benefits, services or use constitutes an investment.

The Privy Council’s dictum in *Culverden* has two important consequences. The first is a significant expansion of a “contributory scheme” and a corresponding narrowing of the exemptions available under section 5(1)(b) or (c). For example, suppose an arrangement is put in place whereby six or more persons purchase a horse. The owners have the right to ride the horse

²⁸⁸ Id., 260,856; *Culverden Retirement Village v. Registrar of Companies* (1996) 1 BCSLR 162 (CA), 168. See P. Fitzsimons, “The Expanding Reach of the Securities Act 1978 - Retirement Villages and the Privy Council” [1997] 3 C&SLB 31, 34; E. Toomey, “Securities Legislation and Real Property Law in New Zealand” (1998) 6 (2) Asia Pacific LR 57-92.

²⁸⁹ *Culverden Retirement Village v. Registrar of Companies* (1996) 1 BCSLR 162 (CA), 168.

and the right to a share of the sale proceeds when the horse is sold (perhaps for less than the original price). Under the lower courts' approach, such an arrangement would not constitute a contributory scheme since these persons would not be expecting to receive a profit or to earn interest (assuming that they were not also using the horse for racing or the production of progeny for sale). By contrast, under the Privy Council's approach, this arrangement could constitute a contributory scheme provided the investors received back "a large part of their outlay" in the form of monetary and non-monetary benefits. Thus, the interest in the horse (a chattel) would not be exempt from section 5(1)(c). Consequently, the issuer of such an interest would have to comply with Part II of the Act. A second consequence flowing from the Privy Council's dictum is the necessity to determine the meaning of the term "benefits". Use of land (or a chattel) would come within this term and it would appear that "services" provided by the issuer could also constitute a benefit.

3.5 Summary

In summary, the definition of a "security" includes the following characteristics:

- The term "security" is widely defined (*City Realities* and *Culverden*)
- The term "interest" means a legal interest but may include an interest in future property (*Smith* cf. *Abel*)
- Any interest in property would be a security subject to exemptions under sections 5 and 6 (e.g. chattels or interest in land). (*Culverden*)
- "Participation" means that there is some continuing activity by the people who have invested in the scheme. (*Smith*)
- It appears that one examines whether or not a security is offered from the point of view of the investor. (*Abel* and *Culverden*)
- One can have more than one form of security in any transaction, and one can have a security being offered which forms part only of a scheme or transaction. (*Culverden*)

²⁹⁰ *Culverden Retirement Village Ltd v. Registrar of Companies* (1997) 8 NZCLC 261,301 (PC), 261,305. Emphasis added.

- A part of a transaction that is not merely ancillary and forms a cardinal feature of the transaction may constitute a security. (*Culverden*)
- The courts are prepared to view a scheme as a whole in order to determine if there is a (debt) security. (*Culverden*)
- A (debt) security includes the obligation to repay money or retransfer property even if it is a lower value than the original transaction. (*Culverden*)
- An interest in land or chattels is exempt from Part II of the Act unless it is part of a contributory scheme (and for land, no separate certificate of title is available for a specified part of the land) (section 5(1)(b) and (c))
- An “investment” may include a transaction where an investor receives both monetary and non-monetary benefits.

The process to determine whether Part II of the Act applies to a transaction is as follows:

- (1) Part II applies if the interest is a security (section 2(1));
- (2) Part II does not apply if the sections 5 (1)(b) or (c) (or other) exemptions are available
- (3) The section 5(1)(b) or (c) exemptions are not available if there is a contributory scheme (section 2(1)). The elements of a contributory scheme are:
 - The investment of money;
 - An investor acquires an interest or right in respect of property
 - The interest or right will or may be used or exercised in conjunction with any other interest acquired in like circumstances.
 - The number of investors exceeds 5; or
 - A manager or associated person is a manager of any other such scheme or arrangement.
- (4) Part II does not apply if the transaction is not a contributory scheme.

3.6 Conclusions

The application of conventional canons of statutory interpretation enables a purposive interpretation of the term “security”. Early cases such as *Marac* and *Smith* may be conventionally explained by failure to apply such doctrines, which in turn implies a failure in the exercise of judicial discretion. Insofar as *Marac* rests on Richardson J’s “form of the transaction” doctrine, it is submitted that the decision is wrong in light of the Privy Council’s focus on the substance of the transaction in *Culverden*. In addition, the latter decision is authority for the proposition that there may be more than one security in any transaction and a security may be offered which forms only part of a scheme or transaction. Thus, part of a transaction that is not merely ancillary and forms a cardinal feature of the transaction may constitute a security. *Culverden* also reaffirms and extends the wide definition of security adopted by the Court of Appeal in *City Realties*. Hence, while the term “interest” must encompass a legal and equitable interest (see *Smith*), it extends to include an interest in future property - see *Abel*. The dictum in *Abel* to this effect is supported by the dictum of the Privy Council in *Culverden*. This reading of the law implies that *Smith* was wrongly decided because the investors held a legal interest (contractual rights) in future property and section 4(1) of the Act supports this conclusion. Further, it now appears that one examines the question of whether a security is offered from the point of view of the investor - see *Abel* and *Culverden*. Hence, Wylie J’s finding in *Smith* that what the investors thought they were obtaining was a security goes to the characterisation question.

Two principal reasons why *Culverden* supports a wide, purposive reading of the term security may be found in the expansive reading of a debt security and the term “investment” for the purposes of a contributory scheme. Supporting the substance over form approach, *Culverden* holds that the courts should view the scheme as a whole to determine whether a debt security is present. Further, a debt security goes further than a mere loan since it includes any obligation to repay money or retransfer property even at a lower value than the original transaction. As to the meaning of “investment” for the purposes of a contributory scheme, the extension to include non-monetary benefits supports a wide reading of the term security.

We may conclude, therefore, that subsequent to the *Culverden* decision, New Zealand courts will more readily adopt a wide purposive approach to the definition of a security. To remove any doubt, however, it is recommended that section 1 of the Securities Act 1978 be amended to

include a new section 1 (3) stating, inter alia, that the purpose of the Act is facilitate the raising of capital by means of timely disclosure of investment information in the interests of investor protection and that the definitions and provisions of the Act shall be given such large, wide and liberal interpretation as shall best achieve that end. The rationale behind this suggestion is that a clear direction to the judiciary within the Act may curb the aberrant exercise of judicial discretion. Thus, when a judge has to make the law there is clear guidance as to how the statute is to be interpreted – the “pass word” *cannot* be muddled.²⁹¹

This discussion of the definition of a security has largely focussed on the issue of judicial discretion. To recapitulate the argument: while the purpose and statutory expression of the definition of a security are clear, the two early cases of *Marac* and *Smith* show a misapplication of judicial discretion in the interpretation of that definition. To this extent, we observe in these cases a gap between purpose and practice - an absence of “fit” - which has been remedied by subsequent case law but might be further cured by highly transitive legislative direction in a new section 1(3).

291 “There was a time when it was thought almost indecent to suggest that judges make the law they only declare it. Those with a taste for fairy tales seem to have thought that in some Aladdin’s Cave there is hidden the Common Law in all its splendour and that on a judge’s appointment there descends on him knowledge of the magic words, Open Sesame. Bad decisions are given when the judge has muddled the password and the wrong door opens. But we do not believe in fairy tales any more.” Lord Reid, “The Judge as Lawmaker” (1972) 12 Journal of the Society of Public Teachers of Law 22.