Robbing Peter to pay Paul?

Shareholder compensation for violations of continuous disclosure obligations in New Zealand securities law

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A dissertation completed in partial fulfilment of the requirements for the degree of Bachelor of Laws (Honours) at the University of Otago, Dunedin

October 2011
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Acknowledgements

Thanks firstly to my supervisor, Shelley Griffiths, for her invaluable guidance throughout the year.

Thanks also to Lauren and my friends, who have kept me going with their banter. A special mention here goes to my flatmates and the inhabitants of 9N12.

Finally, thank you to mum and dad, for their unwavering support in all my endeavours.
Introduction

This dissertation will provide a critical analysis of shareholder compensation as a remedy for violations of continuous disclosure obligations. Shareholder compensation is a subject which has attracted significant overseas criticism on the grounds that it is ineffective both as a means of compensating victims and deterring non-compliance. In addition, its presence undermines the efficiency and fairness of securities markets by facilitating a costly transfer of wealth between two groups of innocent investors. Despite these criticisms, shareholder compensation has worked its way into New Zealand securities law via Australia, with very little assessment of its theoretical justifications or practical effects. This dissertation seeks to remedy this oversight, and assess whether or not shareholder compensation is a desirable feature of New Zealand securities law.

Chapter one provides an overview of the current legislative regime and its origins. It traces the development of shareholder compensation from its inception in Australia through to its current position in New Zealand securities law. It also gives some insight into the objectives of securities law in order to provide a framework with which to assess the desirability of shareholder compensation. Chapter two illustrates the flawed theoretical underpinnings of shareholder compensation. It demonstrates, with reference to the role of the shareholder in a modern listed company, that compensation does no more than simply shift wealth between two equally innocent groups of shareholders. Chapter three discusses some further practical justifications for compensation. It shows that shareholder compensation is not only theoretically inconsistent, but also heavily flawed as a tool of enforcement and compensation. Finally, chapter four examines alternatives to the current regime. It provides an overview of the approaches to compensation taken in the United Kingdom and Singapore, as well as some academic suggestions for reform.
I: The origins of shareholder compensation in New Zealand

1.1 The controversy over shareholder compensation

In February 2011, the Securities Commission announced that it had reached a settlement with the directors of NZX listed company Nuplex for breaches of the continuous disclosure provisions of the Securities Markets Act 1988.¹ The terms of the settlement were such that actions against both the directors and the company were dropped, in return for Nuplex establishing a $3.2 million fund to compensate investors who purchased shares over the period of contravention.² The Chairman of the New Zealand Shareholders association decried the terms of the settlement on the grounds that they “demonstrated a cynical disregard for the rights of shareholders” and represented a “classic robbing Peter to pay Peter scenario”.³ This criticism stems from the fact that although it was the Nuplex directors who failed to satisfy the company’s disclosure obligations, it was the shareholders who ultimately paid the price for this breach.

Such criticism raises important issues of principle in respect of who bears ultimate responsibility for compliance with the continuous disclosure regime. Specifically, it raises the question of whether shareholders should be entitled to claim compensation for a public issuer’s failure to fulfil its continuous disclosure obligations. Under the current regime, shareholders who purchase shares during a period of non-compliance may obtain compensation against the issuer for losses resulting from this failure.⁴ The effect of this is that one group of shareholders (those who purchase after a breach has occurred) are compensated by another group of shareholders (those who owned shares prior to the breach) via the funds of the company.

Similar provisions overseas have attracted significant academic criticism due to a perception that the ‘pocket shifting’ effect of compensatory orders is inefficient and

¹ Securities Commission “Securities Commission and Nuplex Reach Settlement” (press release, 23 February 2011)
⁴ Securities Markets Act 1988, ss 42ZA-42ZB.
in addition, it has been argued that the regime is ineffective at both compensating innocent parties and inducing compliance with the disclosure regime.\(^5\)

This dissertation will examine the relevance of these objections to New Zealand securities regulation. Specifically it will seek to assess whether shareholder compensation furthers, hinders or is superfluous to the fulfilment of New Zealand’s securities law objectives.

### 1.2 The current enforcement regime for continuous disclosure

An important part of an efficient secondary market\(^7\) is the ability for investors to access information which affects a company’s share price. In a sharemarket, where prices are constantly in a state of change, it is important that investors have access to up to the minute information about listed companies. In New Zealand this is achieved through a process known as continuous disclosure. The NZX listing rules require that listed companies immediately disclose any information which: “a reasonable person would expect, if it were generally available to the market, to have a material effect on the price of the Issuer’s Listed Securities”.\(^8\) Exceptions to this rule apply to confidential information, and information which “a reasonable person would not expect to be disclosed”.\(^9\) This latter category is particularly ambiguous, but is likely to apply to circumstances such as those where disclosure would adversely affect an ongoing negotiation that the issuer is involved in.\(^10\)

By their very nature these rules can be difficult to apply in practice. Whether a ‘reasonable person’ would expect a particular piece of information to be disclosed

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\(^7\) The secondary market is where securities are traded between investors, rather than purchased from the company. Unlike the primary market (where shares are purchased directly from the issuer) an issuer does not receive any funds from secondary market trading. See generally: S Griffiths “Securities Regulation” in Farrar (gen ed) Company and Securities Law in New Zealand (Brookers, Wellington, 2008) at 1062-1063.

\(^8\) NZX Listing Rules, rule 10.1.1.

\(^9\) Ibid, rule 10.1 note 3.

\(^10\) NZX Markets Supervision, “Guidance Note- Continuous Disclosure” (April 2011) at 8.
will often require a very fine judgment call to be made by company directors and officers. This is particularly true in circumstances such as commercial negotiations, where information is constantly changing and compliance with disclosure obligations can be especially difficult. Despite these compliance difficulties, strict liability applies to the continuous disclosure rules, with no element of intent or negligence required to establish a violation.\textsuperscript{11}

These rules are enforced in the first instance by the NZX,\textsuperscript{12} however since 2002 they have also received statutory backing from the Securities Markets Act 1988.\textsuperscript{13} The statutory regime sets out a range of measures that may be taken against both issuers and individuals involved in contraventions of disclosure requirements. The primary statutory means of enforcing these obligations is the civil penalty regime.\textsuperscript{14} The regime empowers the Financial Markets Authority (FMA)\textsuperscript{15} to seek a declaration that an issuer and/or individual has violated a civil remedy provision.\textsuperscript{16} Primary liability for contravening the continuous disclosure provisions rests with the issuer company. However, since 2006 secondary liability has also attached to those who aid, abet or are in any way a party to a contravention.\textsuperscript{17} Therefore, directors and senior officers who are involved in a company’s failure to comply with continuous disclosure obligations are also likely to attract liability.

On granting of a declaration of contravention, the FMA may apply for a pecuniary penalty of up to one million dollars against each party found to have contravened the

\textsuperscript{11} NZX Listing Rules, rule 10.1; Securities Markets Act 1988, ss 19A-19D.
\textsuperscript{12} Memorandum of Understanding between the Securities Commission and NZSE Limited on regulatory co-operation (27 February 2003) at 6, 7.2. Describing NZX as the ‘front-line’ regulator of continuous disclosure obligations.
\textsuperscript{13} Securities Markets Act 1988, ss 19A-19D. The civil remedy provisions include, amongst other things, continuous disclosure: s 42S.
\textsuperscript{14} Ibid, s 42R.
\textsuperscript{15} The FMA is the statutory regulator of the New Zealand securities market. Their powers and functions are set out in the Financial Markets Authority Act 2011.
\textsuperscript{16} Securities Markets Act 1988, ss 42S-42T.
\textsuperscript{17} Securities Markets Act 1988, s 2 ‘contravene’ is defined as: (a) a contravention of the provision; or
(b) an attempt to contravene the provision; or
(c) aiding, abetting, counselling, or procuring any other person to contravene the provision; or
(d) inducing, or attempting to induce, any other person, whether by or promises or otherwise, to contravene the provision; or
(e) being in any way, directly or indirectly, knowingly concerned in, or a party to, the contravention by any other person of the provision; or
(f) conspiring with any other person to contravene the provision
Act.\textsuperscript{18} In addition, individual investors (or the FMA on their behalf) may claim compensation for losses resulting from the failure to disclose.\textsuperscript{19} Thus an investor who purchases shares at an inflated value due to a contravention may apply to be compensated for the amount paid over and above the ‘true’ value of the shares.

Unlike other dealing misconduct provisions such as insider trading and market manipulation, violations of continuous disclosure obligations do not attract criminal liability.\textsuperscript{20} However, if an individual is persistently involved in breaches of the continuous disclosure regime (or any other part of the Act) the FMA may apply for an order banning that person from being involved in the management of a company for up to 10 years.\textsuperscript{21}

As this structure indicates, securities law in New Zealand relies largely on public, rather than private enforcement of obligations. Investor compensation through section 42ZA\textsuperscript{22} is therefore the only means of privately enforcing obligations, and even then the section purports to have a primarily compensatory rather than deterrent purpose.\textsuperscript{23} In this respect the regime is more similar to the United Kingdom than the United States and Australia, both of whom use private enforcement through class actions as a key element of the enforcement regime.\textsuperscript{24}

### 1.3 History of shareholder compensation in New Zealand

Like many of the recent developments in New Zealand securities law, the continuous disclosure and civil remedy provisions (including 42ZA) have their genesis in Australia.\textsuperscript{25} Indeed the New Zealand continuous disclosure and enforcement sections

\textsuperscript{18} Securities Markets Act 1988, s 42W (2).
\textsuperscript{19} Ibid, s 42ZA.
\textsuperscript{20} See for example: Securities Markets Act 1988, ss 43-43E which provide for criminal liability for violations of insider trading, market manipulation, knowingly false or misleading statements and director and substantial shareholding disclosures.
\textsuperscript{21} Securities Markets Act 1998, 43F.
\textsuperscript{22} Ibid.
are largely a ‘cut and paste’ of the Australian provisions, with amendments in 2002 and 2006 mimicking modifications to the Australian regime. Such reforms largely result from a desire to harmonise corporate law between New Zealand and Australia in accordance with the Memorandum of Understanding on the co-ordination of business law.\textsuperscript{26} However the downside of such a commitment to harmonisation is that any oversights made by Australian legislators are automatically imported into the New Zealand system. As will be shown, shareholder compensation is arguably one such example where flaws in Australian legislation have crept into the New Zealand legislative framework.

\textit{History of the Australian compensation regime}

The Australian civil remedy regime dates back to the 1989 \textit{Senate committee report on the Social and Fiduciary Duties and Obligations of Company Directors} (‘The Cooney Report’).\textsuperscript{27} The Cooney report was a response to the perceived inability of corporate regulatory bodies to control director conduct solely through criminal penalties. The high burden of proof, and unnecessary ‘stigmatisation’ of criminal sanctions led to the committee’s investigation of alternative enforcement powers.\textsuperscript{28} Their response was to recommend the introduction of ‘civil’ remedy provisions in the form of compensatory and pecuniary penalties, which would assist public regulators such as the Australian Securities and Investment Commission (ASIC) in better enforcing directors’ duties.\textsuperscript{29} Such a model was based on the ‘Braithwaite Pyramid’ of enforcement, which argued for a wide range of penalties for corporate law violations, each with differing degrees of seriousness. The purpose of such an approach was to recognise that violators of corporate law have varying degrees of culpability, with

\textsuperscript{26} Memorandum of Understanding Between the Government of New Zealand and the Government of Australia on Coordination of Business Law (signed on 1 July 1988). The most recent revision to this Memorandum was signed on 23 June 2010. See also: G Walker “The CER agreement and Trans-Tasman Securities Regulation” (Submission to Australian Treasury and New Zealand Ministry of Economic development on “Trans-Tasman Mutual Recognition of Offers of Securities and Managed Investment Scheme Interests”, 2004) at 25 - 32.
\textsuperscript{27} Australian Senate Committee on Legal and Constitutional Affairs “Report on the Social and Fiduciary Duties and Obligations of Company Directors” (November 1989).
\textsuperscript{28} Ibid, at 13.14.
\textsuperscript{29} Ibid, at 13.15.
some offenders deserving of minor reminders to take more care, and others deserving of the full force of the criminal law.\textsuperscript{30}

In the context of directors’ duties such recommendations appear relatively uncontroversial. If a director commits a wrong, the regulator ought to have the power to fine them (through a pecuniary penalty), and an investor who has suffered loss as a result of the wrong ought to be entitled to compensation from the director (through a compensatory remedy). More serious conduct could also be punished through criminal sanctions. The Cooney Report recommendations were subsequently adopted by the Federal Parliament, and provided the basis for the civil remedy provisions in the Corporate Law Reform Act 1992.\textsuperscript{31}

Running parallel to the introduction of civil remedy provisions was the development of a continuous disclosure regime for listed issuers.\textsuperscript{32} This bore fruit in 1994, with the creation of a statutory continuous disclosure scheme intended to supplement the listing rules of the Australian Stock Exchange (ASX).\textsuperscript{33} The continuous disclosure regime initially came with its own set of criminal remedy provisions,\textsuperscript{34} and as such was distinct from the civil remedy provisions which applied to directors duties. Initially the contravention of these provisions required an intentional, reckless or negligent failure to disclose.\textsuperscript{35}

The two developments co-existed independently until 2002, at which time the Federal Parliament sought to consolidate the multiple penalty regimes operating under the Corporations Act 2001. The result of this consolidation of penalties was the Financial Services Reform Act 2001, which added continuous disclosure to the list of ‘civil


\textsuperscript{31} Corporate Law Reform Act 1992 (Cth), s 17 amending Corporations Law (Cth), Part 9.4b; esp. s 1317HA.

\textsuperscript{32} Companies and Securities Advisory Committee (CASAC), “Report on an Enhanced Statutory Disclosure System” (September 1991) at 10-13. For a general discussion of the the regime see: A Neagle and N Tsykin “‘Please Explain’: ASX Share Price Queries and the Australian Continuous Disclosure Regime” (Research Report, University of Melbourne, 2001) at 8-16.


\textsuperscript{34} Corporations Law (Cth), s 1001A (2).

\textsuperscript{35} Ibid.
remedy provisions’. A further change to the legislation was made in 2004 which ‘clarified’ the fact that compensation claims for breaches of continuous disclosure may be made regardless of whether ASIC had been granted a declaration of contravention. Until that point it had been unclear whether investors could make claims for compensation if ASIC had not already been granted a declaration of contravention. Prior to 2004 this had meant that ASIC had to deem it to be in the ‘public interest’ to apply for a declaration of contravention, thus limiting any subsequent claims for investor compensation. It is likely to be no coincidence that immediately following this change, the number of securities class actions taken in Australia rose significantly.

The impact of these changes was far greater than legislators appear to have appreciated at the time. The civil remedy regime (as discussed above) was introduced as a means of financially punishing directors, and requiring them to directly compensate shareholders for losses resulting from their illegal actions. However, the same rationale does not readily apply to breaches of continuous disclosure obligations. Because continuous disclosure is deemed to be the responsibility of the issuer, the company rather than the directors are liable for compensation and pecuniary penalties. Thus legislators appear to have assumed that the Cooney Report’s recommendations in relation to the enforcement of duties owed by directors apply equally to obligations owed by the company. In making this assertion legislators in both Australia and New Zealand never addressed the conceptual question of whether one group of shareholders should be effectively required to compensate another group of shareholders via the funds of the company. Even if this ‘pocket shifting’ effect is justified (and this dissertation argues that it is not), it speaks volumes about the passage of securities legislation on both sides of the Tasman that such a significant change was undertaken without full consideration of the conceptual issues it raised.

1.4 The increasing relevance of shareholder compensation in New Zealand

Since its introduction in 2006 shareholder compensation has remained a sleeping giant in New Zealand’s securities legislation. This is most likely due to the fact that the majority of individual investor losses are not substantial enough to warrant the expense of litigation. However two recent developments have the potential to breathe life into the provision, and thus raise issues of principle not envisaged by the drafters of our regulatory framework.

The first of these developments is the establishment of the Financial Markets Authority (FMA) in May 2011. Through its empowering legislation, the FMA has the power to take on investors’ rights of action under the Securities Markets Act 1988. This new power thus allows the Authority to ‘pool’ the compensation claims of a number of investors so as to make litigation financially worthwhile. In addition, given the willingness of the FMA’s predecessor to seek shareholder compensation in Nuplex and the aggressive approach threatened by the FMA it seems highly likely that this power will be utilised.

The second development is the potential passage of legislation which would allow class actions to be undertaken in New Zealand. A class action bill has already been drafted, and debate over such reform appears likely in the next Parliamentary term. The Australian experience has been that opening the door to class actions for continuous disclosure breaches post-2004 has resulted in a significant increase in compensation claims under the Australian equivalent to 42ZA. It is likely such an increase is due in large part to the influence of litigation funders, who incentivise shareholder actions by creating ‘risk free’ incentives to bringing securities litigation. Whilst this dissertation will not specifically assess the desirability of class actions per se, it stands to reason that allowing such actions would compound many of the criticisms levied against shareholder compensation.

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39 Financial Markets Authority Act 2011, s 34.
40 Financial Markets Authority “FMA announces its enforcement policy” (press release, 12 September 2011).
41 Class Actions Bill 2008 (draft), PCO 8247/2.3. See also: New Zealand Rules Committee, “Class actions for New Zealand, a second consultation paper prepared by the rules committee” (October 2008).
42 Houston, above n 38, at 4.
1.5 The unique nature of securities markets

One of the reasons compensation for continuous disclosure violations poses difficult conceptual issues is the unique nature of sharemarket trading. Indeed one of the inherent difficulties in the regulation of securities markets is the disconnect between buyers and sellers due to the anonymous nature of the sharemarket. In most trading relationships buyers and sellers deal directly with each other (or at least through each others agents), with each placing reliance on representations made by the other party. If such representations turn out to be false or misleading, the party who has been misled is generally entitled to compensation for losses they suffer as a result.

The position is more complex, however, when dealing with secondary market share trading. In this context both buyer and seller rely\textsuperscript{43} on the accuracy and completeness of information provided by the company, which is ultimately determined by the company’s officers and directors. This means that when buyer and seller trade on the basis of inaccurate information (because continuous disclosure has not occurred), one party will innocently inflict a loss on the other. Assuming the party who inflicts this harm does not have inside information,\textsuperscript{44} they will effectively have received an innocent windfall, making a lucky escape before the true value of the company is reflected in the share price. But what is to be made of the party on the other side of that trade? Ought they be entitled to compensation for their loss, or have they simply suffered from an inherent investment risk? If compensation is desirable then who should pay it? Should it be the directors and officers who had the ability to disclose the information? Or the issuer itself (and thus indirectly other shareholders)? Perhaps the losses should be clawed back from all the ‘lucky’ traders who received a windfall? (Although given the trades occurred through a faceless market it will be impossible to know for sure who traded with whom). Clearly none of these options is without its downsides, however this dissertation will seek to examine which of these is the most desirable in a New Zealand context.

\textsuperscript{43} Investors are deemed to rely on all available information by virtue of the ‘fraud on the market’ theory. See generally: P Mahoney, “Precaution costs and the law of fraud in impersonal markets” (1992) 78 VA L Rev 623.

\textsuperscript{44} This would constitute an insider trading offence in itself see: Securities Markets Act, ss 8-8F.
1.6 The role of securities law in New Zealand

In order to assess the desirability of shareholder compensation, it is necessary to set out the objectives of securities law in New Zealand. This provides a framework for assessing how well compensation furthers these objectives, and thus whether it represents a valid part of the securities law landscape.

The most recent statement of the current Government’s securities law objectives can be found in the recently released Financial Markets Conduct Bill. The Bill states the ‘main purposes’ of securities law as being to:

(a) promote the confident and informed participation of businesses, investors, and consumers in the financial markets; and
(b) promote and facilitate the development of fair, efficient, and transparent financial markets.45

In a broad sense such objectives are aimed at promoting efficient financial markets by instilling confidence in the minds of market participants. Investors should be able to have faith that the information which is available to the market provides an accurate representation of the company in which they are proposing to invest. Modern views of securities law recognise that there is a public benefit to be derived from a confident and informed market,46 thus justifying a statutory framework for ensuring the prompt and efficient release of material information to the market.

Despite there being a clear case for market regulation of information disclosure, the extent to which market confidence should be upheld by the law actively providing ‘investor protection’ remains open for debate. Central to this debate is the question of who ought to bear the risk for a failure to disclose material information. On the one hand, it is arguable that risks to investors should be minimised as much as possible, with the company or other individuals (such as directors) instead responsible for bearing the risk. Such an approach is likely to instil confidence in the minds of small

45 Financial Markets Conduct Bill 2011 (consultation draft), cl 3.
scale or “mum and dad” investors, who will rest easy knowing that information is ‘guaranteed’ by the company to be accurate.\textsuperscript{47} On the other hand, it is arguable that investors are the appropriate group to bear risk in securities markets, and should take steps themselves to mitigate the risk of non-disclosure. All investors (and especially larger ones) have the ability to diversify their share portfolio, thus offsetting the risk that material information about a particular company has not been disclosed. Such a view arguably reduces confidence from the perspective of smaller investors, who are less likely to diversify and thus more likely to suffer loss as a result of an issuer’s failure to disclose.

Over recent years there has been a significant movement towards investor protection in New Zealand and Australia and in many respects equities investors are now viewed as ‘consumers’ worthy of increased protection.\textsuperscript{48} The desirability of such an approach is highly questionable. Whilst Parliament regularly deems consumers of certain products worthy of additional protections,\textsuperscript{49} equity securities should not be considered such a ‘product’. This is because the extent to which securities law compensates investors for risks which could be avoided through diversification, it creates an inefficiency in the market.\textsuperscript{50} A diversified investor will benefit from a failure to disclose as often as they suffer a loss, thus the investigative and legal costs of facilitating compensation are an unnecessary waste of resources.\textsuperscript{51} Furthermore, as will be discussed in chapter two, there are a number of factors which render shareholder compensation largely ineffective even as a means of compensating small scale consumer-investors.

This is not to disregard the importance of enforcing accurate disclosure by listed companies. Indeed all investors regardless of size or level of diversification benefit

\textsuperscript{47} There is a ‘guarantee’ in the sense that if it turns out material information has not been disclosed, the investor can recover their loss by suing the company for compensation.

\textsuperscript{48} M Legg “Shareholder class actions in Australia -The Perfect Storm?” (2008) 31 UNSWLJ 669 at 671-674. See also the discussion in Sons of Gwalia v Margaretic [2007] HCA 1 at [18] per Gleeson CJ.

\textsuperscript{49} For example the common law notion of caveat emptor compared with Consumer Guarantees Act 1993.


from such information, and are more confident investors.\textsuperscript{52} Increased investor confidence encourages participation in capital markets, and thus plays an important part in ensuring their liquidity and efficiency. However, I argue that disclosure is best enforced solely through a strong central regulator. Statutory compensation is superfluous to this enforcement mechanism, and is ineffective and inefficient as a compensatory device.

\textbf{1.7 The nature of continuous disclosure violations: wrongful acts or an inherent market risk?}

One factor that arguably distinguishes continuous disclosure violations from other market risks is the ability to ‘blame’ somebody for the failure to disclose. Directors, officers and the issuer are under a statutory obligation to disclose certain types of information, and thus a failure to do so results in an identifiable breach of duty. This creates an expectation that because there is an identifiable wrong, there should be a corresponding remedy.\textsuperscript{53} Such a view distinguishes (at least in the minds of investors) disclosure failures from other market fluctuations which result in them suffering a loss. From a psychological perspective the former warrants compensation and censure, whilst the latter may be dismissed as a mere ‘vagary of the market’.

The intuitive appeal of such an approach is clear. Loss that derives from a wrong deserves a remedy. However, it is arguable that such a view misstates the true nature of a violation of the continuous disclosure regime. It is important to note at the outset that compliance with the continuous disclosure regime can by no means be said to be an exact science. Much criticism has been levied against the regime on the basis that it is incredibly difficult to know the point at which information should be disclosed. It is therefore likely that many (if not most) breaches of the regime will be genuine errors of judgment, not truly ‘wrongful’ acts. Even with clarifications,\textsuperscript{54} the regime

\textsuperscript{52} Easterbrook and Fischel, above n 50, at 640.


\textsuperscript{54} NZX Markets Supervision, “Guidance Note- Continuous Disclosure” (guidance note, April 2011)
relies on directors and officers making highly subjective minute-by-minute decisions about what information must be disclosed.\textsuperscript{55}

It follows that such a strict disclosure regime will always have some degree of unintentional non-compliance. It is therefore arguable that some level of non-disclosure is just an inherent market risk. Conceptualising the continuous disclosure regime in such a way shifts ‘blame’ for a failure to comply away from the company and its directors and instead recognises that the market is inherently imperfect in respect of information disclosure. The reality is that holding issuers to a virtually impossible standard of perfection in continuous disclosure simply allocates risk to individual issuers rather than the market at large.

One Australian commentator takes this point further and argues that the existence of investor protection legislation has itself “created a new morality and a sense of entitlement” amongst investors.\textsuperscript{56} This view reflects the fact that shareholder compensation diminishes the responsibility shareholders should have to diversify their portfolios. Just as shareholders should diversify to protect themselves from fluctuations in prices generally, so should they diversify to mitigate fluctuations in prices resulting from continuous disclosure violations.

The practical effect of the current regime is to shift risk from investors (who can avoid it through diversification), to the company (who cannot fully avoid it due to some degree of unavoidable non-compliance).\textsuperscript{57} It is therefore my view that the current regime’s characterisation of continuous disclosure breaches as an ‘individualised wrong’ rather than a ‘market risk’ is illusory, and thus creates a shaky foundation for investor compensation. Instead, breaches of continuous disclosure should be characterised as a general market failure with the risk borne equally by all market participants, rather than as a compensable wrong.

\textsuperscript{55} For example, Bell Gully note that the “complexities involved in complying with the continuous disclosure regime mean that it is not always going to be easy to get it right”. Bell Gully, “Expanded Liability under the continuous disclosure regime” (Commercial Quarterly, Winter 2007) at 22.

\textsuperscript{56} M Legg “The transformation of a share price fall into litigation- shareholder class actions in Australia” (paper presented at Corporate Law Teachers Association Conference, Sydney, 3-5 February 2008) at 5.

\textsuperscript{57} Easterbrook and Fischel, above n 50, at 641.
1.8 The common law approach to diminution in share value

At common law, it has been settled for some time that a diminution in the value of shares does not give shareholders an independent right of action against directors or the company. This point was made by the English Court of Appeal in *Prudential Assurance Co Ltd v Newman Industries (No. 2)*\(^{58}\) at 222:

[A shareholder] cannot recover a sum equal to the diminution in the market value of his shares, or equal to the likely diminution in dividend, because such a "loss" is merely a reflection of the loss suffered by the company. The shareholder does not suffer any personal loss. His only “loss” is through the company, in the diminution in the value of the net assets of the company.

The facts of *Prudential* concerned a claim brought by a shareholder against the defendant company Newman (which was at the time listed on the stock market) and its directors. It was alleged that directors had made misleading statements to shareholders regarding the value of other companies which Newman proposed to purchase. On the basis of these misleading statements shareholders approved the purchase and subsequently suffered a substantial loss when the true value of the purchased companies was realised. The court rejected the claim that shareholders had been *personally* defrauded by the misleading statements, and instead held that as the company was the one to suffer the loss, it must be the one to bring an action against the directors for the fraudulent statements.

The parallels between the action in *Prudential* and claims for compensation under the Securities Markets Act for breaches of continuous disclosure are clear. In continuous disclosure cases shareholders sue for the diminution in value of their shares as a consequence of the failure by directors and officers to disclose accurate information about the company’s current position. Such failure induces shareholders to purchase shares in the company at an inflated price, thus causing their shares to diminish in value when the information is eventually revealed. One Australian commentator has

\(^{58}\) *Prudential Assurance Co Ltd v Newman Industries (No. 2)* [1984] Ch 204 at 222
noted that the willingness of the courts to disregard these parallels in the context of class actions appears to amount to a ‘sidestepping’ of the principle in Prudential.59

However, despite these similarities there exist some clear differences between the rule in Prudential and compensation for breaches of continuous disclosure. The most obvious of these is that continuous disclosure is deemed by the legislation to be an obligation of the company.60 The effect of this is that the company is responsible for causing the loss which arises from a non-disclosure, rather than suffering loss as a result of the directors’ conduct (as was the case in Prudential).61 Whilst in a practical sense directors are the ones responsible for a failure to disclose, because the statutory scheme deems them only to have secondary liability for breaches of the regime they are not legally responsible for compliance.

There is also a further policy distinction between shareholder compensation and the principle in Prudential. One of the key rationales for preventing a private cause of action against directors was that it potentially allowed double recovery of damages by both shareholders and the company. The diminution in value of an investor’s shares was merely a reflection of the loss the company suffered as a result of the misleading statements. By contrast, a breach of continuous disclosure does not cause any actual harm to the company itself, but only to those investors who purchased shares while information was unreleased. This means that the loss they suffer cannot be said to be ‘reflective’ of a loss to the company, but is instead of an entirely different nature.

Such a situation is thus more analogous to that in Christenson v Scott.62 In that case the Court of Appeal held that where diminution in share value occurs as a result of a breach of a personal duty owed to a shareholder, the value of such diminution is not barred by the rule in Prudential. In this sense, it can be said that the duty of continuous disclosure is owed to the market as a whole, and those who purchase shares over the non-disclosure period suffer an individualised loss as a result.

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60 Securities Markets Act 1988, 19B.
62 Christenson v Scott [1996] 1 NZLR 273
Therefore although securities compensation does provide an apparent deviation from the traditional common law position, on consideration it is readily distinguishable.

This chapter has provided an outline of the current legislative regime governing shareholder compensation for continuous disclosure violations. It has also shown the origins of this regime, and given some indication of its role in fulfilling the objectives of securities law in New Zealand. The following chapter focuses on the theoretical basis of the regime. It provides an overview of international academic criticism of shareholder compensation, and assesses the relevance of this criticism in a New Zealand context.
II: The theory behind shareholder compensation

2.1 The problem with shareholder compensation

Shareholder compensation for securities fraud is a topic which has attracted substantial criticism abroad. John Coffee, one of the leading US commentators on the subject, has described compensation as producing “wealth transfers that neither compensate nor deter”, while the most recent overseas commentary alleges the ‘consensus’ view to be that compensation is “flat-out senseless, mindless, and reasonless.” Such criticism is based on a variety of objections to the current regime. However most criticism ultimately derives from the fact that compensation payments transfer wealth from one group of shareholders to another in an apparently arbitrary manner. This is because although a non-trading company derives no benefit from breaching its continuous disclosure obligations, it is nonetheless required to compensate ‘new’ investors who suffer loss as a result of the company’s inflated share price. The cost of this compensation is borne by the company’s shareholders, none of whom benefitted from the failure to disclose and all of whom assumed the same risk that such a diminution in value would occur. The effect of compensation is therefore circular. It does not disgorge an unlawful profit from a wrongdoer but rather shifts the loss between two parties who assumed the same risk.

The following example illustrates the nature of this problem: Imagine Company X is initially valued at $1 per share. The company then fails to disclose the fact that its goldmine is less productive than previously thought. This information, had it been disclosed when it first became known to the directors, would have reduced the price of the shares to $0.50. However, because the information is not disclosed, the trading price of the shares remains at $1. Over the following two months that this ‘bad’ news exists but is not known to the market 50% of the company’s shares change hands.

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63 See above, note 5.
66 A company is ‘non-trading’ if it does not, over the period a breach occurs, repurchase its own shares on the secondary market (a rare type of transaction).
67 Coffee, above n 64, at 1556-1557.
Once the information is finally disclosed, the share price immediately drops to $0.50 to reflect the company’s ‘true’ value.

Under the current regime, those who purchased their shares for $1 over this two month period may sue the company for compensation. If successful in their claim, the company will be required to pay $0.50 to each shareholder who traded over the non-disclosure period, resulting in the share price (ceteris paribus) reducing to $0.25. The effect of this is that the existing group of shareholders compensate the ‘new’ group of shareholders (albeit indirectly through the funds of the company). The final result is that ‘new’ shareholders have an effective investment value of $0.75 and ‘continuing’ shareholders have an effective value of $0.25. The existing shareholders therefore suffer a ‘double loss’; firstly through the release of the information which dropped the value of their shares from $1 to $0.50, followed by the payment of compensation which reduced their value further to $0.25.69

As this example demonstrates, shareholder compensation has the circular effect of redistributing wealth between two groups of shareholders. Critics of shareholder compensation contend that each of these shareholder groups are equally ‘innocent’, and therefore redistribution between them is no fairer than letting losses lie where they fall.70

This critique, however, rests on the premise that ‘continuing’ shareholders (those who own shares prior to a breach of the continuous disclosure regime and retain them for the duration of the non-disclosure period) are no more culpable for violations of continuous disclosure than ‘new’ shareholders (those who purchase shares over the non-disclosure period). This section will assess the validity of this assertion in light of the modern role of the shareholder in a listed company.

68 This is made up of an actual share value of $0.25 plus compensation of $0.50.
69 It should be noted that this example provides an oversimplification of the practical effects of shareholder compensation. It does, however, illustrate the theoretical nature of the problem.
70 Coffee, above n 64, at 1556.
2.2 The ‘continuing’ shareholder: innocent or irresponsible?

On one level it is self evident that continuing shareholders are not directly responsible for breaches of continuous disclosure. By their very nature continuous disclosure decisions are made exclusively by directors and senior officers. However, it remains arguable that continuing shareholders indirectly bear responsibility for directors’ actions by virtue of electing those directors. This argument obtains support from Lawrence Mitchell in the context of US securities class actions.\(^{71}\) Mitchell examines the historical role of the shareholder in the corporation, and concludes that the characterisation of continuing shareholders as ‘innocent’ is misguided. He asserts that a failure by shareholders to elect competent directors means that shareholders are complicit in any wrongdoing by those directors. It is on this foundation that he rejects the innocent shareholder theory posited by commentators such as Coffee and reaches the conclusion that “the innocent shareholder is, in fact, the irresponsible shareholder”.\(^{72}\)

Mitchell’s analysis therefore provides some support for the current New Zealand position on shareholder compensation. Under his analysis investors who own shares prior to and after a breach of continuous disclosure are indirectly culpable for the harm caused, by virtue of electing inadequate directors. It is therefore logical to conclude that those shareholders who buy in after a violation begins are not complicit in the failure to disclose and thus the company should compensate them for their loss. However, whilst this theory of corporate governance provides a starting point for analysis, there are a number of features which I argue make the distinction between these two classes of shareholders more illusory than real.

2.3 Shareholder control of listed companies: real or illusory?

Mitchell’s criticism of the ‘innocent shareholder’ is deeply rooted in a traditional conception of corporate governance.\(^{73}\) As the orthodox theory goes, shareholders surrender direct control of their capital to the company, which is in turn controlled by


\(^{72}\) Ibid, at 291.

\(^{73}\) H Hansmann and R Kraakman “The End of History for Corporate Law” (2001) 89 Geo LJ 439 at 440-441.
the directors. Any losses or gains suffered by the company are borne by the shareholders through an increase or diminution in share value. Shareholders retain ultimate control, however, through the election and removal of directors.

Whilst the validity of this theory generally holds in private firms with concentrated ownership, it provides an imperfect model for the modern publically listed company. Because ownership of listed companies is by nature highly diffuse, the level of control able to be exercised by individual shareholders is severely diminished.74

Whilst the New Zealand market does have significantly higher levels of ownership concentration than those in the US and UK,75 studies have indicated that this has not resulted in increased monitoring by shareholders. As Bhabra puts it “although companies in New Zealand have higher institutional and concentrated shareholdings, the overall effectiveness in their ability and, or, willingness to monitor is at best weak.”76

Furthermore, even where shareholders are capable of controlling directors the costs of doing so are often prohibitive.77 For example, even if shareholders were able to band together and replace a company’s board, the cost of doing so would almost certainly outweigh the benefits.78 Even for the largest institutional shareholders it is often not worth actively rallying against wayward directors, when instead shareholdings in a particular company can simply be divested. Indeed rather than incurring the significant costs of directly monitoring and controlling director conduct, skilled investors diversify their portfolios in an effort to limit their exposure to any one board of directors.79 If particular directors fail to perform, it is generally more rational for shareholders to sell down their shares in that company than attempt to replace the directors.

77 Bainbridge, above n 74, at 557-558; De Ano, above n 74, at 539-540.
78 Ibid.
79 De Ano, above n 74, at 539.
The impact of this is that shareholders in public companies often become little more than passive conduits of capital. This ‘shareholder passivity’ phenomenon has been recognised for many years, and has given rise to a number of competing theories attempting to describe the role of the shareholder in the modern public company.

One such alternative theory is that of director primacy. This model posits that directors maintain ultimate control of the company, but do so beneficially for the shareholders. Shareholder wealth maximisation remains at the heart of the directors’ objectives, but it is recognised that shareholders do not have any real input into the governance and control of the company. The application of this model to shareholder compensation serves to illustrate the arbitrariness of transferring wealth from one group of shareholders to another. Under this model no shareholder has practical control of directors. Thus it is fallacious to argue that ‘continuing’ investors are any more culpable for a breach of continuous disclosure than investors who purchase during the non-disclosure period. Mitchell’s rejection of shareholder innocence as basis for compensation therefore fails, as it does not take account of the reality that in a liquid capital market, shareholder control of directors is largely an illusion.

The director primacy model of governance is relevant to shareholder compensation in two main respects. Firstly, it erodes the conceptual distinction between shareholders who own shares prior to a disclosure violation and those who purchase during one, as both are equally complicit in the wrongdoing of directors. Secondly, it weakens the argument that shareholder compensation provides directors with incentives for compliance with the continuous disclosure regime. Because shareholders are largely impotent in controlling directors, their ability to induce director compliance with the regime is heavily diminished. This second argument will be addressed in more depth in the following chapter.

80 See for example the seminal publication on the separation of ownership and control: A Berle and G Means The modern corporation and private property (revised edition, Harcourt, Brace & World, New York, 1967)
81 Bainbridge, above n 74, at 573-574, 605. See also: B Black “Shareholder passivity re-examined” (1990) 89 Mich L Rev 520.
82 Bainbridge, above n 74, at 547-552.
83 Bainbridge describes directors as ‘platonic guardians’ in the sense that they act independently of, but beneficially towards, their shareholders: ibid, at 551.
84 Ibid, at 568.
However, even if the notion of shareholder primacy is rejected, there exist further reasons why shareholder compensation is arbitrary in its distinction between ‘continuing’ and ‘new’ investors.

2.4 The continuing nature of continuous disclosure violations

One such reason results from the fact that a continuous disclosure violation is an ongoing wrong rather than one arising out of a single event. The violation begins at the point that material information should have been disclosed and continues until disclosure is actually made. Therefore a shareholder who owns shares prior to a violation beginning is likely to be induced into holding those shares just as much as a ‘new’ investor is induced into buying them. This emphasises the arbitrary distinction between continuing and ‘new’ investors. Both groups suffer as a result of the non-disclosure, but the newer group of shareholders is able to claim the loss back from the company. The unfairness of such a distinction was recognised in the dissenting judgment of Callinan J in Sons of Gwalia v Margaretic at [255] (emphasis added):

…all of the shareholders at the time of the placing of SOG in administration have a fair claim to say that they have been equally wronged. Most could fairly and honestly say that they decided to hold on to their shares by, and on the faith of the deceptive conduct alleged... The consequence of all of that could be a very unfair and incoherent result...It would give only recent purchasers such as Mr Margaretic a very large advantage over other equally wronged, longer term members.

The ongoing nature of a continuous disclosure violation also undermines the orthodox corporate governance defence of compensation posed by Mitchell. Because a violation of continuous disclosure continues beyond the point that a ‘new’ investor purchases shares, for the duration of the non-disclosure period these ‘new’ investors are just as complicit in the directors’ wrongdoing as ‘continuing’ investors. Therefore even under an orthodox theory of corporate governance, all shareholders should be

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86 Coffee, above n 64, at 1560.
87 Sons of Gwalia v Margaretic [2007] HCA 1 at [255].
88 Mitchell, above n 71.
considered equally culpable for the violation and thus be expected to bear the same loss.

2.5 Distinguishing shareholder compensation from other forms of enterprise liability

A further argument for distinguishing between ‘continuing’ and ‘new’ investors is that shareholder compensation is conceptually the same as any other form of enterprise liability. Because new shareholders rely on the accuracy of information provided by the company, their claim is arguably the same as it would be under any other cause of action for which the company could incur liability.

Examples of these causes of action include vicarious liability for negligence, defective product liability and liability arising out of competition and consumer protection legislation. Each of these examples provide for situations where the acts of directors and managers result in the company (and thus its shareholders) being liable to pay compensation to a third party. Cox argues that these types of liability are “indistinguishable” from the liability that results from a failure to disclose material information. There are, however, two fundamental differences between these examples and shareholder compensation.

i) Comparison to other forms of enterprise liability

Firstly, each of the above examples concerns a wrong committed by the company against an entirely distinct third party, rather than against another group of shareholders. Take competition law as an example. If company A engages in illegal anti-competitive conduct which causes company B to suffer loss, it is clear that company B should be entitled to recovery. The rationale for the recovery is that

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90 Ibid, at 142-156.
91 See for example Commerce Act 1986, s 82
company A’s conduct has harmed company B and thus company A should be required to restore B to its former position.\(^{93}\)

However, the situation is different in the context of a securities law violation. The shareholder being compensated is not a ‘third party’ in the same sense as somebody who suffers loss as a result of a defective product or anti-competitive arrangement.\(^{94}\) Instead, by purchasing shares in the defendant company a shareholder voluntarily assumes the risk that the shares will devalue as the result of an unforeseen event. Such a risk is no different in nature from that associated with normal market fluctuations.\(^{95}\) Indeed all a violation of continuous disclosure does is postpone an inevitable drop in the company’s share price. Just as it would have been ‘bad luck’ if this loss had fallen on the investor who sold their shares during the non-disclosure period, so it is ‘bad luck’ for the investor who purchased these shares and suffered the loss when it did materialise. By contrast, a third party who is wronged by anti-competitive conduct or purchases a defective product has assumed no such risk. They are entirely innocent as against the company and thus not in a comparable position to a shareholder.\(^{96}\)

This discussion illustrates why shareholder compensation is distinguishable in principle from other forms of enterprise liability. However, it does not yet answer the normative question of whether the risk of non-disclosure should nonetheless rest with the company through enterprise liability.\(^{97}\) Cox also justifies compensation on this ground, arguing that it is appropriate for the company to internalise failures of disclosure rather than impose them on individual shareholders.\(^{98}\) This issue is addressed separately in chapter three.\(^{99}\)

\textit{ii) Comparison to other types of director misconduct}

Another way of distinguishing continuous disclosure violations from other forms of enterprise liability is by the nature of the wrongdoing which gives rise to the breach.

\(^{93}\) Coffee above n 64 at 1562. For a fuller analysis of the rationale for such a remedy see: P Birks “Rights, Wrongs and Remedies” (2000) 20 OJLS 1 at 12-14.

\(^{94}\) Coffee, above n 64, at 1562.

\(^{95}\) See further discussion above at 1.7.

\(^{96}\) Coffee, above n 64, at 1562.

\(^{97}\) Cox, above n 92, at 510-511.

\(^{98}\) Ibid.

\(^{99}\) See below at 3.1-3.2
Most conduct which gives rise to enterprise liability is undertaken in pursuit of profit maximisation for the benefit of shareholders. The same cannot be said for a breach of continuous disclosure. In this case, the delayed notification of material information provides no benefit to the company or its shareholders.\textsuperscript{100} Indeed, as noted above, ‘continuing’ shareholders also suffer harm from breaches of continuous disclosure, as they may be induced into holding their shares for a longer period than they otherwise would have.\textsuperscript{101}

Against this background it is possible to draw a distinction between two types of managerial decisions. Firstly there are ‘strategic’ decisions that are made with the goal of maximising profit, and thus shareholder value. Secondly, there are decisions which can under no circumstances benefit shareholders, and could only be made as a result of poor director decision-making or out of the self-interest of directors.

It is clear that on any model of corporate governance, shareholders must be responsible for strategic decisions made by the company’s directors. Whilst these decisions have the\textit{ objective} of maximising profit, it is self-evident this will not always materialise and shareholders are the appropriate group to bear any loss which results. Most forms of enterprise liability result from this type of decision. For example, if a company decides to manufacture a poor quality good which violates the Consumer Guarantees Act 1993, they do so to minimise their costs. Equally, if they drive another company out of business by abusing their market power in violation of the Commerce Act 1986, they do so in the hope of making monopoly profits. Just as the shareholders would be the ones to benefit if this conduct had gone undetected, so should they be the ones to pay the price when detection occurs.

However, the failure of a company to satisfy its continuous disclosure obligations cannot be said to be a strategic decision made to benefit shareholders. No shareholder with profit maximising objectives could condone a failure to comply with continuous disclosure, as the failure provides no benefit to the company. Coffee argues that the

\textsuperscript{100} Indeed the only ones who may benefit are the company’s directors. This may occur, for example, through performance based pay for meeting share price targets. See Coffee, above n 64, at 1562.

\textsuperscript{101} At the very least the practical effect of allowing compensation is that continuing investors suffer twice; first through the initial loss in share value when information is released, and second from the subsequent drop in value after compensation is paid.
only reason directors would intentionally fail to disclose would be out of their own self-interest,\textsuperscript{102} for example in order to maintain their directorships or receive performance based bonuses. In any case, the ‘continuing’ shareholder never stood to benefit, and thus there is no basis for distinguishing them from ‘new’ shareholders.

This analysis has demonstrated the theoretical fallacy in justifying shareholder compensation on the basis of ‘fairness’.\textsuperscript{103} The effect of compensation is to transfer investment losses between two equally innocent groups of shareholders. Both groups assumed the same risk that the value of their shares would diminish, and thus it is no fairer for ‘continuing’ investors to bear financial responsibility for the breach.\textsuperscript{104}

\textsuperscript{102} Coffee, above n 64, at 1562.
\textsuperscript{103} Fox, above n 85, at 302-303.
\textsuperscript{104} Coffee, above n 64, at 1556-1557, 1560.
III: Pragmatism vs Principle? Practical justifications for shareholder compensation

The discussion thus far has attempted to show why shareholder compensation arbitrarily distinguishes between ‘continuing’ and ‘new’ investors and thus results in an unfair pocket shifting effect. I will now move to question whether, even in light of this effect, there exist other policy justifications for shareholder compensation. I will seek to show that whilst some of these justifications have intuitive appeal, ultimately they do not overcome the strong efficiency arguments against maintaining the status quo.

3.1 Shareholder compensation as a means of achieving corrective justice

A key argument in support of shareholder compensation is that of corrective justice. There is a perception within society that investors who are wronged at the hands of another should be entitled to a remedy. Alicia Evans summarises this justification in the following way:

One of the fundamental tenets of our legal system is that when someone is harmed by the misconduct of another, she should receive compensation for her loss. The commission of securities fraud can lead to real human suffering, primarily in cases where retail investors are not properly diversified and lose virtually all of their savings because of an investment in a company engaging in fraud.105

The intuitive merit of this argument is clear. Society does not like the idea that an investor suffers loss as a result of a failure by directors to comply with a legal duty. Such an argument is particularly pertinent in the context of small retail investors, who are less likely to be diversified and thus suffer the full brunt of a share price drop. Given the increasing protection offered to these investors under securities law, there is clearly a strong argument that such investors deserve a remedy for their losses.106

However, even if consumer-investors are deemed a group worthy of such additional legal protection, on average even they are unlikely to benefit from compensation. Basic probability suggests a consumer-investor is just as likely to be on the losing side of a compensation payment as they are to be on the winning side. In reality though, consumer-investors are substantially more likely to pay compensation than they are to receive it. Because consumer-investors by their very nature trade less often than large sophisticated investors, they are on average less likely to be ‘buying’ shares than they are to be holding them. Thus whilst some individual consumer investors will be better off under a shareholder compensation regime, it is likely more will be worse off.

All this may be cold comfort to the individual retail investor who purchases shares at an inflated price, only to suffer a significant loss when information is finally disclosed. The plight of this investor must, however, be weighed against that of the consumer-investor who would be on the other side of a compensation payment. Such an investor (who may have purchased shares only a day before their compensated counterpart) will suffer not only the loss in value from the delayed disclosure, but also an additional loss as a result of the compensation. Thus even from a corrective justice perspective, the status quo proves undesirable.

3.2 Is shareholder compensation justifiable as a loss-spreading device?

Another defence of shareholder compensation is that it provides a means of spreading loss across a wider number of investors, essentially operating as a form of mandatory insurance for the risk of non-disclosure. Thus if 20% of ‘new’ shareholders are compensated by the company for their $0.25 loss in share value, their loss will be

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107 Coffee, above n 64, at 1559-1560.
108 Ibid.
109 Ibid.
111 Even proponents of corrective justice such as Evans concede that compensation in its current form is ineffective in achieving this. She posits an alternative means of compensation which is discussed below at 4.2.
112 J Park “Shareholder Compensation as Dividend” (2009) 108 Mich L Rev 323 at 340. An explanation and rejection of this rationale is provided in Fox, above n 85, at 304-305.
spread across all shareholders, each of whom will bear $0.05 of the loss.\textsuperscript{113} Such loss-spreading sounds intuitively appealing, until it is remembered that the other 80% of shareholders also lost $0.25 per share, and following a compensation payment will lose $0.30. Given the above discussion arguing that both groups of shareholders assumed the same risk of such a loss occurring, it is entirely equitable for each shareholder to suffer the same $0.25 loss. On this reasoning, the losses of the ‘new’ shareholders have not been \textit{spread} but merely \textit{shifted} to another group who already suffered the same loss in share value.

Even if it conceded that the loss suffered by ‘new’ shareholders should be spread amongst a wider group of investors, compensation does not necessarily achieve this. Indeed loss spreading requires that the ‘continuing’ shareholder group is large relative to the ‘new’ shareholder group. If it is not, then the bulk of the losses will simply be spread amongst the same investors, completely negating the loss spreading effect. Thus if the above scenario were turned on its head and 80% of shares were traded over the non-disclosure period, then $0.20 of the $0.25 recovered by each defrauded investor would have been funded by themselves.\textsuperscript{114} By the time legal fees are subtracted from this, it is likely the actual recovery will be nominal. Given that many non-disclosure violations often occur over a significant period of time,\textsuperscript{115} it is at least reasonably likely that the size of the compensation claiming class will be significant. Merrit Fox provides some evidence that this may be so, indicating that in the US context the loss spreading rationale is often confounded by the relatively high proportion of shareholders in the compensation claiming class.\textsuperscript{116}

3.3 \textbf{Does shareholder compensation actually compensate victims?}

At its most basic level, the objective of the shareholder compensation provisions is to compensate those who suffer loss from a failure to disclose.\textsuperscript{117} It is therefore self-

\begin{itemize}
\item \textsuperscript{113} This is calculated by: $0.25 \times (20\%) = \$0.05$. This loss manifests in a $0.05$ reduction in the value of each share.
\item \textsuperscript{114} This occurs because the $0.25$ compensation payment is paid to 80\% of shareholders, with the cost of such payment reflected through a reduction in the company’s value. Because the loss is spread over only 20\% more shareholders, the likely diminution in share value is only slightly less than the compensation payment made.
\item \textsuperscript{115} Fox, above n 85, at 304-305.
\item \textsuperscript{116} Ibid.
\item \textsuperscript{117} Cabinet Economic Development Committee, “Review of Securities Trading Law: Penalties and Remedies” (cabinet paper, 27 January 2006) at [31].
\end{itemize}
evident that this objective must be satisfied in order for these provisions to remain part of New Zealand securities law. Whilst the provision remains as yet untested in New Zealand, there exists a significant volume of both theoretical and empirical evidence to suggest that similar rights of compensation overseas have been ineffective at providing compensation for defrauded investors.

A key hindrance to effective compensation is the cost of enforcement. As noted in chapter one, the cost of taking individual compensation claims against the company is almost always prohibitive. Even if the value of a claim is sufficiently large to warrant legal action, the costs associated with this are likely to substantially reduce the actual compensation received. This is compounded by the fact that investors incur these costs twice.118 Because it is the company being sued, an investor must bear the cost of their own action, as well as indirectly paying a portion of the company’s costs. Such a method of transferring wealth between shareholders is highly inefficient, as it results in a loss of economic welfare to all shareholders regardless of which group they fall into.

In Australia and the US, investors can pool individual compensation claims and take a class action against the company. These securities class actions are so prevalent in the US that they have been described as an “800-pound gorilla”.119 A similar trend is emerging in Australia, where the number of securities class actions has increased rapidly over the last five years.120 However, despite being prolific in number, the compensation that investors ultimately receive from these actions is generally very low. One 2011 report estimates that in 2010 US securities fraud cases reclaimed just 6.8 percent of the actual losses incurred by investors in those cases.121

There are a number of likely reasons for this low recovery rate. The first of which is the clear incentive for class actions to settle, rather than go to trial.122 Because trials are expensive and risky, litigation funders can maximise their own return by settling

118 Fox, above n 85, at 306.
119 Coffee, above n 64, at 1539.
121 L Simmons and E Ryan “Securities class action settlements, 2010 review and analysis” (2011) Cornerstone research report at 6. (Finding settlements represent a median 6.8% of "estimated damages" in 2006 and 9.0% of "estimated damages" in 1996-2005).
122 Bratton and Wachter, above n 65, at 23.
cases without incurring the expense and risk of a trial. Thus in order for shareholders to achieve any recovery, they generally must accept a settlement. This is compounded by the fact that directors also have a strong incentive to settle. Given the potential that they may incur personal liability (not to mention public embarrassment) at trial, they are clearly motivated to settle on behalf of the company. These incentives ultimately mean that securities class actions rarely see the inside of a courtroom, and thus settlements are rarely anywhere near the full value of the loss suffered.

It is true that such criticism derives specifically from the operation of class actions, rather than shareholder compensation per se. However the reality is that the vast majority of compensation cases will need to be taken via a class action if they are to be taken at all. Thus, to the extent that the two are inextricably linked, the flaws of class actions are also flaws of shareholder compensation.

The only other way compensation actions are likely to occur is if they are taken by the FMA on behalf of shareholders. Such actions are, however, likely to incur many of the same barriers to compensation as class actions. In Nuplex for example, the Securities Commission spent over two years investigating and negotiating a settlement with the company and its directors. Corporate lawyers Bell Gully acted for Nuplex and drafted the eventual settlement agreement. In addition to the compensation payment, Nuplex paid just under $150,000 as a “contribution” to the Commission’s legal and investigative costs. It is therefore likely that the combined legal costs incurred by the Commission and Nuplex ran substantially above $300,000, or more than 10% of the settlement itself. Such figures illustrate that

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124 Black, above n 123, at 1099.
125 See above discussion at 1.4.
127 Ibid.
128 Ibid, at [3].
129 It is speculative to estimate the costs beyond this point, but given the involvement of corporate lawyers and the Commission over a two year period it seems highly probable that actual costs were much higher.
even in a public action, settlement costs substantially erode the value of the company
for all shareholders.

Ultimately, the only consistent winners from shareholder compensation are likely to
be the lawyers and litigation funders who drive the actions. Whilst concerns about the
involvement of these institutions in New Zealand may seem speculative, the
Australian experience has demonstrated that such an industry can develop extremely
rapidly.\textsuperscript{130} Indeed New Zealand has already witnessed the involvement of litigation
funders in the Feltex litigation,\textsuperscript{131} as well as a number of insolvency cases, indicating
a willingness from the industry to enter the New Zealand market if conditions become
favourable.\textsuperscript{132}

3.4 The enforcement value of shareholder compensation

Despite the flaws in shareholder compensation as a compensatory tool, it remains
arguable that compensation nonetheless acts as an effective means of enforcing
continuous disclosure obligations.\textsuperscript{133} Whilst the primary rationale for introducing
compensation orders in New Zealand was a compensatory one,\textsuperscript{134} Cabinet at the time
also recognised their value as a means of enforcing compliance with the continuous
disclosure regime.\textsuperscript{135} It therefore needs to be examined whether compensation orders
are an effective means of achieving compliance.

As discussed in chapter one, New Zealand securities law is mainly enforced by a
public regulator – the FMA. This is primarily due to the inability of shareholders to

\textsuperscript{130} Houston et al, above n 120, at 4.
\textsuperscript{131} \textit{Saunders v Houghton} [2009] NZCA 610, at [21] –[34]. (discussing the principles to be
applied in determining whether to allow involvement of a litigation funder).
\textsuperscript{132} See for example: A Zhou, “Funding Litigation” \textit{NZ Lawyer}, (New Zealand, issue 132, 19
March 2010); L Craymer “Private funder Quantum Litigation enters NZ Market” \textit{National
Business Review} (New Zealand, May 22 2009) <http://www.nbr.co.nz/article/private-funder-
quantum-litigation-enters-nz-market-102729>; J Gray “Lawyers eyeing class actions for
investors” \textit{New Zealand Herald} (New Zealand, 24 May 2011)
\textsuperscript{133} Coffee, above n 64, at 1547.
\textsuperscript{134} Cabinet Economic Development Committee, above n 115, at [31], [33].
\textsuperscript{135} Ibid, at [5]: Noting that the aim of the civil remedy provisions is to: “to prevent harm,
remedy a situation when harm has been suffered and to deter. They also aim to compensate
individuals for harm caused by the prohibited conduct.”
bring class actions in New Zealand. However overseas experience gives some insight on the likely effectiveness of private enforcement if this barrier were to be removed.

It is interesting to note that in the United States, shareholder compensation emerged primarily as a tool of enforcement, rather than a means of compensating victims. In fact shareholder compensation represented a pragmatic judicial response to under enforcement of securities law obligations.\textsuperscript{136} Given the limited resources of the Securities and Exchange Commission (SEC)\textsuperscript{137} to chase securities law violators, the US Supreme Court reasoned that private actions were needed to boost enforcement. On this basis the Court in \textit{J.I Case Co. v Borak}\textsuperscript{138} implied a right to claim compensation for breaches of the Securities Exchange Act, holding that “private enforcement of the proxy rules provides a necessary supplement to Commission action.”\textsuperscript{139} From the outset this rationale appears less applicable in a New Zealand context. Whilst there has been some criticism that the FMA’s predecessor (the Securities Commission) suffered from under-resourcing,\textsuperscript{140} there is little hard evidence to suggest that this has led to an inability to enforce continuous disclosure obligations.\textsuperscript{141} Furthermore, a recent increase in funding for the FMA is likely to further ensure continuous disclosure obligations are adequately enforced.\textsuperscript{142}

However, even if more enforcement is required, shareholder compensation remains a highly inefficient means of achieving it. In order to be an effective enforcement tool, compensation must provide a deterrent for directors and officers to violate the regime. But because it is the company who is primarily liable for a continuous disclosure violation, directors suffer very little by way of direct financial detriment. Although directors may attract secondary liability, it is highly unlikely investors will pursue

\begin{footnotesize}
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\item\textsuperscript{136} Bratton and Wachter, above n 65, at 9.
\item\textsuperscript{137} The SEC is the public regulator responsible for US Securities Markets.
\item\textsuperscript{138} \textit{J. I Case Co. v. Borak} 377 US 426 (1964).
\item\textsuperscript{139} Ibid, at 432.
\item\textsuperscript{140} M Prada and N Walter “Report on the effectiveness of New Zealand’s Securities Commission” (September 2009) at 29; N Kloeten “Securities Commission toothless, under-resourced” \textit{National Business Review} (September 24 2009) <http://www nbr co nz/article/seccom toothless and under resourced report says 111708>.\textsuperscript{141}
\item\textsuperscript{141} In fact anecdotal evidence suggests the opposite to be true, with the FMA quickly asserting its willingness to investigate continuous disclosure violations by investigating market operator NZX: Financial Markets Authority, “FMA completes NZX inquiry” (press release, 3 August 2011).
\item\textsuperscript{142} The FMA has received a 44% increase in funding beyond the level of the Securities Commission: S Power “Cabinet approves funding for FMA” (press release, 20 April 2011).
\end{itemize}
\end{footnotesize}
directors rather than the company. The company will almost certainly have deeper pockets, and thus provide a more fruitful target for litigation. Such a phenomenon has been empirically observed in the US, where directors made out of pocket payments in only 13 of 1754 securities fraud settlements between 1980 and 2004.\textsuperscript{143} Furthermore, only one of these settlements involved the directors of a solvent company, indicating directors will generally only be targeted when company funds are exhausted.\textsuperscript{144} In New Zealand, the \textit{Nuplex} settlement provides further confirmation of this trend, with even the public regulator willing to drop civil action against directors in return for settlement by the company.\textsuperscript{145}

Of course the absence of direct financial liability for directors does not necessarily mean that shareholder compensation has no deterrent effect. In fact it is arguable that the harm to directors’ reputations which results from a violation is just as strong a deterrent as direct financial liability.\textsuperscript{146} Evidence that this reputational effect occurs, however, is mixed.\textsuperscript{147} Using remuneration and future board appointments of directors involved in securities fraud settlements as a proxy for the reputational impact of a violation, studies in the US have purported to identify both a positive\textsuperscript{148} and negative effect on director reputation respectively.\textsuperscript{149} Such results indicate that if a reputational effect does exist, its influence is relatively low. Interestingly however, both studies concluded that when only directors who were involved in SEC sponsored litigation were included, a negative effect on director reputation was identified.\textsuperscript{150} This provides an indication that for the most serious violations (where the public regulator’s involvement is warranted) directors \textit{will} suffer reputational harm.

\textsuperscript{144} Ibid, at 1074.
\textsuperscript{145} \textit{Nuplex} above n 126.
\textsuperscript{148} Helland, above, n 147, at 375.
\textsuperscript{149} Fich, above n 147, at 317.
\textsuperscript{150} Helland, above n147, at 384-385.
But if directors only suffer reputational harm in cases serious enough to warrant intervention by the public regulator, then by definition private actions serve little to no deterrent function. Indeed this simply supports the notion that a public regulator has sufficient power to enforce duties without the need for supplementary private actions. Given that the FMA already has the power to impose pecuniary penalties and management banning orders on directors, there seems little justification for this to be supplemented by private actions which are unlikely to cause any additional reputational harm.

Another factor which calls into question the effectiveness of reputational harm as a deterrent to non-disclosure is the fact that director selection is not solely a product of a director’s disclosure record. Indeed a director who persistently fails to comply with the continuous disclosure regime may nonetheless be an incredibly effective profit generator for the company in other respects. Thus a director who costs the company millions in compensation payments for continuous disclosure violations may make millions more for the company by being a strategic genius. In many instances there is therefore likely to be a conflict between the public interest in directors who are effective at disclosure, and the shareholders’ interest in directors who maximise profit. Such a phenomenon is likely to further ‘blunt’ the effect of compensation as an enforcement tool, as a director’s disclosure record is only one factor in determining their suitability for directorship.

Using shareholder compensation as a means of enforcing compliance also raises issues regarding the role of civil law. Critics of compensation argue that the civil law is an inappropriate mechanism to enforce compliance with what are essentially public

151 An example of this is Andrew Forrest, who was alleged to have persistently been involved in continuous disclosure violations in relation to Australian mining company Fortescue Metals. Threatened with a banning order, one financial reporter noted: “Mr Forrest is the driving force behind Fortescue, so banning him from the board and management would be a much bigger blow to shareholders than a fine.”; M Chambers “Forrest bides his time on appeal until he knows penalty” The Australian, (February 21, 2011) <www.theaustralian.com.au/business/forrest-bides-his-time-on-appeal-until-he-knows-penalty/story-e6frg8zx-122609072427>

152 It should be clarified that such a conflict derives not from shareholders benefitting from the non-disclosure (as non-disclosure hurts all shareholders), but rather from other benefits provided by these directors outweighing the harm from non-disclosure.
duties.153 Particularly in the context of continuous disclosure, which is in essence a
duty owed to the market at large, private enforcement is arguably not a desirable
means of ensuring compliance. Such criticisms are compounded by the fact that
compensation is awarded against the company rather than the directors and officers
who committed the wrongful acts. John Coffee uses the following analogy to describe
this criticism:

Thus, enterprise liability in this context is a strategy akin to punishing the victims of
burglary for their failure to take greater precautions. Although this strategy might
produce some enhanced monitoring, it offends social norms, including the public's
basic sense of fairness, to punish the victim for conduct that it did not cause.154

In this sense, compensation essentially uses shareholders as a ‘means to an end’ in
order to achieve compliance. Punishing the innocent because they have some ability
to effect a change in director behaviour is at best inefficient and at worst contrary to
basic principles of justice.155 This is further emphasised by the practical inability of
shareholders to effect managerial change in public companies, as discussed in the
chapter two.156

All this emphasises the point that, at best, shareholder compensation is a blunt
instrument for enforcing disclosure. Whilst not entirely ineffective, using shareholders
as a means of modifying director conduct can best be described as a ‘scattergun’
approach to enforcement. As will be discussed further in the following chapter, the
FMA’s ability to directly target directors is likely to be a far more focussed and
efficient method of achieving enforcement objectives.

3.5 The economic inefficiency of shareholder compensation

Aside from the effect of shareholder compensation on investors themselves, it is also
useful to consider the effects of compensation on economic welfare more generally.

153 M Kirby “Class Actions and Corporations” (paper presented to The Association of
Corporate Solicitors in Victoria, April 1979) at 11-12; J Donnan “Class Actions in Securities
Fraud in Australia” (2000) 18 C&SLJ 82, at 86.
154 Coffee, above n 64, at 1562.
155 Donnan, above n 153, at 86.
156 See discussion above at 2.3; A Evans “The Investor Compensation Fund” (2007) 33 J Corp
L 223 at 239.
From an economic perspective, the efficiency of compensation is measured only by its effect on net social welfare.\textsuperscript{157} Net social welfare does not take into account the distribution of welfare between different economic participants, but only on the overall level of welfare within an economy.\textsuperscript{158} When measured against this standard, shareholder compensation again does poorly. This is due to the fact that the ‘loss’ suffered by a defrauded investor is not a loss at all from an economic perspective. Because the investor who sold the shares at an inflated value made a gain equal to the loss suffered by the defrauded investor, overall social welfare remains the same.\textsuperscript{159} In this sense, there are no net losers and therefore no prima facie economic case for compensation.\textsuperscript{160}

Using compensation to shift the distribution of wealth between these parties incurs transaction costs in the form of legal and investigative fees. These costs represent a loss in efficiency (as all shareholders are worse off), and thus result in a reduction in net social welfare. As Langevoort puts it, compensation causes a “total deadweight social loss”.\textsuperscript{161} Given that the core purpose of a securities market is to efficiently allocate capital,\textsuperscript{162} it is difficult to see how shareholder compensation provides a worthy addition to securities law when it directly undermines this purpose.

There is, however, one limitation to this economic analysis. As Fischel and Easterwood note the net social welfare loss from a failure to disclose is not entirely zero.\textsuperscript{163} This is due to the fact that a failure to disclose causes a reduction in investor confidence. Because the efficiency of the market relies on investors having

\textsuperscript{159} Easterbrook and Fischel above n 157, at 641.
\textsuperscript{160} The ‘net social welfare’ test to efficiency may seem overly harsh to certain parties, due to the fact that it ignores the distribution of welfare between different economic actors. However, such an approach is not new to New Zealand commercial law and is the method used to assess authorisation applications under the Commerce Act 1986. See: Commerce Commission, “Guidelines to the analysis of public benefits and detriments” (1997) at 14.
\textsuperscript{161} D Langevoort, “Capping Damages for Open Market Securities Fraud” (1996) 38 Ariz L Rev 639 at 651.
\textsuperscript{163} Fischel and Easterwood, above n 157, at 641.
confidence that there is not undisclosed information, such a loss in confidence reduces efficiency and thus reduces net social welfare.\textsuperscript{164}

However, there remains little to no link between the value of investors’ out of pocket ‘losses’ and the economic value of the market’s loss in confidence.\textsuperscript{165} The losses are independent of each other, and therefore compensating investors is a crude means of restoring market confidence. It is rather like saying that compensating victims of road crashes will increase driver confidence by reducing the number of crashes that occur. Such action may indeed reduce crashes somewhat (by providing incentives for drivers to take more care), but will likely be far less effective at improving driver confidence than building safer roads and publically censuring dangerous drivers (as these target the \textit{actual cause} of the crashes).

The disconnect between market confidence and out of pocket losses may be illustrated in an example. Imagine two equally sized companies listed on a sharemarket – Company A and Company B. It is self-evident that Company A’s failure to disclose material information for a one month period is likely to diminish market confidence just as much as if Company B failed to disclose over the same period. However, imagine twice as many shares in Company A happened to be traded over the non-disclosure period. In that case Company A would be liable to pay twice as much compensation as Company B, despite causing the same reduction in market confidence. Langevoort observes that this phenomenon is likely to cause ‘overcompensation’, as the amount required to remedy the market’s loss in confidence will generally be less than the ‘loss’ suffered by defrauded investors.\textsuperscript{166}

As I will go on to show in the following chapter, public enforcement of disclosure obligations is itself sufficient to remedy the loss in market confidence resulting from non-disclosure. Such a regime is more economically efficient, as it can be tailored to restore market confidence without the deadweight loss attached to shareholder compensation.

\textsuperscript{164} Fischel and Easterwood, above n 157, at 641-642.
\textsuperscript{165} Langevoort, above n 161, at 652.
\textsuperscript{166} Ibid, at 646.
IV: Where to from here? Alternatives to shareholder compensation

Having discussed a number of the objections to shareholder compensation, the focus now shifts to alternatives. This chapter will first provide a critical analysis of the compensation regimes operating in the United Kingdom and Singapore. These jurisdictions have been selected as they offer unique alternatives to the shareholder compensation regime currently operating in New Zealand and Australia. In addition, the UK has recently assessed the desirability of compensation for disclosure violations, and as such has had cause to consider the significant academic criticism of compensation in the United States. The chapter will then discuss other alternatives to the status quo and attempt to recommend an appropriate regime for New Zealand.

4.1 Comparative international approaches to compensation

i) United Kingdom

The UK operates a system of both continuous and periodic disclosure for listed companies.\(^{167}\) The regime has a statutory basis in Section 96A of the Financial Services and Markets Act 2000, with full disclosure requirements set out in rules\(^{168}\) issued by the Financial Services Authority (FSA).\(^{169}\) The current rules impose an obligation on companies to disclose ‘inside information’ that is likely to affect the company’s share price.\(^{170}\) The provisions have their genesis in a European Union (EU) disclosure directive aimed at strengthening and harmonising corporate disclosure requirements across Europe.\(^{171}\)

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\(^{168}\)FSA Disclosure and Transparency Rules (UK) 2, 4.

\(^{169}\)The Financial Services Authority (FSA) is the public regulator of financial services in the UK, and fulfils a broadly similar role as the New Zealand FMA.


The mechanisms of enforcing disclosure have a number of parallels to the New Zealand regime. Primary enforcement responsibility lies with the FSA, with private enforcement largely restricted by the inability to bring class actions.\(^{172}\) Nonetheless section 90A gives investors a right of action against an issuer who fraudulently makes an incorrect disclosure, or dishonestly delays the making of a disclosure.\(^{173}\) The rationale for this enforcement regime was assessed in the 2007 Davies Report on Issuer Liability. Amongst other things, the Davies Report addressed whether or not public issuers should be liable to compensate investors for a failure to comply with continuous disclosure obligations.\(^ {174}\) The report considered many of the objections to issuer liability addressed in this dissertation, including the ‘pocket-shifting’ effect of compensation.\(^ {175}\) It acknowledged the merit in these arguments, and on this basis rejected strict liability or negligence as a basis for issuer liability. However, the report nonetheless recommended compensation be available when fraud\(^ {176}\) was the reason for a failure to disclose.\(^ {177}\) The report noted that although the pocket-shifting effect still occurs in cases of fraud, it was justifiable on the following rationale:

…it can be said that fraud is so corrosive of the basic trust on which the market operates that civil liability for such statements performs a valuable public function in deterring fraud; and that the absence of liability in damages for fraudulent misstatements would fail to meet the legitimate expectations of investors, as the current common law recognises. Moreover, fraud being less prevalent than negligence, even long-term investors may not think that, over a reasonable period of time, their gains from fraudulent statements will outweigh their losses.\(^ {178}\)

The report therefore concedes the circular nature of civil liability as a compensatory tool, but reasons that it is nonetheless justified as a means of maintaining market confidence in the very worst cases of non-disclosure. Such an argument is perhaps


\(^{173}\) Financial Services and Markets Act 2000 (UK), s 90A.

\(^{174}\) Davies, above n 172, at [7]-[18].

\(^{175}\) Ibid, at [7]-[8], [15]-[16].


\(^{177}\) Davies, above n 172, at [17]-[19].

\(^{178}\) Ibid, at [22].
more theoretically appealing than practically sound. Whilst there can be no doubt that fraudulent non-disclosure is likely to be more harmful to market confidence than negligent non-disclosure, there exists little to no correlation between the level of out-of-pocket losses incurred by investors and the harm done to market confidence.\(^{179}\)

This weakness is compounded by the report’s recommendation that directors should not attract personal liability for non-disclosure.\(^{180}\) The rationale being that such liability is likely to either over-deter or, if indemnity insurance exists, provide no deterrent effect.\(^{181}\) Such concerns may be valid in the context of negligent non-disclosure, but where the standard is fraud it is difficult to imagine how such conduct could be ‘over-deterred’. Perhaps more convincingly, the report notes that the FSA has the power to issue its own public censure and pecuniary penalties against directors, which provide a more desirable means of controlling director conduct than civil liability.\(^{182}\)

Another interesting feature of the English regime is that remedies for non-disclosure are available for investors who hold shares over a non-disclosure period, as well as those who buy and sell.\(^{183}\) This avoids the arbitrary distinction between these groups of investors identified in *Sons of Gwalia* and discussed in Chapter two.\(^{184}\) Whilst the Davies Report did not recommend the inclusion of holding shareholders, the Government nonetheless found the distinction between buying, selling and holding investors to be illusory and thus included them in a 2010 amendment.\(^{185}\) It should be noted however, that investors must show they relied on the information in a misleading disclosure in order to claim compensation. Such a requirement is likely to be very difficult for a holding investor to satisfy in a practical sense,\(^{186}\) but their inclusion nonetheless improves the consistency of the regime.

Overall, the English approach suffers from the same circularity problem which plagues the New Zealand, Australian and US regimes. One group of shareholders

\(^{179}\) See above at 3.5.
\(^{180}\) Davies, above n 167, at [25].
\(^{181}\) Ibid, at [26].
\(^{182}\) Ibid, at [25].
\(^{183}\) HM Treasury “Extension of the statutory regime for issuer liability: a response to consultation” (March 2010) [5.1] – [5.9].
\(^{184}\) See discussion above at 2.2.
\(^{185}\) HM Treasury, above n 183, at [5.7].
\(^{186}\) Ibid, at [5.9].
compensate another, with substantial transaction costs reducing the net welfare of both groups. However, the use of a fraud standard for compensation is an improvement on the strict liability approach applied by New Zealand. Such a standard limits shareholder actions to those where the acts of the company are clearly wrongful, as opposed to merely a strict liability violation of the continuous disclosure regime. Similarly, there is arguably merit in the notion that because fraudulent non-disclosure is likely to be rarer than circumstances where it is accidental, it is not truly capable of being avoided through diversification.

**ii) Singapore**

Singapore also operates a system of continuous disclosure for listed issuers. Like New Zealand, the Singaporean continuous disclosure provisions are largely modelled on the Australian regime. Section 203 of the Securities and Futures Act provides that listed companies must disclose information as required by the listing rules of the market operator. This obligation primarily lies with the company, however secondary liability also exists against officers involved in a contravention. However, unlike the current New Zealand and Australian regimes where strict liability exists, contravention of the Singaporean provisions requires intention, knowledge or recklessness.

The provisions are primarily enforced through a public regulator—the Monetary Authority of Singapore (MAS). Like the FMA in New Zealand, the MAS is empowered to seek both civil and criminal penalties against violators of the regime. Criminal liability applies to individuals where a contravention is intentional or reckless and sanctions are severe, with penalties of up to 7 years imprisonment and/or

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187 Securities and Futures Act (Singapore), s 203.
188 W Wan “Civil Liabilities for false or misleading statements made by listed companies to the securities market in Singapore” (2008) 26 C&SLJ 377 at 380, footnote 22.
189 Securities and Futures Act (Singapore), s 331 (1). The Section attributes secondary liability where a violation is committed with the “consent or connivance of, or to be attributable to any neglect on the part of an officer of the body corporate”.
190 The Australian equivalent s 1001A originally required this standard but, like the New Zealand provisions, have since been modified to apply strictly to any non-disclosure of material information.
191 Securities and Futures Act (Singapore), s 204. Individual civil pecuniary penalties may be sought under s 232.
up to S$250,000 in fines.\textsuperscript{192} Civil penalties against the company can range from between S$50,000 and S$2 million.\textsuperscript{193}

With the exception of criminal sanctions, these public enforcement powers are largely similar to those in New Zealand. However, the most unique feature of the Singaporean system is the means by which compensation can be obtained by investors. Rather than giving investors a right of action against the company itself, the regime allows investors who suffer as a result of non-disclosure to reclaim their losses from the investor that gained.\textsuperscript{194} The Act uses the concept of ‘contemporaneous trading’ as a means of approximating which parties traded with each other.\textsuperscript{195} This attempts to solve the anonymity problem identified in chapter one, whereby in a sharemarket all trades occur through a centralised clearinghouse with no direct contact between buyer and seller.

At first glance this system seems to solve the core theoretical problem with shareholder compensation. Rather than shifting wealth from one innocent group of shareholders to another, the regime disgorges the gains of those who profited from the non-disclosure. In this sense it attempts to recreate what would have occurred if the material information had been disclosed when the company was legally required to do so.

Despite the ‘theoretical purity’ of such a regime, on closer examination the model begins to crumble. Its first limitation is that it only allows compensation to be obtained from investors who possess \textit{inside information} which led them to sell their shares over the non-disclosure period.\textsuperscript{196} Such a restriction renders it extremely difficult for an investor to ever successfully obtain compensation. Even with the wide

\textsuperscript{192} Securities and Futures Act (Singapore), s 204. NB: S$1 is worth circa NZ$1 as at 22 September 2011.
\textsuperscript{193} Securities and Futures Act (Singapore), s 232(3). For an example of the application of this penalty regime see: H Tjho “Enforcing Corporate Disclosure” (2009) Sing JLS 332 at 339.
\textsuperscript{194} The Act uses the concept of ‘contemporaneous trading’ as a means of approximating which parties traded with each other. The regime is based on the US system, however Singapore has been chosen as a comparison as, like New Zealand, they operate a continuous disclosure regime for listed issuers. By contrast the US requires only periodic disclosure under Rule 10-5b. For the origins of the Singapore compensation regime see: L Joyce “‘Americanisation’ of the civil liability regime for insider trading in Singapore” (2005) 23 C&SLJ 396.
\textsuperscript{195} The legislation sets out a number of factors to be considered by the Court in determining whether trading is contemporaneous, see: Securities and Futures Act (Singapore), s 234 (5) (c). See also Joyce, above n 194, at 399 – 402.
\textsuperscript{196} Securities and Futures Act (Singapore), s 234 (1).
investigative powers available to the Securities Commission and now the FMA, there have been no public prosecutions for insider trading in New Zealand since the regimes inception in 2006. It thus seems highly unlikely that investors would be able to prove such conduct, a weakness confirmed by the absence of any successful private actions under the Singaporean provisions.197

A further limitation is that the regime makes an apparently arbitrary distinction between investors who incur a loss by trading with a counterparty who possesses inside information and investors who trade with one who does not. There is no clear justification (from the perspective of the losing investor) as to why the former should be entitled to recovery while the latter is left empty handed.198

Overall, the Singaporean regime provides some useful insights for New Zealand. The absence of issuer liability for disclosure violations avoids many of the efficiency and circularity issues suffered in the US and Australia. Furthermore, the availability of strong public sanctions against directors and officers who violate the regime is likely to deter non-compliance and thus strengthen investor confidence.

4.2 The investor compensation fund

Another alternative to the current system of investor compensation is the establishment of a fund to compensate investors who suffer from violations of the continuous disclosure regime. Alicia Evans has proposed the establishment of such a fund in the US, and the following discussion is based loosely on the structure she proposes.199 Such a fund would essentially operate as a form of mandatory insurance against the risk of non-disclosure. Each time shares are traded on the secondary market a small fee would be deducted and held in a centralised account, perhaps

197 Wan, above n 188, at 378.
198 Booth suggests remediying this inequity by giving the issuer company, rather than a contemporaneous trader, the right to sue an insider. This prevents the arbitrary distinction between those who trade with insiders and those who do not. It does not, however, solve the fundamental difficulty in proving insider trading. See R Booth “The Paulson Report Reconsidered: How to Fix Securities Litigation by Converting Class Actions into Issuer Actions” (2008) Villanova University School of Law working paper no. 94 at 8-10.
operated by the FMA. 200 When an investor suffers loss from non-disclosure, they can call on the fund and receive compensation for their loss.

The key benefits of this approach are two-fold. Firstly, undiversified investors are able to receive full compensation for their out-of-pocket loss. The regime therefore satisfies the ‘corrective justice’ rationale for compensation discussed in the previous chapter. 201 Given the inability of most investors to obtain compensation under the status quo, it is likely that a fund would substantially increase the availability of compensation to investors who suffer from non-disclosure. The flow-on effect of this is likely to be a substantial increase in the level of confidence on the part of undiversified investors.

Secondly, a mandatory insurance scheme has the effect of spreading the burden of non-disclosure across all market participants, rather than placing it entirely on the innocent shareholders of the non-disclosing company. This is desirable as it reflects the notion that some degree of non-compliance is an inherent feature of a strict liability continuous disclosure regime. 202 Given that this non-disclosure represents a structural failure of the market itself, it is fair that the losses resulting from it are distributed equally between all market participants.

Despite these benefits, however, such a fund suffers from some clear drawbacks. Perhaps the most obvious of these is the significant expense involved in establishing and administering such a regime. Evans defends this high cost in a US context on the basis that it is likely to be no higher than the existing cost of securities class actions. 203 Given that a compensation fund is a fairer and more efficient method of compensating investors than class actions, she concludes that such costs are justifiable. 204

However, this justification is less persuasive in New Zealand, which has not yet succumbed to the culture of securities class actions which plagues the US. Given the

200 Evans suggests the SEC as the administrator of such a regime: Ibid, at 241.
201 See above at 3.1.
203 Evans, above n 199, at 248-249.
204 Ibid.
relative infancy of shareholder compensation in New Zealand there is wide scope to enact a regime which entirely avoids such costs, and thus no impetus to accept a regime that is only relatively more desirable than the status quo.

Furthermore, whilst the regime provides obvious benefits to undiversified investors, the regime is likely to provide no benefit to those who are adequately diversified.\(^\text{205}\) Despite this, all investors would be subject to the trading fee and thus be required to fund the operation of such a scheme. The implication of this is that the fund operates at the expense of all market participants, for the benefit of only those who are not diversified.\(^\text{206}\) Such criticism is compounded by the fact that a compensation fund creates a ‘moral hazard’, as investors no longer need to protect themselves against the risk of non-disclosure. This moral hazard occurs because such a scheme provides no incentive for investors to diversify, as they will receive compensation regardless. Given that they could have mitigated the risk at no cost by diversifying, such an effect creates a deadweight loss.

On balance, despite arguably providing a more effective method of spreading the losses that result from non-disclosure, an investor compensation scheme does not provide a desirable alternative for New Zealand. The inefficiencies inherent in such a regime ultimately render it a second best alternative to abolishing a right to shareholder compensation altogether.

4.3 Preventing investor losses without compensation

Despite their differences, the above models all remain premised on the notion that an investor who suffers an out of pocket loss should be entitled to compensation. However, in attempting to achieve this objective all alternatives ultimately suffer the same problem – they impose a substantial deadweight loss on the market in the form of transaction costs. Indeed, regardless of how fairly and efficiently compensation is provided, transaction costs remain inherent in any system that requires a transfer of

\(^{205}\) This is because those who are diversified are already insured against the risk of loss by offsetting it through the potential for gain.

\(^{206}\) Whilst all investors (including those who are diversified) would be eligible to claim from the fund in the event of they suffer loss arising from non-disclosure, the losses and gains arising to diversified investors would balance out to zero even without a compensation fund. Thus, diversified investors are relatively worse off, as they are forced to fund the administration of a scheme they do not benefit from.

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wealth between investors. Thus, the optimum solution is one that does not require shifting wealth between investors, but nonetheless puts investors in the same position as they would be but for violations of the continuous disclosure regime.

Diversification provides such a solution. If investors are properly diversified, they will, on average, not suffer a loss as a result of non-disclosure.\textsuperscript{207} There is therefore no need for the law to provide a compensatory remedy for non-disclosure, as the market itself ensures that diversified investors are no worse off over time.

Investment diversification is by no means a new development in finance theory. Indeed, the portfolio theory of investment has long been regarded as an essential means of minimising risk in equities markets.\textsuperscript{208} As the theory goes, market risk may be either diversifiable or un-diversifiable. Diversifiable risk is the risk that an individual company will reduce in value at a disproportionate rate relative to the market average – in other words, company specific risk. Un-diversifiable risk is that which is inherent in any equity investment, and is essentially the risk that the value of the market as a whole will decrease. Because rational investors diversify their investments, they avoid diversifiable risk at no cost.\textsuperscript{209} Diversification therefore acts as a form of free insurance against the risk that a company will suffer a loss which the market at large does not.

In this sense, the risk of non-disclosure may be viewed as a typical form of diversifiable risk. If an investor happens to be the buyer when bad news is not disclosed to the market they will suffer a loss, however this loss will be cancelled out when the same investor inevitably makes a sale at an inflated value.\textsuperscript{210} A diversified investor is therefore just as likely to be a ‘winner’ from non-disclosure as they are to be a ‘loser’, and the losses in the long term should approximately net to zero.\textsuperscript{211} As well as being logically persuasive, research in the US has provided some empirical

\textsuperscript{208} See for example: H Markowitz \textit{Portfolio Selection: Efficient diversification of investments} (Yale University Press, London, 1959).
\textsuperscript{209} Booth, above n 202, at 12.
\textsuperscript{210} Ibid at 11-13; Fox, above n 85, at 308.
\textsuperscript{211} Fischel and Easterwood, above n 157, at 641.
confirmation that the losses and gains accrued by diversified institutional investors do indeed cancel each other out over the medium term.\textsuperscript{212}

The efficiency benefits of diversification can be further illustrated by conceptualising shareholder compensation itself as a form of ‘insurance’ against non-disclosure. A right to compensation essentially amounts to the company providing an enforceable ‘guarantee’ that all information about it has been disclosed. If this turns out to be untrue the company breaches its guarantee, and shareholders can claim compensation to the extent they are out of pocket. The company therefore bears the risk that its directors have failed to disclose. By its very nature though, the company is not as well equipped to bear this risk as investors are. Investors can obtain free insurance against the risk of non-disclosure by spreading their investments over a number of companies. By contrast an individual company must either pay for insurance against the risk (as they frequently do in the US), or make good the losses arising when a disclosure violation occurs. As Fischel and Easterwood put it, shareholders have a “comparative advantage” at bearing risk relative to the company and its directors.\textsuperscript{213} By requiring that an issuer company bear the risk of non-disclosure, the legislation counteracts this natural comparative advantage and creates an inefficiency in the market.

Despite these apparent benefits, diversification is not without its critics. Jill Fisch argues that if all investors were diversified equally between all companies in a market, the efficiency of the market would be threatened.\textsuperscript{214} This occurs because market efficiency relies on investors making investment decisions based on research and company information, rather than passively investing against a market index.\textsuperscript{215} However, this somewhat overstates what diversification requires of investors. Spreading risk across a number of companies does not require investing in all companies, but rather a cross section of the market. A successful investor is likely to

\textsuperscript{212} Thakor et al “The Economic Reality of Securities Class Action Litigation” (2005) US Chamber Institute for Legal Reform Research paper at 14. This study of 2596 institutional investors found that on average, gains and losses largely or wholly netted out over the medium term.

\textsuperscript{213} Fischel and Easterwood, above n 157, at 641.


\textsuperscript{215} In an efficient market the fundamental value of a company should be reflected in its share price, as investors will bid up the price of successful companies and bid down the value of unsuccessful companies.
constantly modify the makeup of their portfolio based on company research, but would be nonetheless be unwise to place all their funds in one company.

Another objection to diversification is simply that not all investors are diversified, and therefore without a right to compensation are likely to be severely out of pocket as a result of non-disclosure. Some argue that because such a burden falls disproportionately on smaller investors, it is unjust not to provide a compensatory remedy. However such an objection is entirely inconsistent with the purpose of a securities market, which is to efficiently allocate capital between companies. The role of market regulation is not to provide investors with a ‘safety net’ in circumstances where they choose not to reduce their risk exposure through diversification. Such criticisms are further undermined by the increased availability of managed funds and listed investment vehicles with ready-made diversified portfolios. The availability of these funds mean that regardless of how small ones investment is, diversification is possible and affordable. The clear implication is that there is simply no excuse not to diversify. Any investor who fails to do so voluntarily assumes an additional risk, and thus should not be entitled to compensation when the risk is realised in the form of a loss.

4.4 Maintaining investor confidence without shareholder compensation

This chapter has so far demonstrated that diversification is the most efficient means of dealing with the out-of-pocket losses which result from non-disclosure. However, even if out-of-pocket losses can be avoided through diversification, there is a more abstract but equally harmful loss which results from non-disclosure in the form of reduced market confidence. Given that an efficient market requires confident investors, any loss in confidence harms market efficiency and thus should be prevented. In the context of information disclosure, investor confidence can be maintained in two ways; firstly by preventing disclosure violations happening in the first place, and secondly by providing a remedy to those who suffer as a result of a

217 Goshen and Parchomovsky, above n 162, at 713
218 Easterbrook and Fischel above n 157, at 619, footnote 13.
219 One example of this is Smartshares, which offers a number of pre-diversified portfolios of NZX listed companies: <www.smartshares.nzx.com>.
220 Easterbrook and Fischel above n 157, at 619, footnote 13.
221 Ibid, at 641.
violation after the fact. The following discussion will assess the contribution of both mechanisms to investor confidence, and suggest how securities law should best give effect to these objectives.

4.5 Preventing violations of continuous disclosure

The most effective way to instil investor confidence is to provide an appropriate level of deterrence against non-disclosure. Such deterrence can be best achieved through a legal framework which penalises the company and its directors for the harm to market confidence caused by their non-compliance.222 Put another way, the company must internalise the harm which it does to the market as a result of non-disclosure. Determining the extent of such an abstract harm is inherently difficult. However, it is clear is that the social harm resulting from a loss in market confidence is largely distinct from the out of pocket losses incurred by investors.223 The law must therefore provide a penalty mechanism which approximates the harm that a violation does to market confidence, and thus adequately deters non-disclosure.

The current public enforcement regime under the Securities Markets Act 1988 is arguably sufficient to achieve these deterrent objectives. As discussed in chapter one, the civil penalty regime allows the FMA to impose pecuniary penalties on both the company and individuals involved in continuous disclosure violations.224 In this sense, the Act already provides a means of internalising the harm of non-disclosure and in doing so ensures investor confidence is maintained.

Furthermore, companies that repeatedly offend can be delisted from the NZX,225 and persistently offending directors can be banned from managing a company.226 These severe penalties provide an appropriate backstop for when market confidence is so damaged by non-disclosure that those complicit in the harm must be removed from the market.

222 Langevoort, above n 161, at 654-657.
223 Alexander, above n 207, at 1489.
224 See above at 1.2.
225 NZX Listing Rules, rule 17.15.1.
226 Securities Markets Act 1998, 43F.
One potential improvement to the current enforcement regime is the implementation of ‘infringement penalties’ for minor violations of continuous disclosure obligations. These penalties are comparable to ‘speeding fines’ and consist of a relatively small fine which can be imposed by the public regulator without involving the courts. Because a strict liability standard applies for continuous disclosure violations, at times infringements may occur that do not warrant judicial action. Under the status quo, the FMA are essentially powerless to deal with this type of low level offending, meaning small violations may go unpunished. This has the dual harm of encouraging complacency on the part of companies and their directors, and negatively affecting market confidence by creating a perception amongst investors that smaller violations can ‘slip under the radar’ of the FMA.

In Australia, ASIC is empowered to unilaterally issue infringement notices for violations of the continuous disclosure regime. Whilst the new Financial Markets Conduct Bill proposes to empower the FMA to issue infringement notices for conduct that violates certain provisions, continuous disclosure has not been included as one of these. In my view extending their coverage to the continuous disclosure regime would provide a positive addition to the existing enforcement framework.

Some commentators have also argued that private enforcement of penalties should be available as a supplement to public enforcement. Langevoort for example, envisages capping damages for disclosure violations but leaving them open to private enforcement. Such a mechanism could provide a backup to public enforcement in circumstances where the FMA does not have the will or resources to pursue action itself. The benefit of capped damages as opposed to compensation is that they are aimed at restoring the loss in investor confidence resulting from non-disclosure, rather than the out-of-pocket loss suffered by investors. Their size reflects this objective, resulting in penalties that are likely to be far lower than the out-of-pocket loss suffered by investors.

228 Financial Markets Conduct Bill 2011 (explanatory note) at 9.
229 Langevoort, above n 161, at 641-643.
230 This assumes, however, that the damages payment is equal to the loss in market confidence. Whilst this is unlikely to ever be perfect due to the nature of such a loss, fixed
However, such a model is inappropriate in a New Zealand context for two reasons. Firstly, as discussed in chapter three, there is no evidence that the FMA lacks the resources to prosecute violations of continuous disclosure. Whilst the size of the US securities market may make private enforcement a necessary part of deterrence, the small size of the New Zealand market should be capable of falling within the surveillance of the FMA. Secondly, even if the FMA’s enforcement is (or becomes) inadequate to maintain market confidence, private actions remain an inappropriate alternative. Given that a loss in market confidence does not specifically harm any individual, giving individuals a right to claim a ‘bounty’ for enforcing such obligations simply perpetuates the cost inefficiencies inherent with shareholder compensation. Therefore, whilst allowing investors to claim ‘capped’ damages is a more logically consistent means of enforcement than compensation (as it targets the true harm resulting from non-disclosure rather than the out of pocket losses of investors), it remains a second best alternative when compared to public enforcement.

4.6 Maintaining confidence after a continuous disclosure violation

The second component of investor confidence relates to what happens when disclosure violations inevitably do occur. Regardless of how strong legislative deterrents are, and how stringently they are enforced, there will always be situations where disclosure does not occur. Clearly investors would feel more confident if they could be guaranteed that in such circumstances their loss would be compensated. However, as this dissertation has demonstrated, a right to compensation creates a deadweight loss which is detrimental to the efficient operation of the market. Therefore, to the extent that investor confidence is eroded by an inability to reclaim losses from securities violations there is a conflict between instilling confidence and maintaining market efficiency.

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231 See above at 3.5
232 See above at 1.2 and 1.7.
This illustrates an inherent conflict between the two ‘main purposes’ of New Zealand securities law set out in chapter one – those of investor confidence and market efficiency.\textsuperscript{234} Whilst to an extent, increased confidence leads to increased market efficiency, at a certain point the goals become mutually exclusive. Taken to its extreme, maximum investor confidence would be achieved by guaranteeing that investments would never depreciate in value. Such a guarantee would most certainly encourage participation in equities markets (as there is no investment risk), but would entirely obliterate the role of the market as an efficient allocator of capital. To a lesser extent, shareholder compensation for disclosure violations provides a similar guarantee. It increases confidence by removing an investment risk, at the expense of market efficiency.

Thus, to the extent that there is conflict between achieving investor confidence and ensuring market efficiency, the latter objective should be preferred. Investor confidence should not be viewed as an end in itself, but rather as a means of achieving the ultimate goal of an efficient capital market. Because shareholder compensation has been demonstrated to undermine this ultimate goal, any positive effect it has on investor confidence falls by the wayside.

Aside from its inefficiency, it is also arguable that compensation has a misleading psychological effect on investors. It sends the message that investors need not protect their own investment interests, but can instead rely on the law to do so. Whilst the law clearly has a role in establishing a fair market framework, its role is not to provide an insurance policy for investors. Rather than acting as an ‘ambulance at the bottom of the cliff’ for undiversified investors, securities law should instead be focussed at preventing these losses occurring in the first place. Strategies which focus on educating investors of the risks associated with investment and the way these risks can be mitigated provide a far more desirable means of building investor confidence than legislating these risks away.\textsuperscript{235}

This chapter has provided an overview of some potential alternatives to shareholder compensation for violations of continuous disclosure. Overall, it has demonstrated

\textsuperscript{234} Ibid.
\textsuperscript{235} The FMA has a statutory mandate to provide investor education: Financial Markets Authority Act 2011, s 9 (1)(a)(iv).
that the most effective means of achieving a confident and efficient capital market is to abolish the statutory right to compensation, and ensure effective enforcement of disclosure obligations through a public regulator. Aside from suggesting some minor additions to the menu of enforcement options currently available to the FMA, in my view the current powers are adequate to ensure investor confidence is maintained.
Conclusion

Shareholder compensation has the potential to be a ticking time bomb in New Zealand securities law. As the Australian experience has shown, shareholder compensation for continuous disclosure violations can very quickly become a significant driver of private securities litigation. This dissertation has concluded that such a phenomenon should be avoided in New Zealand, due to the inherent flaws in shareholder compensation as a remedy for disclosure violations.

It has shown that, for the most part, shareholder compensation is an ineffective means of compensating victims and deterring continuous disclosure violations. Even to the extent that compensation does satisfy these objectives, it does so in a manner that is relatively less efficient than available alternatives, and is thus an undesirable addition to New Zealand securities law. Specifically, it has concluded that the deterrent role of compensation is best fulfilled through public enforcement by the FMA. A well-resourced FMA is likely to provide a far more efficient and targeted means of maintaining market confidence than a private right of compensation. Given the FMA already possesses a wide range of powers for dealing with disclosure violations, there is little need for significant change in this area. The addition of ‘infringement penalties’ to the FMA’s enforcement toolbox would be a useful means of deterring low level non-compliance, and should be seriously considered as an element of the new Financial Markets Conduct Bill.

The compensatory rationale for shareholder compensation has also been shown to be misguided. Because compensation simply shifts losses from one innocent group of shareholders to another, it does not provide a principled means of compensating investors for their loss. Furthermore, the significant transaction costs involved in transferring wealth between these groups render it a highly inefficient (and often practically ineffective) method of providing compensation. The fallacy of the compensatory rationale is compounded by the fact that investors can avoid their loss at no cost through diversification. By conceptualising non-disclosure as an avoidable market risk, it becomes clear that investors are no more deserving of compensation for disclosure violations than they are for any other type of investment loss. Rather than providing legal redress for undiversified investors, public policy should be
directed at educating investors of the importance of diversification, and thus placing the onus on investors to make rational investment decisions.

Overall, shareholder compensation has been demonstrated to be at best superfluous and at worst harmful to the attainment of a fair and efficient securities market in New Zealand. It should therefore be removed from the statute books before it is given the opportunity to become entrenched in the psyche of investors and lawyers as it has in the US and now Australia. By that stage, it may be too late.
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