TO: COMMERCE SELECT COMMITTEE

SUPPLEMENTARY SUBMISSION

ON: FINANCIAL MARKETS (REGULATORS AND KIWISAVER) BILL

(LOW BALL OFFERS)

FEBRUARY 2011

INTRODUCTION

1 This supplementary written submission on the Financial Markets (Regulators and Kiwisaver) Bill (**Bill**) is from Chapman Tripp, PO Box 2206, Auckland 1140.

It reflects our view that the Bill should be amended to address concerns we, and a number of other market participants, have that inexperienced investors are being taken advantage of through unsolicited offers for their share holdings or distressed debentures with inadequate disclosure or time to consider such offers, to the detriment of the integrity of New Zealand financial markets.

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LOW BALL OFFERS

3 We have long been concerned about the comparative ease with which third parties can obtain copies of New Zealand security holder registers for improper purposes.

In our experience the most prevalent use of such register copies was for unsolicited direct mail offerings of unrelated financial products.

More recently we have acted for a number of distressed debenture holder issuers, or their receivers[1], where the registers have been sought for the purpose of making offers to acquire debentures at a price significantly below the issuer's, or receivers' estimate of recoverable value.

Most recently Mr Bernard Whimp has targeted investors in some of New Zealand's largest listed companies to make offers for shares approximately 30% below the most recent quoted market price, on terms providing for settlement to be effected some weeks after shares have been acquired.

We wrote about these practices in our recent Brief Counsel, which we have attached as an Appendix to this submission.

Recent media coverage indicates that other well-known proponents of unsolicited predatory offers intend to target New Zealand investors, in part because the Australian regulatory framework has recently been further strengthened.[2]

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[1] Including Hanover Finance, North South Finance, Dorchester Finance, and the receivers of Bridgecorp and Strategic Finance.

[2] *Australian lowball operator targets NZ*, Sunday Star Times February 6 2011, Page C28.

RECOMMENDED REFORMS

4 The topics of security register access, and unsolicited offers were included in the Ministry of Economic Development's *Review of Securities Law* June 2010 discussion paper.

While reform of this area should be the outcome of the Review of Securities Law, we think more urgent action is needed through amendment to the Bill to:

- enable regulations to be made prescribing minimum disclosure requirements for unsolicited offers – in particular, where there is a market price for the securities, to require the market price to be unambiguously stated; where there is an issuer's or receiver's published estimate of value, for the estimate to be referred to. Any other unusual terms (such as instalment payments over 20 years) should also be prominently and clearly stated

- require unsolicited offers to be open for a reasonable time period – we suggest at least 21 days – to enable investors properly to consider the merits of the offer without being coerced through 'first in first served' offer terms.

Inclusion of a regulation making power in the Bill would enable consultation to be undertaken on the detailed disclosure requirements, and would provide flexibility to amend the requirements as unsolicited offeror practices evolve.

In addition we suggest that the Minister of Commerce direct officials to review the fees currently prescribed[3] for security register access. One option for consideration should be a tiered approach depending on the number of holders, as recently adopted in Australia.

TECHNICAL ASPECTS

5 We would be happy to discuss this supplementary submission directly with officials, if that would assist.

[3] Regulation 2 of the Securities (Fees) Regulations 1998 (SR 1998/461).

Appendix: Chapman Tripp Brief Counsel 3 February 2001

Time to whack the low ball out of the park

Bernard Whimp's audacious low ball offers late last year to shareholders in New Zealand's top publicly listed companies has brought the need for law reform in this area into sharper focus.

Abuse of the obligation under the Securities Act for issuers to provide copies of their shareholder register on request is long-standing and will be addressed in the current securities law review. But in our view more urgent action is needed to prevent more inexperienced investors from being ripped off – especially those under intense financial pressure.

This Brief Counsel canvasses the issues and suggests possible solutions.

A problem with pedigree

The unsolicited offers Bernard Whimp sent just before Christmas to investors in at least seven companies (Vector, Contact Energy, Telecom, Fisher & Paykel Appliances, TrustPower, Guinness Peat Group and Fletcher Building) offered prices as much as 30% or more below market value.

Whimp seems to create a different limited partnership for each offer. He targets smaller shareholdings and puts investors under time pressure, urging them to "act now" as it is a "first in first served" short notice offer. He does not quote the current share price in his letters, and he finds his mark.

Vector estimates that he made more than $300,000 from Vector shares alone in his pre-Christmas foray. Vector chairman Michael Stiassny said: "These shareholders did not receive a fair price for their shares and that absolutely galls me". Last year, Whimp acquired 2.2 million DNZ Property Fund shares for 60c each. DNZ is currently trading at $1.21 a share.

Nothing he is doing is illegal – and there are others playing the same game. The Securities Commission posted a series of health warnings, and guidance for investors, on its website last year after a spate of predatory offers to debenture holders in failed or failing finance houses. Many of those offers were from the Australian-based Stock and Share Trading Company.

The ability to access security holders' contact details through the securities register has also been misused by direct marketing organisations to pump other investment products.

Chapman Tripp flagged the need for better regulation with officials in February 2005 as the Securities Act 1978 was being reviewed, and again in April last year. The current statutes[1] provide almost no meaningful protections against abuse.

Issuers can require a modest payment (up to 20c per printed page)[2], but cannot refuse a request to access the securities register even if they know it is for an improper purpose, and must provide information about shareholdings within five working days[3]. Apart from the general obligation not to mislead or deceive, there are no predatory offer content or disclosure requirements.

Until the law is tightened, the sharks will keep circling. We think the best option is to introduce amendments to the Financial Markets (Regulators and KiwiSaver) Bill to address the worst of the conduct and to revise the fees payable to a more realistic rate. The Bill is now with the Commerce Select Committee and is due to be reported back by the end of this month.

The Australian approach

The Australians have progressively fine-tuned their legislation over the years; often in an attempt to rein in David Tweed, a low ball specialist who was briefly active in the New Zealand market two or three years ago through Colonial Capital Corporation. As a result, the Australians now have a much more robust framework.

Features include:

- a prohibition against using personal information obtained from the register to direct mail the person, unless the material is relevant to the holding of the shares (this deals with the direct marketer issue, but not with low ball offers)
- a requirement that the latest market price be prominently displayed in any unsolicited buy offers to shareholders (this deals with the low ball offer, but Tweed has adapted his strategy and now offers near market (and sometimes above market) prices, but payable through annual instalments over 15 to 20 years to attract investors who do not understand the time value of money)
- a 'proper purpose' test under which a company can refuse to supply information if it is to be used improperly. A refusal to supply can be challenged in the Courts. Improper use includes:
    - gathering information about a security holder's personal wealth
    - making off-market purchases, except for the purposes of a take-over.

These provisions are backed by a tough penalties regime, including liability to pay compensation for any losses or damages suffered by others as a result of the contravention and the return of any profits.

The fees structure is also higher than here and is three-tiered. Companies with fewer than 5,000 shareholders can charge a flat $250. Those in the 5,000 to 20,000 range can charge $250 plus an additional 5c per member above 5,000. Those with 20,000 or more security holders can charge a fee of $1,000 plus 1c per holder above 20,000.

United Kingdom approach

The Australian reforms followed the United Kingdom except that - importantly – it is the issuer's responsibility in the UK to refer to the court any requests for access to the securities register which may be for an improper purpose.

Reform options for New Zealand

The MED Review of Securities Law June 2010 discussion paper sought submissions on both the securities register, and predatory offer issues.

MED's tentative view was that it is "not convinced that New Zealand should adopt an approach similar to that currently applying in the United Kingdom or that proposed in Australia. We have yet to see evidence to suggest that there is a significant problem in New Zealand, but we would be interested in evidence where access to registers has resulted in significant disadvantage".

MED was more supportive of regulation on predatory offers suggesting an option might be to allow issuers or trustees to require that a statement be included in any unsolicited offer warning about the nature of the offer.

Our view

Consistent with most submitters, we supported greater restrictions on both register access and predatory offers. In our submission we suggested:

- narrowing the access to securities registers to prevent parties from abusing the system for direct mail communications unrelated to the financial product. A provision similar to section 177 of the Corporations Act 2001, coupled with an offence provision, would provide a remedy against the most aggressive behaviours

- including a power in the replacement statute for regulations to be made specifying minimum content requirements for unsolicited offers. The regulations could be developed from Part 7.9, Division 5A, of the Corporations Act 2001, requiring the predatory offeror to state the market price of a security or to give an estimate of value (including assumptions made). While we consider the Australian provisions may be unduly prescriptive, they do ensure that the investor is able to make an informed decision

- requiring that offers be held open for a statutory minimum period so that investors can take financial advice and not feel pressured into making a hasty commitment on a 'first in first served' basis.

What next

A principled reform in this area may need to await the final outcomes of the Review of Securities Law. However, in our experience (including market activity since the June 2010 discussion paper), there is a significant problem in New Zealand. So we would advocate:

- the Minister promoting changes to the fee regulations to allow issuers to better recover the costs of providing registers – a tiered approach reflecting the number of holders as per Australia makes sense

- modest reform through the soon to be passed Financial Markets (Regulators and KiwiSaver) Bill to curb the worst predatory behaviour by:

    - including a regulation making power to allow consultation on detailed regulations for clearer disclosure, particularly of market price and any unusual terms (i.e. instalment payments over 20 years), and

    - requiring predatory offers to be open for at least 21 days.

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1 Section 52 of the Securities Act 1978 applies to all issuers; section 218 of the Companies Act 1993 (which applies to both closely held and widely held companies) contains some different requirements for share registers.

2 Securities (Fees) Regulations 1998 (SR 1998/461) at: http://www.legislation.govt.nz/regulation/public/1998/0461/latest/DLM272251.html.

3 Under the Securities Act, there is currently no time frame specified for providing copies of the registers once the prescribed fee is paid; they must be made available immediately although an issuer for unlisted securities can close its securities register for periods of up to 30 days.

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