Has the Supreme Court *Turned and Waved* Goodbye to the Essence of the New Zealand Securities Regime?

An Analysis of the Purposes Underpinning Securities Market Regulation in New Zealand

Evan Mackenzie Jones

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Introduction

The Securities Act 1978 lacks a legislated purpose, and as such the underlying objectives it aims to achieve are unclear. This paper challenges the conception that the Act is primarily geared toward investor protection. Rather the underlying principles of securities market regulation generally are suggested as providing the backbone of securities regulation in New Zealand. This key principle is that securities regulation primarily aims to promote the confident participation of investors and issuers alike in efficient, transparent and equitable financial markets, through mandatory disclosure requirements. This purpose is a touchstone that is frequently referred to during the analysis conducted by this paper.

This broad principle has recently been enacted as the purpose of the successor to the Securities Act, the Financial Markets Conduct Act. A key point this paper aims to establish is that these purposes are merely the explicit recognition of what already existed as the underpinning principles of the regime. Importantly, the paper does not suggest that investor protection is now a redundant concept, rather finding that it is a collateral result of the aforementioned principles.

Having established these broad underpinning concepts of the securities regime in New Zealand, the second limb of the paper provides a critique of the Supreme Court of New Zealand's decision in *Hickman v Turner and Waverley*. The case attracted widespread criticism for the broad-brush interpretive approach it took with regard to the definition of a "debt security." Firstly the relevant legislative provisions and preceding authority are outlined, with the various courts application of these wide principles being analysed. The Supreme Court decision turned its back on the bulk of this judicial history. Thus the Courts methodology and eventual outcome is tested in its compatibility with these wider purposes. Finally the ongoing relevance of the case is considered, in light of the legislative changes made under the Financial Markets Conduct Act.

Chapter One: General Theories of Securities Market Regulation

1.1 Securities Markets Generally

Broadly speaking, a security is intangible property in the form of an enforceable claim held by one person over another.[1] The trading of shares in companies on public exchanges such as the NZX are the most common form of security, called "equity securities", however a securities market encompasses an ever-swelling range of differentiated financial products.[2]

A securities market exists primarily to facilitate the raising of capital from the public through the issuing of such securities on the primary market, and further to enable the trading of previously issued securities on the secondary market.[3] In carrying out this function, not only does a securities market provide a marketplace in which buyers and sellers of securities are brought together, but importantly provides a continuous measure of the worth of those securities.[4] This is significant because unlike physical goods, which have an intrinsic value, a security's value depends largely on the financial standing it holds within the market. This standing is determined through market forces, and is based almost solely upon the information that has been made available to the market by the issuer of the security.[5] Typically there is a significant imbalance between the information held by the issuer and that made available to the market, meaning that in the absence of mandatory disclosure the market value of a product can be easily manipulated.

As such, securities markets were initially fairly uninhibited affairs, where "sharp practice" on the part of unscrupulous promoters was not uncommon.[6] Such promoters were able to distort the perceived value of the security on offer through the selective

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[1] Baxt, Maxwell and Bajada *Stock Markets and the Securities Industry Law and Practice* (3rd ed, Butterworths, Sydney, 1988) at [101].
[2] Shelley Griffiths "Securities Regulation" in John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Brookers Ltd, Wellington, 2013) at 1025.
[3] Griffiths, above n 2, at 1025.
[4] Farrar and Russell *Company Law and Securities Regulation in New Zealand* (Butterworths, Wellington, 1985) at 345.
[5] Baxt, Maxwell and Bajada, above n 1, at [101].
[6] Gordon Walker and Brent Fisse *Securities Regulation in Australia and New Zealand* (Oxford University Press, Auckland, 1994) at 59.

provision of information to the market.[7] However, as the financial products on offer became more complex, with greater opportunity for such offerors to mislead investors, regulators and market participants increasingly called upon companies to provide improved and enhanced disclosure as to the worth of the products they were offering.[8] Such disclosure is the backbone of a securities regime, upholding the confidence of investors that they will get their money's worth from an investment.

1.2 Securities Market Regulation

"The securities market must operate fairly and efficiently ... Investor confidence and an efficient securities market are complementary conditions each contributing to the other. Legislation affecting the securities industry has generally been directed towards increasing investor confidence by ensuring a fair operation of the market and with the ultimate purpose of enhancing its efficiency."[9]

This statement, made by founding chairman of the Australian National Companies and Securities Commission **("NCSC")**, Leigh Masel, summarises the broad purposes of not only the Australian regime, but the overall global objective of securities market regulation.

This general focus aligns with the guiding principles of the International Organisation of Securities Commissions **("IOSCO"),** an international body made up of 95% of the world's security market regulators. IOSCO is recognised as the global standard setter for the securities sector, and has a charter outlining the principles they operate under, including three key objectives of securities regulation. These are stated as: [10]

- Protecting investors
- Ensuring that markets are fair, efficient and transparent
- Reducing systemic risk.

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[7] Farrar and Russell, above n 4, at 342.
[8] Linda Lanham "Consumer Disclosure as Consumer Protection" (2007) 26 Journal of Insurance Regulation 7 at 7.
[9] Baxt, Maxwell and Bajada, above n 1, at [409].
[10] Robert Baxt, Ashley Black and Pamela Hanrahan, *Securities and Financial Services Law* (7th ed, Lexis Nexis Butterworths, Chatswood (NSW), 2008) at 1.11. See also The International Organisation of Securities Commissions "General Information" (2013) <www.iosco.com/about>.

These objectives provide a framework as to the underlying purposes a securities regime should strive to uphold. Thus the principal objective of securities regulation is to instil confidence in the securities market, creating an environment conducive to greater investment in securities.[11] In pursuit of this, the key underlying factors a regulator must consider are the maintenance of a market in which the most efficient allocation of capital is promoted, and ensuring that such a market is both transparent and equitable.

Importantly, it is suggested that the notion of investor protection is not a direct objective of the regime, as indicated by further comments by Leigh Masel, who stated that "… the securities market … should at all times be competitive, efficient and well informed. This is the best protection we believe we can give an investor."[12] Thus although investor protection is a touchstone of securities market regulation, the laws relating to the regulation of such markets should not be considered *consumer protection legislation*.[13] Rather, investors will be inherently protected through the upholding of an efficient, clear and equitable market in which public confidence is instilled.

1.3 Regulation Through Disclosure

Given this underlying systemic purpose, the cornerstone of securities market regulation in pursuing these goals is disclosure, as was noted by the New Zealand Ministry of Business, Innovation and Employment **("MBIE")** in its discussion paper on the Financial Markets Conduct Bill **("FMCB")**. Such a disclosure focus broadly requires any person seeking investment from the public to inform the market of the material facts relevant to their proposal[14] with the intention of addressing informational asymmetries between issuers and investors.

[11] Leigh Masel "The NCSC – A Synoptic View" (Address to the Queensland Institute of Directors, 25 July 1980) as cited in Baxt, Maxwell and Bajada, above n 1, at [409].
[12] Masel as cited in Baxt, Maxwell and Bajada, above n 1, at [409].
[13] Baxt, Maxwell and Bajada, above n 1, at [409].
[14] Andrew Borrowdale and others *Morison's Securities Law* (online looseleaf ed, LexisNexis) at [1.6].

Typically, an issuer of securities has more information than the market does regarding the nature of its product and its associated risks and benefits. Such an information imbalance disadvantages both the market and investors within it. Thus through a focus on disclosure, the market is better informed, and the broad goals of securities regulation are able to be better satisfied.

The provision of information regarding securities has many of the characteristics of a public good, especially in that the provider of the information cannot extract private profit from its provision, nor easily exclude users from accessing the information. It is a well-known economic theory that such goods tend to be under-produced as a result of this lack of private incentive, and thus mandatory disclosure requirements are required in order to ensure that the socially desirable level of that information is provided.[15]

a) Efficiency

The enforcement of mandatory financial disclosure promotes the goal of allocational efficiency within an economy, as more accurate decisions by better informed investors will lead to a more efficient allocation of capital resources.[16] In line with the efficient capital markets hypothesis, if wider information is available to the market, through the forces of supply and demand based on that information, the prices of financial products will better reflect all relevant information. This is of particular importance in financial markets. As already noted the products on offer are intangible, with their value entirely based on the information that is available in the market. As such, through wider disclosure the market is better informed, with stronger securities prospering and attracting greater capital investment. This results in greater gains to not only investors, but also the economy generally.

Wider disclosure also raises efficiency in the market through reducing the costs to investors and financial advisors of searching for information. . With information more readily available, not only will searchers be more efficient, but will have further

[15] Christian J Meier-Schatz "Objectives of Financial Disclosure Regulation" 8 (1986) Journal of Comparative Business and Capital Market Law 219 at [2.2.4].
[16] Meier-Schatz, above n 15, at 223.

resources to utilise in carrying out wider or more detailed analysis. This again results in a better-informed market, further raising the allocative efficiency of that market.

b) Equity

Through disclosure, the scope for fraudulent and misleading practices is reduced.[17] Although consumers are undoubtedly protected in this respect, the key issue that disclosure aims to address is that inequitable practices on the part of issuers, such as the selective provision of sensitive information, are inherently inefficient. Such practices are not conducive to the efficient use of resources, or to the equitable treatment of the participants in a securities market.[18] Whilst the issuer may benefit short term by misleading the market, such practices are to the long-term detriment of securities markets and the wider economy, through the inefficient allocation of resources. As such through promoting an equitable market, not only is efficiency maintained, but investors are indirectly protected from being misled by unscrupulous issuers.

c) Investor Confidence

The interrelationship between investor confidence and wider disclosure provisions is highlighted by the financial theory of risk aversion, which states that "an investor who believes the market is a fair game puts more in equities and spends less investigating."[19] The more information that is disseminated through the financial markets, the more confident investors will be that they are getting a fair deal, resulting in a greater incentive to participate in the market. However, as American securities law expert Professor Loss noted regarding the American Securities Act, "Congress did not take away from the citizen his inalienable right to make a fool of himself! It simply attempted to prevent others from making a fool of him."[20] As such it is important to note that regulation is concerned purely with the provision of

[17] Meier-Schatz, above n 15, at 226.
[18] Baxt, Maxwell and Bajada, above n 1, at [409].
[19] Meier-Schatz, above n 15, at 226.
[20] Richard Morton and Frank E Booker "The Paradoxical Nature of Federal Securities Regulations" (1967) 44 Denver Law Journal 479 at 485.

information and its quality, and not necessarily on the investors' actual use of that information.

1.4 Wider Disclosure - A double-edged sword?

Prior to the enactment of the New Zealand Securities Act 1978, The Securities Commission noted concerns on the part of the issuers of securities that given the significant costs of disclosure, there must be sufficient clarity and certainty as to when the regime will require disclosure.[21] If a disclosure regime pursues the confidence of investors overzealously, with an overly wide framing of the disclosure requirements, participants will be uncertain of the circumstances in which disclosure is required. Such a wide interpretation can have repressive and restrictive effects, in that the benefit to issuers of offering products to the market is limited, and thus the range of financial products issuers are willing to offer may diminish.[22] Further, such uncertainty provides an incentive for non-compliance, and thus may in fact increase the number of issuers who look to exploit the uncertainty as to the scope of a regime. Further, potential investors will also be unaware of the circumstances in which a prospectus is required.

A very wide reaching interpretation can in fact increase certainty, as the range of circumstances in which disclosure is not required is decreased. Under such a wide approach, areas of uncertainty are minimised, meaning that issuers can be more confident of the circumstances in which they should provide a prospectus or investment statement. Whilst concerns over uncertainty as to when disclosure is required can be lessened through a wide interpretation, the concerns of issuers regarding the increased costs of that wider disclosure are not alleviated. However, the Securities Commission addressed this issue by stating that "to those who must provide the information they feel is surplusage to their well-conducted activities, we feel obliged to say that the burden of providing it is part of the price they must pay for the benefit of public confidence in the fund-raising mechanisms of the business

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[21] Securities Commission *Proposals for the Enactment of Regulations under the Securities Act 1978* (31 March 1980) at 15.
[22] David L Johnston *Canadian Securities Regulation* (Butterworths, Toronto, 1977) at 1.

sector."[23] As such, although as was noted in Morison's Securities Law, "the disclosure philosophy behind the legislation must be reconciled with commercial reality and practice,"[24] this balance will generally be resolved in favour of the consumer of financial products, as it is the issuer who seeks to benefit from the transaction, and is better placed to bear the increased costs of wider disclosure.

However, disclosure creates a further paradox, in that whilst a wide interpretation does appear in the best interests of consumer confidence, the risk of over-disclosure must also be considered. Although generally speaking the more information the market is provided, the more efficiently it should run, if issuers feel forced to disclose as a precautionary measure such over-disclosure could occur. The risk arises that the market could become flooded with surplus information that is unable to be processed. As such the clarity of the market is threatened as a result of higher costs of gathering and analysing such financial information. Thus in determining the optimal level of disclosure required, a balance must be struck between the positive outcomes resulting from greater dissemination of information within the financial markets, and the need for certainty on the part of issuers as to when they must provide financial information, in ensuring that the market is not over-informed with surplus information that is unable to be digested.

1.5 Conclusion

A securities regime generally aims to create an efficient market in which the confident participation of investors and issuers alike is encouraged. As noted by the MBIE, if regulation can better inform investors, information asymmetry is lessened and investors are able to compare financial products and determine which best align with their resources and risk adversity, whilst remaining confident that they will not be misled as to the worth of an investment.[25] This was a clear consideration in *Re AIC Merchant Finance Ltd (in rec)*, where the Court noted that "… the best protection of the public lies in full disclosure of the company's affairs, and of the security it is

[23] Securities Commission, above n 21, at [3.3.6].
[24] Borrowdale, above n 14, at [1.6].
[25] Ministry of Business, Innovation and Employment *Financial Markets Conduct Regulations* (December 2012) at [1.1] – [1.2].

offering. That then allows the investor to make an informed investment decision, which in turn facilitates the functioning of financial markets."[26]

As such the proposition will generally hold true that wider mandatory requirements of disclosure on the part of issuers of securities will better accord with the purposes of securities regulation. However such disclosure requirements cannot be open ended, and must be tempered by considerations of commercial certainty in ensuring that the circumstances in which disclosure is required are clear, and that the information provided is in fact useful to the market.

[26] *Re AIC Merchant Finance Ltd (in rec)* [1990] 2 NZLR 385 (CA) at 14.

Chapter Two: The New Zealand Securities Market

2.1 Background

The Securities Act 1978 **("The Act")** underpins the securities markets in New Zealand in regulating the process of raising investment funds from the public.[27] In the period prior to the enactment of the Securities Act there were a large number of commercial failures in which members of the public lost substantial amounts on investments in companies from which they had not had the benefit of a prospectus.[28] Significantly, public pressure for reform rose markedly following the high profile collapse of the Securitibank group of companies in 1976.[29] In the wake of that collapse, Parliament reconsidered the "piecemeal" legislation that was in force within the Companies Act 1955, the Protection of Depositors Act 1968 and the Syndicates Act 1973.[30] This led to the tabling of the Securities Advertising Bill 1977, which the then Justice Minister, David Thomson, stated aimed to "consolidate and amend the law relating to the raising of investment money from the public." Further it was noted that there was a "need for legislation to give a greater degree of protection to the public."[31] Thus, although the Act does not have a stated legislative purpose, Parliament indicated that a purpose of the Act was to better protect the investing public through more stringent disclosure requirements.

2.2 General Purpose of the Regime

Generally speaking the purpose of the New Zealand Securities Market Regime has been interpreted by the Courts as being investor protection achieved through a focus on disclosure, aligning with the Parliamentary remarks at the time of enactment.[32]

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[27] Shelley Griffiths "The Primary Market" in John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Brookers Ltd, Wellington, 2013) at 1044.
[28] Borrowdale, above n 14, at [1.5].
[29] Borrowdale, above n 14, at [1.5].
[30] Darvell and Clarke *Securities Law in New Zealand* (Butterworths, Wellington, 1983) at [1.02].
[31] Darvell and Clarke, above n 30, at [1.02].
[32] Griffiths, above n 27, at 1045 citing *Re AiC Merchant Finance Ltd (in rec)* [1990] 2 NZR 385 (CA) at 391; see also *Securities Commission v Kiwi Co-operative Daires Ltd* [1995] 3 NZLR 26 (CA) at 31; *Culverden Retirement Village Ltd v Registrar of Companies* (1996) 1 BSSLR 162 (CA) at 166; *Lawrence v Registrar of Companies* [2004] 3 NZLR 37 (CA) at 44;

Although the leading New Zealand authors share the view that the Securities Act was brought about to protect the public following the collapse of a number of high profile investment companies,[33] this is with respect an erroneous conception.

The concern that the regime aimed to address was not that investors were being defrauded by misleading information. Rather the problem was that in the wake of a number of very public commercial failures, potential investors had lost confidence in the securities market regime.[34] That confidence needed to be restored as the source of funds raised by that portion of the economy had dried up considerably. The situation faced at this time in New Zealand was very similar to that in America prior to the enactment of the American Securities Act 1933, which was passed as a response to the lack of public confidence following the great depression.[35] The key purpose underlying the changes to the securities market regime in New Zealand was, despite the remarks of Parliament, to restore and maintain the confidence of investors and issuers alike, achieved through the deployment of a wider disclosure-based regime.

Whilst Parliament noted that the legislation aimed to *"give a greater degree of protection*"[36] to the investing public than was available under the previous provisions, it cannot be said that their intention was to draft a form of consumer protection legislation. Thus, although emotive reference was made throughout the enactment of the Securities Act to the "ma and pa" investors who had lost everything, their protection was not at the forefront of Parliaments mind.[37] The fundamental purpose of any securities regime is, as earlier noted, to keep the engines of industry turning. If the securities markets are functioning efficiently, the confidence and protection of investors will naturally follow.

Christchurch Pavilion Partnership No 1 v Deloitte and Touche Tohmatsu Trustee Co Ltd [2002] 3 NZLR 289 (PC) at 296.
[33] Griffiths, above n 27, at 1045; Borrowdale, above n 14, at [1.6].
[34] Walker and Fisse, above n 6, at 72.
[35] Morton and Booker, above n 20, at 480.
[36] (14 December 1977) 416 NZPD 5339.
[37] (14 December 1977) 416 NZPD 5339.

Interestingly, these wider goals of a securities regime[38] are expressed in the specifically legislated purposes of the Financial Markets Conduct Act **("FMCA")**.[39] In line with the proposition that Parliament's primary objective in enacting the Securities Act was promoting the wider systemic purpose of restoring the confidence of the market as opposed to the more paternalistic focus on investor protection, it is suggested that the FMCA's legislated purposes are far from ground-breaking, and in fact have simply made explicit the key purposes which have underpinned the Securities Act since its inception.

2.3 Financial Markets Conduct Act Purpose

The Ministry of Business, Innovation and Employment **("MBIE")** discussion paper on the Financial Markets Conduct Bill **("FMCB")** stated the principal policy objective of the Bill as being to "facilitate capital market activity, in order to help businesses to fund growth and individuals to reach their financial goals."[40] This was made explicit in the "main purposes" of the resulting and recently introduced FMCA. The FMCA outlines the dual purposes of the new legislation as:[41]

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

Section 4 of the FMCA then goes on to outline four additional purposes, being:[42]

a) To provide for timely, accurate, and understandable information to be provided to persons to assist those persons to make decisions relating to financial products or the provision of financial services;
b) To ensure that appropriate governance arrangements apply to financial products and certain financial services that allow for effective monitoring and reduce governance risks;
c) To avoid unnecessary compliance costs; and

[38] See discussion above, at Chapter Two.
[39] Financial Markets Conduct Act 2013, s 3.
[40] Ministry of Business, Innovation and Employment, above n 25, at 4.
[41] Financial Markets Conduct Act, s 3.
[42] Financial Markets Conduct Act, s 4.

d) To promote innovation and flexibility in the financial markets.

Importantly, neither of these sections makes any explicit reference to a consumer or investor protection purpose. Thus based on the concept of *expression unius est exclusio alterius*, the express mention of the range of purposes in sections 3 and 4 excludes the consideration of any purposes not outlined in that legislation – namely of investor protection.

The main purposes focus solely on the promotion and maintenance of confidence, clarity, equity and efficiency in the financial markets. The additional purposes do importantly highlight the need for disclosure in s 4(a), however Parliament has not expressly linked that disclosure focus to consumer or investor protection. The Kimber report, upon which the bulk of Canadian Securities legislation is based, noted regarding a disclosure focus that "this is not to suggest that the public must be protected against itself; rather, it is a matter of ensuring that the investing public has the fullest possible knowledge to enable it to distinguish the different types of investment activity available."[43] As such the disclosure focus of the regime aims to provide investors with information upon which they can make confident decisions, as opposed to directly protecting them from making poor investments.

Throughout the process of the Bill's enactment Members of Parliament were vocal in their support of these wider purposes. However, they did highlight that they saw a key function of the new legislation being to provide better protection to "ma and pa" investors.[44] These statements are not in any way reinforced by the legislation they related to, in which no mention is made of a consumer or investor protection focus. Parliament has clearly stated that the purpose of the Securities Markets is to maintain the confidence in the financial markets so as to preserve that source of finance for local industry, and the various politicians' statements that the focus is on the protection of the everyday investor can thus be put down to nothing more than political "jaw-boning".

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[43] Mark R Gillen *Securities Regulation In Canada* (3rd ed, Thomson Carswell, Toronto, 2007) at 91-92.
[44] (27 August 2013) 693 NZPD 12993; (6 March 2012) 678 NZPD 882.

The Credit Contract and Consumer Finance Act provides a clear example of legislation which is primarily geared toward consumer protection. Its purposes as outlined in s 3 include such phrases as "to protect the interests of consumers in connection with credit contracts …" and "to provide for the disclosure of adequate information to consumers under consumer credit contracts…"[45] These sections are a clear embodiment of a Parliamentary intention to protect consumers of credit contracts. If through the FMCA Parliament had intended to predominantly protect consumers in the securities markets, the legislation would surely have been drafted in a similarly clear manner.

This is likely the result of the political reality that highlighting the underlying purpose of the securities regime being to promote investment through the maintenance of consumer confidence and market efficiency is a far harder sell to the voting public than an emotively charged consumer protection mantra. As such, politicians in passing the Act have erroneously identified a collateral purpose of the Act as being central to it. In fact, the true primary aims of the Act will naturally provide protection for consumers through the provision of a clear, efficient and fair market. This was eloquently put by Canadian author David Johnson, in highlighting investor protection as the core goal of the legislation being "misleading in its simplicity. It focuses on only one of a number of parties to a securities transaction. Moreover, it fails to reflect the fact that the goal of protection must be achieved while taking into account a diverse range of other objectives, some of which compete with one another."[46]

Despite the comments made by politicians during the passing of this Bill, its core purpose is not one of consumer or investor protection. Rather it aims to promote investment in the New Zealand capital markets through maintaining consumer confidence in a clear, fair and efficient market. Chapman Tripp partner Roger Wallis validated this, in that whilst the new law is intended to provide better information and protections for investors, as well as clearer rules for companies looking to raise

[45]Sections 3(a) and (b) – However the entire section echoes a similar consumer protection sentiment.
[46] Johnston, above n 22, at 1.

capital, these purposes are coupled with the broader aim of the Act to encourage greater development of the New Zealand financial markets.[47]

These systemic objectives of securities regulation are further embodied in the purposes of New Zealand's Financial Markets Authority **("FMA")**. The FMA is the regulator of New Zealand's financial markets, having succeeded the Securities Commission in 2011 in a further bid to "restore the confidence of 'Mum and Dad' investors following a number of collapses in the financial sector in the preceding few years."[48] The FMA has the express objective of promoting and facilitating the development of fair, efficient, and transparent financial markets, which aligns with the wider purposes of securities regulation as have been discussed, and as embodied in the FMCA.[49] Again, this purpose does not include any express mention of protecting the investing public, but rather focuses on promoting investment through the maintenance of investor confidence in the market.

2.4 Conclusion as to the Purpose

The core concern of the New Zealand securities markets is to facilitate the raising of money from the public by private entities. Underpinning this regime are the general, systemic principles of securities market regulation,[50] which were implicit in the Securities Act, and more recently reinforced explicitly in the FMCA. The pursuit of such an efficient, fair and transparent market, as Labour MP for Dunedin North David Clark noted, creates "a solid foundation for our markets to exchange information, to provide confidence to investors, and to ensure that capital flows towards its best use."[51] Despite a Parliamentary focus upon investor protection, it is with respect an erroneous conception to view the legislation as being investor or consumer protection based. Rather, such a paternalistic outcome is achieved as a collateral consequence of

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[47] Radio New Zealand "Investor Confidence Legislation Approved" (2 September 2013) Radio New Zealand News <www.radionz.co.nz>.
[48] Griffiths, above n 27, at 1045.
[49] Shelley Griffiths "The Financial Markets Authority" in John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Brookers Ltd, Wellington, 2013) at 1034. See also Financial Markets Authority "About Us" (2011) Financial Markets Authority <www.fma.govt.nz>.
[50] See discussion above, at Chapter 2
[51] (27 August 2013) 693 NZPD 12988.

the upholding of the wider more systemic purposes. This was the view of Richardson J in *Re AIC Merchant Finance*, in that "the pattern of the Securities Act … makes it plain that the broad statutory goal is to facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers for securities. In that way the Act is aimed at the protection of investors."[52]

[52] *Re AIC Merchant Finance Ltd*, above n 26, at 391.

Chapter Three: The Securities Act Reflecting This Purpose

On the premise that the wide principles highlighted previously underpin the Securities Act, it is necessary to analyse how the Act reflects such a purpose, and how well it achieves these broadly defined goals of a securities regulation regime. The drafting of the legislation frames the disclosure obligations widely, which accords with the broad nature of these concepts. However, the effectiveness of that disclosure is hindered by a mismatch between the class of person to whom the Act demands disclosure, and those to whom that disclosure is meaningful.

3.1 Widening the Scope of Disclosure

Parliament identified that there was a need for the legislation "to give a greater degree of protection to the public."[53] In pursuing such an objective, Parliament accepted that wide-ranging "activity based" legislation was required, with a shift in focus from *who was offering a product*, to *what was being offered*.[54] Thus the legislation requires disclosure from all persons offering securities to the public, as opposed to a narrower focus on certain kinds of offerors, which as David Thomson noted, would "remove the present opportunity for disreputable promoters to operate in less well regulated areas."[55]

In line with the activity-based focus of Parliament, the Act is very widely framed, with broad primary provisions coupled with express exceptions. In particular, the definition of a "security" widely dictates the scope of the Act in framing the financial products to which its provisions apply. This definition highlights the wide approach taken by the legislature, under which the Act became more focused upon the *substance* of what was on offer, as opposed to the precise *form* it took. Such a broad provision has extended the potential reach of the Act to include "investment in less usual types of securities" which prior to the Act's enactment did not have the same disclosure duties and responsibilities that applied to usual types of investment.[56] Such

[53] (14 December 1977) 416 NZPD 5339.
[54](14 December 1977) 416 NZPD 5339.
[55] (14 December 1977) 416 NZPD 5339.
[56] (14 December 1977) 416 NZPD 5339.

wider disclosure, as has already been established, promotes the core principles underlying a securities regime.[57] This wide disclosure is coupled with some express exceptions, notably s 5(1)(b) regarding real estate.[58] This exception is tolerated by the regime as land has a clear intrinsic value, and thus is comparatively less reliant upon the information provided to the market in determining its value than a typical security.

A security as defined in s 2D of the Securities Act importantly includes equity and debt securities. A further class of security, participatory securities is also defined in s 2 of the Act. An equity security is fairly narrowly framed, applying generally to shares in a company.[59] However, the definitions of a debt security and participatory security clearly embody this "substance over form" approach. A debt security is defined broadly as "any interest or right to be paid money that is, or is to be, deposited with, lent to, or otherwise owing, by any person." A participatory security, on the other hand, is defined residually as "any security" other than equity securities, debt securities, and a number of other specific classes of security.[60] Both definitions are very open textured and non-prescriptive, allowing the Act flexibility in its ability to demand disclosure from offerors of securities that the legislation had not initially envisaged. The definition of a debt security in particular has a focus on the function of the interest or right held, requiring a broad repayment obligation as opposed a strict focus on the form a security takes.

Through such flexibility the Securities Act expanded upon the range of financial products requiring disclosure, allowing scope for a wide judicial interpretation giving the necessary flexibility to cover "less usual types of securities" and "removing the opportunity for disreputable promoters to operate in less well regulated areas."[61] The ability for the law to be constructed widely enough to incorporate products which had not been initially envisaged by the legislature is crucial in upholding the confidence of that market as the features of financial products on offer evolve. Given that the range of circumstances in which disclosure is required was widened under the Act, it is important that the breadth of the provisions should not be so wide as to create

[57] See discussion above, at Chapter 2
[58] Securities Act 1978, s 5(1)(b).
[59] Securities Act, s 2.
[60] Section 2.
[61] (14 December 1977) 416 NZPD 5339.

untenable uncertainty on the part of issuers as to when disclosure will be required. However, it is suggested that wider disclosure requirements result in the range of situations in which the disclosure obligations are unclear being reduced, as disclosure is simply required more often. Thus through these broad disclosure requirements, the Securities Act aligns with the goal of promoting confident participation in the regime.[62]

3.2 Shortcomings of a Disclosure Focus

Whilst wider disclosure does promote these broad objectives, the effectiveness of such disclosure may limit the Act's ability to uphold them. The MBIE stated that the role of disclosure regulation is to ensure the supply of meaningful and reliable financial product information.[63] The Act's provisions create a clear mismatch between the class of person to whom disclosure must be made, and the nature of the information disclosed, in that for much of "the public" the information is not readily understandable. This inconsistency impedes the Act's ability to successfully meet the systemic goals it sets out to uphold, as the effectiveness of the disclosure is reduced. Further, this lack of clarity lends support to the notion that the Act cannot have been directly geared toward the protection of a particular class of the population, and is rather focused upon the these more systemic goals of securities markets generally, with investor or consumer protection a corollary outcome.

Section 33(1), often considered the Act's core section,[64] prohibits the offering of a security to the public by an issuer unless the offer is accompanied by an authorised advertisement, investment statement, or prospectus.[65] Crucially, the Act aims to regulate "offers to the public", with the definition of "the public" holding significant importance in the context of the Act's purpose.[66]

The Act initially defines "the public" inclusively, outlining three broad categories of person to whom any offer is deemed as to "the public." These classes are defined in s

[62] See discussion above, at Chapter 2
[63] Ministry of Business, Innovation and Employment, above n 25, at [1.1].
[64] Griffiths, above n 27, at 1044.
[65] Securities Act, s 33(1).
[66] Griffiths, above n 27, at 1046.

3(1), and refer to the offerings of securities to “any section of the public however selected”, to “individual members of the public selected at random”, or to “any person who became known to the offeror as a result of an advertisement made by the offeror intended to result in the public seeking further information.” Any offer made to any one of these sectors of the population will be classed as an offer made to the public.[67]

Section 3(1) is framed in the widest possible terms,[68] potentially encompassing virtually any member of the public of New Zealand. Section 3(2) goes on to limit the scope of the definition of “the public” by exclusion. Section 3(2)(a) defines those who are excluded from the category of “the public” in terms of an offer. Importantly, this includes relatives or close business associates of the issuer, those whose principal business is the investment of money or who are habitual investors, those who are required to pay a minimum subscription of $500,000, or “any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public.”[69]

This highlights the manner in which the Act broadly defines those deemed as “the public” for the purposes of an offer in s 3(1), with express carve-outs made for those whom Parliament considers do not require the provision of a prospectus or investment statement in s 3(2). These people are those who it is deemed should know the questions to ask of the issuer and are able to access that information independently, either because of their relationship with the offeror, or because they are considered to have sufficient financial knowledge and experience to obtain it.[70] This leaves a class of “the public” to whom disclosure is required in order to uphold the Act’s primary purpose in promoting confident participation through the maintenance of market efficiency, clarity, and fairness.

This definition of “the public” outlines a clear deficiency in the Securities Act in its inability to match the practical implications of its provisions with the underlying

[67] Securities Act, s 3(1).
[68] Griffiths, above n 27, at 1048 cites *Barclays New Zealand Ltd v Gillies* (1990) 5 NZCLC 66,659 (HC) at 66,679.
[69] Securities Act, s 3(2)(a). For a full discussion of the exceptions see Griffiths, above n 27, at 1049-1050.
[70] Griffiths, above n 27, at 1056.

purposes it seeks to achieve. Although the definition of disclosure is "the act or process of making known something that was previously unknown, or a revelation of facts"[71], this requires more than just presenting a set of facts. It must anticipate that the facts will be presented in a way in which they can be readily understood by the audience to which they are presented.[72] In this respect there is a clear mismatch between those to whom the Securities Act sets out to provide information through the widely framed definition of "the public", and those to whom such disclosure is actually meaningful.[73]

Disclosures are made in the form of a prospectus or investment statement, both of which contain detailed, lengthy and complex financial statements and analysis which are beyond the ability of the hypothetical "ma and pa" investor to comprehend.[74] However, the disclosure is understandable to those more financially sophisticated *investors* whose knowledge or position do not exclude them from the scope of "the public" under s 3(2). Whilst the Act broadly defines those to whom information must be disclosed, the nature of the disclosure does not adequately target the class of person identified. Thus the disclosure requirements of the Act operate to better inform *investors* with a fairly high level of financial knowledge, rather than the everyday *consumer*, despite the Act directly targeting such consumers with its disclosure requirements.

Even with a high level of dissemination of information within the market, if that information is not readily understandable to the bulk of the population at whom it is aimed, its benefit is limited. Due to the discrepancy between those to whom information is disclosed and those to whom such information is understandable, the Act's ability to meet the wider systemic goals which underpin the securities markets is reduced. Firstly, the efficiency of the market is compromised as the "ma and pa" investors are at risk of making poor investment choices having not had the benefit of reading and, crucially, understanding a prospectus or investment statement. Secondly,

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[71] Bryan A Garner (ed) *Black's Law Dictionary* (9th ed, West, Minnesota, 2009) at 531
[72] Linda Lanham, above n 8, at 7.
[73] It is interesting to note that a purpose of the Financial Markets Conduct Act, in s 4(a) is to "provide for timely, accurate, and understandable information …".
[74] Andrew Beck *Guidebook to New Zealand Companies and Securities Law* (CCH New Zealand, Auckland, 2010) at 170.

the clarity of the market is limited as the information within it is not understandable to a large portion of that market. Finally, such a mismatch allows greater scope for issuers to mislead less sophisticated investors with financial products they do not fully understand. This possibility threatens the equitable nature of the market, thereby reducing consumer confidence and their willingness to participate in the market.

It must be noted that such a mismatch is inevitable, as the financial markets are inherently complex. Regardless of the level of simplicity that is required of disclosed statements, to a portion of "the public" that information will not be comprehensible. This gap can be partially closed through the use of financial advisors who can provide a level of understanding to an otherwise unsophisticated investor. However, such advisors cannot be universally relied upon, as not all investors will be willing to employ their services. Making the use of financial advisors mandatory would not be feasible, as again a line would be drawn regarding the class of person to whom such a requirement would apply, which would add a significant burden to knowledgeable investors just below the s 3(2) threshold. As such it is an accepted reality of a securities regime that any attempt to match the disclosure provisions of the Act with the understanding of a portion of the market will always have some element of "deadweight loss" in those who are unable or unwilling to utilise that information. The crucial factor for the regulator is to estimate as well as possible an equilibrium between providing simple information that will minimise that "deadweight loss" and providing information at a level that allows the making of confident and informed investment decisions by the market as a whole. The imbalance that existed under the Securities Act has been targeted in the FMCA, which now requires disclosure at a more basic level than was required under the Securities Act.

3.3 Disclosure Requirements Under the FMCA

Under the FMCA, rather than a prospectus or investment statement, a shorter form product disclosure statement **("PDS")** is required. This follows the recommendation of the Capital Market Development Taskforce that the government "replace the investment statement and prospectus with a new, two-part disclosure document that aids understanding and comparability.[75] The PDS contains only information essential to an investor's decision, and is usually divided into two parts, being a one to two page summary of the key features and risks of the investment, coupled with a more detailed description of information essential to an investors decision.[76] The intention of this simplification is to enable investors to more easily make comparisons between similar products and offers, whilst ensuring that despite this simplification the most relevant information is still provided to investors.[77]

In making these changes Parliament has clearly identified the issue that investors with a lower level of financial knowledge will not generally read detailed analyses. It was stated in the MBIA discussion paper on the FMCB that "the opening text of the key information summary is the most important element of the PDS because it is the first, and perhaps only, disclosure that a potential investor will read before subscribing." This indicates that Parliament is attempting to widen the scope of disclosure to encompass those who are currently unable to fully engage with the more detailed disclosures currently made.

A requirement to simplify the information disclosed by issuers is a positive move in ensuring that the benefit of the Act and its related purposes are accessible to as much of the wide sector of society at whom the Act is directed as possible. Wider and more comprehensible disclosure better fits with the purposes of the regime, to the benefit of consumers and the economy as a whole. Even so, the disclosure focus of the regime operates on the assumption that investors will be aware that the PDS exists, know where to find it, and eventually consider it before making an investment decision. This lack of awareness is particularly relevant with regard to the less obvious types of security that wider disclosure aims to encompass. The lowering of the informational barrier under the FMCA is certainly a positive in minimising the gap between the level of financial sophistication of the PDS and those at whom it is aimed, but it does also highlight an inherent flaw relating to disclosure regimes in general, in that a fully informed market is an unattainable ideal.

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[75] Ministry of Business, Innovation and Employment, above n 25, at [2.1].
[76] Ministry of Business, Innovation and Employment, above n 25, at [2.2].
[77] Ministry of Business, Innovation and Employment, above n 25, at [2.1].

3.4 Conclusion

The provisions of the Securities Act have been shown to be compatible with the wider purposes of securities regulation, which it is suggested have underpinned the Act since its inception. The shortcomings outlined, in terms of a mismatch between those defined as “the public” and those to whom disclosure is understandable, impacts significantly on the Act’s ability to satisfy such objectives. However, these shortcomings relate to a disclosure regime generally, as opposed to the Securities Act specifically. Under the FMCA the information required to be disclosed is more simplistic, and as such disclosure under that Act will be more successful in fulfilling the purposes of securities regulation than its predecessor the Securities Act.

Chapter Four: Legislative and Judicial Background on the Definition of a Debt Security

Whilst it has been suggested that the wider purpose of upholding confidence in the securities market has been underpinning the Securities Act since its inception, the application of the Courts has not mirrored this stance. Thus in analysing the judicial history surrounding interpretation regarding the Act the prevalence of this wider purpose is be highlighted, as well as the fact that the decisions of the courts do in fact accord with the spirit of the legislation, even if not expressly.

4.1 The Relevant Legislation

Part 2 of the Securities Act 1978 **("The Act")** imposes a number of requirements upon the offeror of any security. The general concern of Part 2 of the Act is to ensure that those providing money in exchange for securities are given information regarding their investment, in the form of some combination of a registered prospectus and an authorised investment statement or advertisement.

As discussed, s 33(1) has been described as the Act's core section, prohibiting an *offer* of *debt or equity securities* to the public unless accompanied by an authorised investment statement, authorised advertisement, or a registered prospectus.[78] Further, under s 33(2), no debt security shall be offered to the public for subscription unless a trustee is appointed and the trust deed registered.[79] If these obligations are not complied with, s 37(4) deems the securities "invalid and of no effect."[80]

The primary principle that s 33 embodies is that no security can be offered for subscription to the public unless that offer is made in a mandated way.[81] In applying this principle of disclosure the Act widely frames the definitions of "the public", which has already been discussed in detail,[82] and importantly a "security".

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[78] Securities Act, s 33(1).
[79] Section 33(2).
[80] Section 37(4).
[81] Griffiths, above n 27, at 1045.
[82] See discussion at paragraph [3.2] of this paper.

Section 2D defines the activity which the legislation intends to govern, and in this respect dictates the overall scope of the legislation. Section 2D defines a "security" as any interest or right to participate in any capital, assets, earnings, royalties, or other property of any person, and importantly includes in subsection 1(b), a "debt security."

Section 2 of the Act specifically defines a debt security as:

> *... any interest in or right to be paid money that is, or is to be, deposited with, lent to, <u>or otherwise owing by</u>, any person ...*

An essential element of a debt security is the investor's right to repaid money.[83] In particular, the "or otherwise owing" portion of that definition frames the right to be repaid very broadly, allowing scope for the Courts to expand on the range of financial products encompassed by this definition. The breadth of such interpretation has been the focus of significant litigation,[84] however relevant authority preceding the Supreme Court decision in *Hickman v Turner and Waverley*,[85] was *Culverden Retirement Village v Registrar of Companies*.[86]

4.2 *Culverden Retirement Village v Registrar of Companies*

The authorities preceding the *Blue Chip* case focused their attention on the purpose of the Act as consumer protection, however they did not give effect to that in interpreting the Act purposively. Rather a technical approach was preferred, in reading down the wide scope of the definition of a "security." This implied that wider systemic goals were part of their decision-making rationale, even if they were not central to the Court's thought process. This is important, as whilst the consumer purpose outlined by the Court is disputed, their eventual decision did give

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[83] Griffiths, above n 27, at 1060

[84] Notable cases preceding *Hickman and Ors v Turner and Waverley Ltd* were: *DFC Financial Services Ltd (in stat man) v Abel* [1991] 2 NZLR 619 (HC); *Registrar of Companies v Culverden Retirement Village Ltd* (1995) 7 NZCLC 260,850 (HC); *Culverden Retirement Village Ltd v Registrar of Companies* (1996) 1 BCSLR 162 (CA); *Culverden Retirement Village Ltd v Registrar of Companies* [1997] 1 NZLR 257 (PC).

[85] *Hickman and Ors v Turner and Waverley Ltd* [2012] NZSC 72 [*Blue Chip*].

[86] *Culverden Retirement Village Ltd v Registrar of Companies* [1997] 1 NZLR 257 (PC).

consideration to the wider essence of securities regulation, with a focus on maintaining confidence in the market though promoting that market's efficiency, certainty and fairness.

Prior to the Blue Chip litigation, the relevant authority on the scope of the definition of a "debt security" was *Culverden Retirement Village v Registrar of Companies* [1997] 1 NZLR 257 (PC), which had been appealed from the Court of Appeal decision in *Culverden Retirement Village Ltd v Registrar of Companies* (1996) 1 BCSLR 162 (CA). These decisions broadened the definition of a debt security, with particular focus on the phrase "or otherwise owing." The argument made on behalf of Culverden was that the definition should be construed as only applying to transactions of a similar nature to a deposit or loan.[87] This was rejected by the Court of Appeal, a decision upheld by the Privy Council, which ruled that "money otherwise owing" implied a requirement of reciprocity or mutuality, under which there had to be money payable by an investor to an offeror, in exchange for some future repayment to the investor from the same offeror.[88]

In *Culverden*, it was ruled that this reciprocal payment requirement was met, as under the relevant agreement the retirement home would repurchase an investor's home at purchase price upon their occupation ceasing. While the payment was not in the same vein as a loan, it was "a repayment in the sense of the payment back of the same amount, subject to adjustment charges and inflation.[89] The Court held that the conclusion they had arrived at was "consistent with the purpose of the Act," and this was further endorsed by the Privy Council.[90]

Neither the Court of Appeal nor Privy Council decision expressly touched on the wider more systemic purposes of the Act as have been outlined,[91] although the Court of Appeal did interestingly note that they did not see any reason to read down the wide language of the definition. However, through the requirement of reciprocal

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[87] *Culverden Retirement Village Ltd v Registrar of Companies* (1996) 1 BSSLR 162 (CA) at 165.

[88] *Culverden* (CA), above n 87, at 167.
[89] *Culverden* (PC), above n 86, at 260
[90] *Culverden* (PC), above n 86, at 261
[91] See discussion above, at Chapter 2

payments that the Court applied, they have in fact done precisely that, in limiting the scope of the legislation.[92] Thus the Court clearly did balance what they saw as the Act's purpose, being investor protection, with the risk of commercial uncertainty in their limiting of the scope of a "debt security."[93] Importantly, this was achieved through a narrower and more technical reading of the statutory provisions, as opposed to an application of a purposive approach. Even had a purposive approach been implemented, the tenor of the Court's decision indicates that they would likely have come to the same decision, in limiting the scope of the legislation in line with the need for commercial certainty in upholding the Act's wider purposes.

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[92] *Culverden* (CA), above n 87, at [312].
[93] *Culverden* (CA), above n 87, at [276].

Chapter Five: *Hickman v Turner and Waverley Ltd*

This case arose regarding investment schemes marketed by Blue Chip (New Zealand) Ltd **("Blue Chip"),** under which investors were offered what Blue Chip called a "packaged ownership solution", whereby they gave potential investors the ability to tap into dormant equity in their un-mortgaged homes.[94] Such schemes were prevalent during the mid 2000's, as investors looked to capitalise on the residential property boom through companies such as Blue Chip, who offered them a "hands off" investment option.[95]

5.1 The Schemes

Blue Chip offered investors the opportunity to buy apartments under a range of different products **("The Schemes")**.[96] Broadly these products revolved around a four-stage strategy based upon:[97]

- Blue Chip identifying and securing sites suitable for apartment buildings;
- Either selling those sites to a developer who would build upon them, or Blue Chip directly planning and funding the construction of the apartment buildings;
- Blue Chip then marketing and selling apartments "off the plan" to short-term investors in order to generate sufficient pre-sales to allow funding to be raised to cover the costs of constructing the apartment buildings; and
- Blue Chip either sourcing a new purchaser for each apartment to step into the SPA in the place of the investor, or alternatively Blue Chip retaining the ability to step in and purchase the apartment themselves.

The three products that the Supreme Court was concerned with were the *Joint Venture Agreement* **("JVA"),** *Premium Income Product* **("PIP")** and *Put and Call Agreement* **("PAC")**, which all share some vital features. Generally the investor entered into a

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[94] Barry Allan "Blue Chip and Attribution" (2012) NZLJ 317 at 317.
[95] Greg Ninness "Property Investing The Hands Off Way" *Sunday Star Times* (online ed, Auckland, 22 October 2006).
[96] *Blue Chip* (SC), above n 85, at [7].
[97] At [7].

sale and purchase agreement **("SAP")** with a developer regarding an apartment, with the necessary funds borrowed from an independent third party, such as GE Finance Ltd.[98] Typically the investor would give a mortgage over the family home to secure this borrowing.

Crucially the only payments made by the investor went to the developer, and not to Blue Chip.[99] However, under all three of these products, fees were payable to the investor by Blue Chip, with the payments under the JVA and PIP in particular being in a form very similar to interest.[100] Under the JVA, the investor and Blue Chip jointly owned the apartment, and Blue Chip would pay the investor a fortnightly "procurement fee".[101] Under the PIP the investor was the sole purchaser of the apartment, and was required to pay the developers a ten per cent deposit. In return for the right to step into the SAP, Blue Chip paid a monthly "option fee", which amounted to a return on the investors deposit of approximately 16 per cent per annum.[102] The JVA and PIP both provided the investor with a periodic rate of return on an initial deposit, providing the investor with a source of income that does appear in substance very similar to interest. Lastly, under the PAC, a one off "call option fee", generally of $7,500, was payable, being a proportion of the underwriting fee Blue Chip received from the developer.[103]

Under each product the intention was never for the investor to retain ownership and eventually live in, or personally rent out, the house. Under the JVA, it was envisaged that the property would be on-sold after approximately four years, with 95% of the capital gain going to Blue Chip.[104] Under the PIP, Blue Chip retained an option to acquire the apartment from the investor prior to settlement, and it was envisaged and expected that this right would be exercised after about two years.[105] Finally under the PAC, there were "put and call options" under which Blue Chip could call for, or have

[98] Allan, above n 94, at 317.
[99] Allan, above n 94, at 317.
[100] *Blue Chip*, above n 85, at [10].
[101] At [10].
[102] At [13].
[103] At [15].
[104] At [10].
[105] Allan, above n 94, at 317.

put to it by the investor, the right to acquire the apartment. Relating to this option, the investor held only a limited right requiring Blue Chip to purchase the apartment.[106]

The crucial aspects of these agreements are their similarities in terms of the respective investors making payments to the developers, Blue Chip's subsequent payment of fees similar to interest to those investors, and the investor never being the intended eventual owner of the apartments. These factors were vital elements of the analysis of the courts at every level.

These schemes were offered against the backdrop of a booming Auckland property market, with the Blue Chip business model working well whilst this boom continued.[107] In the event that the market cooled and Blue Chip's fortunes turned, the investor would be left to complete the purchase of the apartment.[108] The nature of this arrangement meant that all of the power in the relationship lay with Blue Chip, as there were no enforceable agreements requiring them to step into the SAPs,[109] and thus if the market did downturn the risk of loss lay primarily with the investor.

As such, upon Blue Chip's collapse in February 2008, investors were left bound by their SPAs and were obliged to settle, with many facing the prospect of losing their family homes.[110] It is against this background that the proceedings began, whereby the investors claimed that the Blue Chip marketing of these products did not comply with the provisions of the Securities Act, and that thus they were not bound by their respective SPAs. The case turned on the breadth of the various courts interpretation of a "security", and ultimately the determination as to whether the Blue Chip products were "debt securities" or not.

[106] Allan, above n 94, at 317.

[107] Fairfax NZ News "Chips Down as Shares Slump" *Sunday Star Times* (online ed, Auckland, 7 November 2007).

[108] *Hickman v Turn and Wave Ltd* [2011] NZCA 100, [2011] 3 NZLR 318, at [3] of the Appendix: The Lester's (investors) were told by Mr Jones (Blue Chip salesperson) that worst case scenario was that they would end up owning an apartment that they could then sell.

[109] Allan, above n 94, at 317

[110] Sacha Judd "Legal Update on Banking and Commercial Law" (August 2012) Buddle Findlay <www.buddlefindlay.com>.

5.2 *Hickman v Turn and Wave Ltd* (CA)

The Blue Chip litigation originated in three separate decisions heard before Venning J in the High Court.[111] These cases were appealed, and heard together in the Court of Appeal case of *Hickman v Turn and Wave Ltd* [2011] NZCA 100, [2011] 3 NZLR 318.

The Court carried out a detailed analysis of the purpose of the Securities Act, stating the purpose of the regime as being to protect the investing public.[112] The Court then noted that the *Culverden* litigation had set out the appropriate approach in interpreting the term "debt security." This approach was summed up in that "the scheme of the Act appears to cast the net in the widest possible terms, and then to rely on specific exclusions to limit its scope … We see no reason to read down the wide language of the definition."[113]

Despite reminding itself of this broad interpretive policy, the Court went on apply the developers *ejusdem generis* argument that "the expression 'any interest or right to be paid money that is … otherwise owing'… should take colour from the other terms included in the definition." In justifying this reading down, the Court noted that "the legislature must have intended some limit on the definition of debt security given the residual nature of the definition of "participatory security."[114]

Under this technical approach, it was ruled that each of those "other terms" (deposits, loans, debentures, debenture stock, bonds, notes, certificates of deposit, and convertible note) shared the "underlying concept of a payment by a subscriber to an

[111] *Lester v Greenstone Barclay Trustees Ltd* [2010] 3 NZLR 67 (HC); *Hickman v Turn and Wave Ltd* HC Auckland CIV-2008-404-5871, 25 November 2009; and *Icon Central Ltd v Collingwood* HC Auckland CIV-2008-404-7424, 25 November 2009.

[112] *Hickman v Turn and Wave* (CA), above n 108, at [274].

[113] At [276]; citing *Culverden* (CA), above n 87, at 166; and *Culverden* (PC), above n 86, at 261.

[114] Participatory security is defined in s 2 of the Securities Act as any security other than an equity security, debt security, unit in a unit trust, interest in a superannuation scheme, or a life insurance policy.

issuer with a right of repayment of the amount contributed, usually with some additional element of interest, profit or other preliminary advantage."[115]

Based on this approach, the Court distinguished *Culverden*, as there the issuer of the security was the vendor of the retirement homes, the same party who would have to make the eventual repayment to the investor. In this case investors dealt separately with the developers to whom they paid money (through deposits relating to the SAPs) and Blue Chip from whom they received payments through the relevant scheme. Further, the repayment obligations upon Blue Chip were not a direct repayment of the deposits investors paid to the developers; rather they were the payment of entirely separate fees. Thus the Courts focused upon the form of the individual transaction, determining that the investors payment of the deposit and corresponding receipt of fee payments were not sufficiently mutual so as to be considered similar to those "other terms".

The Court of Appeal concluded that based upon the narrower definition of a debt security in *Culverden*, requiring an element of reciprocity between the payments made and obligations owed, a three-way interaction such as this could not be seen as a "debt security." Resultantly the investors remained bound by their respective SAPs with the developers. Summing up this literal or technical approach, the Court concluded that:[116]

> While, as *Culverden* attests, the definitions of security and debt security are widely expressed, we do not consider that Parliament intended the definition of debt security to embrace commercial transactions *which do not involve some element of repayment of money subscribed by investors. Culverden* may be regarded as an unusual application of the Act …

Although expressing the purpose of the Act as investor protection,[117] the Court followed the lead of *Culverden* in applying a technical, rather than purposive approach in reading down the scope of the provisions. As such this consumer

[115] *Hickman v Turn and Wave* (CA), above n 108, at [313].
[116] At [312].
[117] At [311].

protection purpose was not given direct effect in the Court's decision. However, the Court did state that "while we are conscious of the need to ensure that the protective purpose of the Act is not diminished by adopting an inappropriately narrow view of what constitutes a debt security, we must also have regard to the risk of adopting an approach which is too broad. That would have the potential for unintended consequences and could create undesirable commercial uncertainty as to the requirements of the Act." Thus, the Court's decision does acknowledge that in the promotion of confidence in the regime a wider interpretation is preferable; however such an interpretation must be tapered by considerations of commercial certainty on the part of issuers, and the sorts of products the legislature is intended to encompass.

Whilst the competing purposes of promoting confidence in the regime and upholding commercial certainty were evidently given weight by the Court, the fact that it did not form a significant portion of the Court's decision is cause for concern. Such gaps in reasoning leave the door ajar for the underlying purposes of the Act to be forgotten, or picked and chosen at will, the dangers of which were highlighted by the Supreme Court decision which did not address them at all.

5.3 *Hickman v Turner and Waverley Ltd* (SC)

The Supreme Court unanimously found that the Blue Chip products were "debt securities" offered in breach of the Securities Act, and that as a result the sale and purchase agreements were unenforceable. In doing so the Court departed in almost every respect from the decisions of the lower Courts, an outcome that set the alarm bells of a number of leading practitioners ringing.[118] Whilst the Court's eventual conclusion is reconcilable with the wider systemic purposes of the Act,[119] its application of legal principle in reaching that conclusion warrants concern.

Broadly speaking the arguments raised before the Court were that, according to the appellants, the Blue Chip products were debt securities as "they conferred on the

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[118] Sacha Judd, above n 110; Gerard Dale "Supreme Court Decision Provides Relief For Investors" (August 2012) Lane Neave <www.laneneave.co.nz>; Murray Tingey "What is a 'Security' and When Does A Sale of Land Require a Prospectus? The Supreme Court Reverses Previous Thinking" (August 2012) Bell Gully <www.bellgully.co.nz>.
[119] See discussion above, at Chapter 2

investors the right to be repaid money that was owing to them by Blue Chip." This arguments inconsistency with the *Culverden* approach were addressed, in that "although that money could not be said to have been deposited with or lent to anyone, it was nonetheless "otherwise owing."[120] Such a broad interpretation aligns more closely with the notion of an investor protection purpose, in justifying an extension of the *Culverden* principle.

The developers on the other hand argued that in line with *Culverden*, the term "otherwise owing" should be read *ejusdem generis* with "deposited with" and "lent to", and thus only include "indebtedness which is of the same general nature as an obligation to repay money that has been 'deposited with' or 'lent to' whoever has the payment obligation." Further, the definition ought to be confined to obligations to repay to a subscriber money previously paid by the subscriber to the issuer.[121] This more restricted interpretation accords with the upholding of commercial certainty as to when disclosure will be required, as is required under the broad principles of the securities regime as have been outlined.

In determining the approach to be taken regarding this interpretation, the Court referred to the history of the legislation, the general structure of the Act and a number of leading decisions on the scope of a "debt security."[122] The critical question to be determined was whether the phrase "or otherwise owing" would include a situation where the money said to be owing had not been paid to the party who owed it.[123] These considerations led the Court to conclude that the definition of a "debt security" required a "*purposeful but non-technical construction*", particularly with regard to the "or otherwise owing" portion of that definition. Such a construction gave the Act the necessary scope to encompass what had been described during the enactment phase of the Act as "less usual types of securities … that had not yet given rise to similar duties and responsibilities as apply to the usual types of investment."[124] An expansion of the disclosure requirements of the regime was the intention of Parliament in passing the

[120] *Blue Chip*, above n 85, at [37].
[121] At [38].
[122] *Blue Chip*, above n 85, at [40].
[123] Allan, above n 71, at 318.
[124] (14 December 1977) 416 NZPD 5339.

Act, and in applying such an expansive approach the wider systemic goal of promoting confident participation in the market can be achieved.

In employing this approach, the Court noted that "sections 33 and 37 and the associated definitions of "security" and "debt security" should, despite their breadth, be read in a way which accords with the ordinary meaning of the words used.[125] The Court noted that the Act's scope was explicitly limited through regulation which could either extend or limit its application. This is carried out by the exemptions in s 5 (particularly s 5(1)(b) in relation to real estate), and s 5(5) giving the FMA the ability to exempt any person or transaction from the operation of the Act if they so chose.[126] In other words, the Court did not see the breadth of the Act's provisions as warranting a reading down exercise, as the Act specifically limited its scope in other areas.[127]

Justice William Young, who gave the lead decision for the majority of the Supreme Court, found support for this proposition in the plain reading given to the relevant Australian provisions by the High Court of Australia in *Australian Softwood Forests Pty Ltd v Attorney-General for the State of New South Wales*.[128] In determining the scope of their definition of "interest",[129] the Australian High Court looked to "glean from the legislative provisions an overall purpose which, being limited in scope, justified a reading down of the definition."[130] In ascertaining such a purpose, the Court quoted the observation of Young CJ in *A Home Away Pty Ltd v Commissioner for Corporate*, in that "if it were said that we should give effect to the purpose Parliament wished to achieve, we must first ascertain the purpose and that can only be

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[125] *Blue Chip*, above n 85, at [46].
[126] *Blue Chip*, above n 85, at [46] notes that the Securities Commission's power to grant exemptions under section 5(5) of the Act was repealed when the Securities Commission was disestablished in 2011. However this exemption power was re-enacted in s 70B, with the power to grant exemption then resting with the FMA.
[127] *Blue Chip*, above n 70, at [46].
[128] *Australian Softwood Forests Pty Ltd v Attorney-General for the State of New South Wales; ex rel Corporate Affairs Commission* (1981) 148 CLR 121.
[129] "Interest" is defined in s 76(1) of the Australian Companies Act 1961 as "any right to participate, or interest, whether enforceable or not and whether actual, prospective or contingent, in any profits, assets or realisation of any financial or business undertaking or scheme, in any common enterprise in which the holder of the interest is led to expect profits, rents or interest from the efforts of the promoter of the enterprise or a third party, or in any investment contract.
[130] *Australian Softwood* Forests, above n 127, at 125.

ascertained from the language used."[131] No such purpose justifying a reading down was able to be found, with the Court determining that "interest" should be given a particularly wide meaning in light of the power under the Act to exempt certain rights or interests from its scope.[132] This analysis aligns with the thrust of the Securities Act, in that the legislation is proscriptive, coupled with specific dispensary powers. As such the Supreme Court felt able to rely on *Australian Softwoods* in deeming that a reading down of the provisions would have been inappropriate, impliedly stating that the investor protection purpose they had highlighted did not warrant such a reading down. In contrast, the Court of Appeal considered that an investor protection focus did justify a more technical reading of the "debt security" definition and as discussed they read the provision down so as to require the common element of the repayment of money contributed, which was consistent with the decision in *Culverden*.

In justifying a broader interpretation in line with the arguments raised by the appellants, the Supreme Court relied heavily on the notion that the predominant purpose of the Act was to protect investors. This justified a focus on the *substance* of the agreements, with the Court asking itself whether money was "otherwise owing" from the *perspective of the investors*, when looking at the *scheme as a whole*. This contrasted with the approaches of the lower Courts, who had taken a more formalistic approach in analysing the various agreements independently, determining that the various "financial products" offered by Blue Chip were additions to the SAPs, as opposed to forming part of the same broad scheme.

a) Purposive approach

Given the wide scope of the definition of a debt security, the Court certainly had the latitude to employ a purposive approach, as opposed to the more literal or technical approach of the Court of Appeal.[133] However, what is alarming about the Supreme Court's application of this purposive approach is the lack of in depth consideration of the purpose to which they were referring. The Court made some very general

[131] *A Home Away Pty Ltd v Commissioner for Corporate Affairs* (1980) 5 ACLR 299 at 302; (1980) CL 34,444 at 34,446.
[132] *Australian Softwood* Forests, above n 127, at 125.
[133] Matthew Dunning "The Definition of "security" for purposes of a Securities Act" (1984) NZLJ 71 at 74.

references indicating that the New Zealand legislation is aimed in a similar direction to the legislation in Canada, America and significantly Australia. Further the Court referred to the comments made by the then Justice Minister, David Spence Thomson, when introducing the Securities Advertising Bill 1977, where an investor protection purpose was indicated.[134] It was thus implied by the Court in a roundabout manner, that the sole focus of the Act is on investor protection and it was this that justified the broad interpretation the Court implemented.

This aspect of the decision is an area in which the Court ought to have entered into more detailed discussion. This is particularly concerning given that the Court of Appeal, after entering into a far more detailed analysis of the Act's purpose, arrived at the same investor protection purpose as the Supreme Court, yet ultimately came to a different conclusion as to the scope that such a purpose warranted.[135] Whilst a purposive approach was generally appropriate based on the wide statutory terms of the Act, the Court not only highlighted an indirect outcome of the Act's provision, being investor protection, as its main objective, but further failed to touch on any of the main purposes that it has been suggested underpin the Act.

b) Substance over form

In pursuing this "purposeful, but non-technical" construction of a "debt security", the Court took a more holistic and substantive approach, departing from the approach taken by preceding cases on the point, which had focused more on the form of the individual agreements.

When determining the question of whether or not there is a security the Courts have generally adopted an investor-centric approach.[136] Further, *Culverden* is authority for the proposition that when determining this question a transaction may be viewed holistically.[137] In line with this reasoning, the Court looked at the nature of the schemes as a whole, in which Blue Chip was in effect the "conductor of the

[134] *Blue Chip*, above n 85, at [45] and [56].
[135] *Hickman v Turn and Wave* (CA), above n 108, at [272]–[279].
[136] *DFC Financial Services Ltd v Abel* [1991] 2 NZLR 619 at 629; cited with approval by the Court of Appeal in *Hickman v Turn and Wave* (CA), above n 108, at 386.
[137] *Culverden* (PC), above n 86, at 260

orchestra". The essence of the transactions when viewed holistically was that Blue Chip were obtaining finance from the public in aiding the accrual of an inventory of apartments which they could either rent out themselves, or sell on at a profit.[138] When considering the four-stage scheme Blue Chip were operating[139] the Supreme Court looked at these elements as a whole. In contrast, the preceding Courts had considered each portion of the arrangement independently. Thus although the payments of the deposits were made to the developers, Blue Chip had orchestrated the scheme and stood at its fulcrum, and were set to indirectly benefit from those payments.[140] Had these arrangements been less elaborate, and Blue Chip simply borrowed money from private investors to purchase the apartments, the transactions would undoubtedly have been deemed the issuing of debt securities.[141] The Supreme Court ruled that in essence this was precisely what Blue Chip were doing through their schemes, masked by the "illusion" that the investors were purchasers of the apartments. As such the Supreme Court decided that the money and obligations owed by Blue Chip to the investors were "financing in nature" and "rather like" those owed to a borrower by a lender.[142]

The Supreme Courts adoption of a "substance over form" approach further allowed them to depart from the rationale of the preceding Courts with regard to their application of the s 5(1)(b) real estate exception. The argument successful in the High Court and Court of Appeal was that some of the schemes offered by Blue Chip fell squarely within the real estate exception found in s 5(1)(b).[143] This section broadly holds that the compliance provisions of the Act do not apply in respect of "any estate or interest in land …".[144] In *Culverden* it was ruled that the exemption aimed to exclude "ordinary purchasers of land", enabling real estate to be sold to the public without requiring compliance with the Act.[145]

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[138] Allan, above n 94, at 319.
[139] For detail of these four stages see paragraph [5.1] of this paper.
[140] Aside from benefits from the scheme as a whole, Blue Chip under the PAC agreement was receiving an underwriting fee from the developer – see *Blue Chip*, above n 85, at [15].
[141] Allan, above n 94, at 319.
[142] *Blue Chip*, above n 85, at [59].
[143] *Hickman v Turn and Wave* (CA), above n 108, at [292].
[144] Securities Act, s 5(1)(b).
[145] Allan, above n 94, at 319.

There is no dispute that the sale of the apartments themselves amounted to the sale of estates or interests in land. However, the question as posed by the Supreme Court, mirroring the approaches taken in the lower Courts, was whether the purchase of land was ancillary or peripheral to the other elements of the transaction. In the High Court decisions a strict formalistic approach was applied, in that the primary purpose of the transactions was entry into the SAPs, with the fees payable by Blue Chip resultant upon that. For instance, the PIP scheme was seen merely as an option to buy an interest in land, and thus placed directly into the s 5(1)(a) exception.[146]

The Court of Appeal noted that "if the agreement … contained an unusual feature which was not merely ancillary but was an important or cardinal feature of the transaction from the investor's point of view, then the exemption would not apply."[147] Thus the Court felt that such an approach would allow investors to be protected against "unusual risk not normally associated with an ordinary agreement for sale and purchase of land."[148] In the case of the JVA the fees payable were the sole, and unusual, reason for entry into the SAP, and thus this product was not exempted from the provisions of the Act. However on the other hand the option fees under the PIP and PAC were seen as quite normal, with the investors gaining an equitable interest in the land, giving them tangible security and protections under the ordinary law of contract, and thus the real estate exception was applied.[149] The applications by both the High Court and Court of Appeal highlight their focus upon the form of the individual transactions, in stark contrast to the holistic consideration of the substance of the transactions as relied upon by the Supreme Court.

The Supreme Court again took a more substantive view, looking at the actual role of the apartments in the transaction, and deeming that in reality the apartments were only of peripheral significance to investors entering into the JVA, PIP and PAC. The investors' entry into the agreements was primarily to obtain the fees from Blue Chip, as opposed to making any gains on the rent or sale of the apartments,[150] or eventually

[146] Griffiths, above n 27, at 1062.
[147] *Hickman v Turn and Wave* (CA), above n 108, at [347].
[148] At [347].
[149] *Hickman v Turn and Wave* (CA), above n 108, at [338].
[150] This was highlighted by the fact that under the JVC the investor only stood to claim 5% of any capital gain

occupying them.[151] This is clearly shown in the nature of some of the actual investments made, with investors such as the Hickmans entering into various agreements to purchase eighteen apartments in total.[152] The scale of this investment indicates that they intended to make their profit on the fees payable by Blue Chip in the short term, with no intention of the property itself being of great significance to the transaction. Further, it is inconceivable they would have had, or been able to raise, the necessary funding to complete the full purchase of all eighteen properties. This indicates that whilst the investors were reliant upon the apartments as a measure of security over their investment,[153] they were in fact more heavily dependent upon the solvency of Blue Chip in meeting their fee paying obligations.[154] This was highlighted by Blue Chip themselves in their 2005 annual report stating that "Blue Chip New Zealand's point of difference remains providing a financial planning solution that utilises property, rather than just providing a property itself … Investors know up-front the returns to expect, which is more akin to a financial product than a standard property investment," a view which the Supreme Court evidently shared.

5.4 Reconciliation with the Purpose of the Act

Ultimately the effect of the Supreme Court decision has expanded the scope of the definition of a "debt security," extending the circumstances in which disclosure may be necessary. Bell Gully partner Murray Tingey issued an update following the decision outlining its broad commercial effects. This noted that if the obligations arising under a transaction are effectively borrower/lender obligations the product may be a debt security, and likewise the product may be deemed a debt security if when the scheme is looked at as a whole it appears to be a mechanism for obtaining financing from the public.[155] Thus the question that must be posed is whether the Supreme Court's focus on the "vibe" of the transaction, as opposed to a "meticulous

[151] *Blue Chip,* above n 85, at [61].
[152] *Hickman v Turn and Wave* (CA), above n 108, appendix at [18].
[153] Ninness, above n 95.
[154] Allan, above n 94, at 319.
[155] Murray Tingey "What is a 'Security' and When Does A Sale of Land Require a Prospectus? The Supreme Court Reverses Previous Thinking" (August 2012) Bell Gully <www.bellgully.co.nz>.

examination of the statutory definition,"[156] accords with the essence of securities regulation as has been outlined.

As discussed, the underlying purpose of the Act is to encourage confident participation in the financial markets, through ensuring that they run efficiently and are sufficiently certain and clear. This purpose is achieved through wider application of the Acts disclosure principles, through which investors are indirectly protected from being misled by "disreputable promoters operating in less well regulated areas."[157]

The Blue Chip decision, through its "investor-centric", "substance over form approach", allows the Act to better target what were referred to at the time of the Act's enactment as "less usual securities."[158] The Act generally aims to target all capital raising or investment activity through casting its net widely, whilst providing for express exceptions. As such, an interpretation with less focus on the form a transaction takes, rather looking to a transactions economic consequences, does better accord with the spirit of the legislation.

Generally speaking the higher the level of understandable information disseminated through the market the more efficiently it will run, with resources being channelled to investments of a higher worth.[159] As such the widening of the Acts disclosure requirements by the Supreme Court does accord with the market efficiency purpose the Act aims to implement. However, the wider requirements do mean that issuers will be more inclined to prepare a prospectus, even as a precaution. The costs of disclosure are significant, and thus the circumstances in which disclosure is required should not be open ended. However, when reporting on the proposed Securities Regulations 1983, the Securities Commission addressed this issue in stating that "to those who must provide the information they feel is surplusage to their well-conducted activities, we feel obliged to say that the burden of providing it is part of the price they must pay for the benefit of public confidence in the fund-raising

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[156] Allan, above n 94, at 318.
[157] (14 December 1977) 416 NZPD 5339.
[158] (14 December 1977) 416 NZPD 5339.
[159] Established at Chapter One of this paper.

mechanisms of the business sector."[160] As such, although as was noted in Morison's Securities Law, "the disclosure philosophy behind the legislation must be reconciled with commercial reality and practice,"[161] this balance will generally be resolved in favour of the consumer of financial products, as it is the issuer who seeks to benefit from the transaction, and is better placed to bear the increased disclosure costs.

The Supreme Court acknowledged that there were a number of arguments that a plain meaning approach as they had implemented would result in a "catastrophically broad application of the Act."[162] In particular, concerns were raised that under such an interpretation the Securities Act would apply whenever some offering of goods or services to the public carried the possibility that the offeror might have to pay money as a result of some defect in those goods or services, or if they were not provided at all.[163] Buddle Findlay issued an update outlining similar concerns in querying whether cell-phone pre-paid balances, gym or other club memberships or insurance might be netted by this wider scope.[164] The Supreme Court answered these concerns by stating that although merchants do have a liability for compensation in the event of fault or misrepresentation, a person offering such goods or services cannot sensibly be said to be further *offering* those compensation rights.[165]

It is, with respect, suggested that this does not sufficiently dispose of the concerns regarding the extension of this law into the sphere of consumer goods and services. The examples given above by Buddle Findlay are in fact not as troublesome as they may appear. They give the supposed "investor" a right to repayment in the form of services, for instance the use of a phone network, or the right to access a gym. Thus under a plain reading of the provisions, such examples could not be said to be an "interest or right to be paid money" as is necessary to be deemed a debt security.[166] However, more troubling would be a situation where a "money back guarantee" is offered. It is difficult to argue on the plain reading endorsed by the Supreme Court that under such a guarantee, a contingent right to be paid money is not being offered

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[160] Securities Commission, above n 21, at [3.3.6].
[161] Borrowdale, above n 14, at [1.6].
[162] *Blue Chip,* above n 85, at [57].
[163] *Blue Chip,* above n 85, at [57].
[164] Buddle Findlay, above n 110.
[165] *Blue Chip*, above n 85, at [58].
[166] Securities Act, s 2.

to the public. Such a "money back guarantee" might arise if real property is marketed which if misrepresented might result in a monetary liability by the vendor to the purchaser.[167] If such a liability would be seen as an "ordinary incident of such property transactions" it would naturally fall within the s 5(1)(b) exception, as per the test applied by the Court of Appeal.[168] However, if the scheme took on a more unusual structure, whereby collateral agreements accompanied the SAP and intended to provide returns based on the efforts of another party (such as Blue Chip), disclosure could be required.[169] As such, for the Court to fully justify their wider conclusion and align it with the wider purposes of the Act, greater reference to their purposive approach would have been necessary.

The regime's intention is to encapsulate "less usual types of securities" that appear to be, in essence, the raising of capital from the public, rather than such "straightforward consumer transactions.[170] Thus if a Court were faced with such arguments regarding consumer goods or services, on the purposive approach preferred, it could not be said that such transactions fell within the intended scope of the legislation. This is because such transactions do not have the necessary *investment purpose* when viewed from the point of view of the investor. As such the wide reading of the Supreme Court, with its related concerns regarding scope, could have been better justified by focusing, which the Supreme Court did not, on what the purpose of the Act is and the classes of activity the Act intends to target. Even so, for those more complex land related products, the Blue Chip case clearly puts such offerors on notice that s 33 disclosure may be required if the scheme when viewed from the investors perspective appears to be geared towards the raising of capital, and thus the Supreme Court decision does accord with the spirit of the legislation generally.

A further concern is raised regarding the fact that not one of the many investors in the Blue Chip schemes asked for a prospectus to be disclosed.[171] Given that the Act has 35 years of history behind it, it is concerning that there remains such a clear lack of understanding of the disclosure requirement underpinning its operation. The investors

[167] *Blue Chip,* above n 85, at [58].
[168] See discussion at paragraph [5.2] of this paper.
[169] Murray Tingey, above n 152.
[170] *Blue Chip*, above n 85, at [58].
[171] Griffiths, above n 27, at 1063.

ranged from typical "ma and pa" investors such as the Lesters,[172] through to more fairly financially sophisticated investors such as Mr Crawford-Greene, who had previously worked as a stockbroker.[173] Whilst it is clear that greater public education is necessary,[174] it is again important to view the schemes from the point of view of the investors. Blue Chip had masked the fact that the schemes were in fact a means of raising capital from the public through the involvement of the apartments in the transaction. As such, exactly as Blue Chip intended, the investors did not see the agreements as presenting risks that would ordinarily be disclosed in a prospectus, and thus did not request to view one. Through the "substance over form" approach employed by the Supreme Court, wider disclosure on the part of issuers is required, which under the FMCA will be provided in a more simplistic form. Thus if a Blue Chip type situation were to arise in the future disclosure would be required, without the need for an investor to request such information. Thus the issue that public do not fully understand when disclosure will be provided is targeted by the wider and more simplistic presentation of information under the FMCA, with the onus of providing information sitting firmly with the issuer of the security.

5.5 Conclusion

This uncertainty regarding the scope of the Act's disclosure requirements is a key area in which this decision may not correspond to the suggested purposes of the Act. It is important that issuers should know in advance the circumstances in which disclosure is required of them, and further that investors know with sufficient certainty when disclosure can be expected.

Such wide disclosure requirements raise the possibility that the market will become flooded with information, as issuers seek to ensure that they do not fall foul of the Act's disclosure requirements. Such an oversupply of information may reduce the efficiency of the market, as the costs of searching for and analysing that information are raised, with the key information useful to investors being diluted. However, this is the lesser of two evils, as it is better for the market to be oversupplied with

[172] *Hickman v Turn and Wave* (CA), above n 108, appendix at [1].
[173] *Hickman v Turn and Wave* (CA), above n 108, appendix at [77].
[174] Griffiths, above n 27, at 1063.

information than undersupplied, and vulnerable to being misled by issuers. Further, such increased disclosure costs may provide a disincentive for issuers to enter the market. Again, this is again a necessary cost of upholding wider confidence in the securities regime generally, and a burden which is better borne by the issuer.

Generally the Blue Chip case has given any issuer of a financial product, the overall design of which looks like it could be geared toward the obtaining of funds from the public, including those connected with real estate, are given a clear red flag to carefully consider whether the disclosure requirements of the Act might apply. Such a wide interpretation in fact provides more certainty than that employed by the Court of Appeal as issuers of "less usual securities" have been given the clear signal that if holistically their scheme raises money from the public, disclosure will be necessary.

Thus following another high profile finance company's collapse, the Supreme Court decision achieves exactly what the Securities Act was initially enacted to do – ensure that investor and issuer confidence in the regime is maintained, so as to encourage their continued participation in New Zealand's capital markets. Through a wider reading of the Act, greater disclosure is encouraged, whilst the scope of the legislation is still tempered by a purposive and investor-centric approach. This provides a means to avoid situations where contingent rights to receive money owing under a straightforward consumer transaction could potentially require disclosure under the Act. As such consumer and issuer confidence is maintained under the Supreme Court approach: the scope for unscrupulous issuers to take advantage of loopholes in the disclosure regulation has been narrowed, and issuers are more certain of their responsibilities of disclosure, albeit meaning that wider disclosure is required.

Chapter Six: Ongoing Influence of the Decision

Given that the FMCA has recently been enacted and will begin its progressive commencement in April 2014,[175] the long-standing effect of the Supreme Court's analysis in the Blue Chip case might well be limited. The case related to fairly unusual circumstances, and the introduction of the FMCA will undoubtedly give rise to new types of transactions, new grey areas and a new set of issues for consideration by the courts.[176] However, as this dissertation has aimed to highlight, the new purposes specifically drafted into the FMCA have in fact been underpinning the Securities Act since its inception, and thus interpretation under the FMCA should follow a similarly holistic and investor-centred approach, giving the case significant ongoing application.

However, the FMCA does slightly alter the definition of a "debt security", with the new definition being more extensively defined[177] as "a right to be repaid money or paid interest on money that is, or is to be, deposited with, lent to, or otherwise owing by, any person."[178] The key change is that the FMCA definition specifically refers to a right to be "repaid" money, which is a change from the broader right to be "paid" money under the Securities Act definition.

Another notable change to the wording of the FMCA is that the term "security" from s 2 of the Securities Act has been replaced by the phrase "investment product" in sections 7 and 8 of the FMCA. This change is an embodiment of what Chapman Tripp noted, in that the changes to the definitions in part 1 of the FMCA focus more on the economic substance of a financial product than on its legal form.[179] Thus it is now clearer under the FMCA that the Act aims to encompass all financial products which appear to be financing in nature. The term "security" previously connoted a

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[175] Roger Wallis "A Navigational Guide to the Financial Markets Conduct Act" (16 September 2013) Chapman Tripp <www. chapmantripp.com>.
[176] Jenny Cooper "Substance Over Form: the Supreme Court rules on Blue Chip" (2012) 193 NZ Lawyer 14 at 15.
[177] Shelley Griffiths "New Directions: Securities Regulations Become Financial Market Law" in John Farrar and Susan Watson (eds) *Company and Securities Law in New Zealand* (2nd ed, Brookers Ltd, Wellington, 2013) at 1182.
[177] Griffiths, above n 2, at 1025.
[178] Financial Markets Conduct Act 2013, s 8(1)(a).
[179] Roger Wallis, above n 167.

more traditional form-based focus, whilst "investment product" has a wider connotation in enabling the incorporation of "less usual" securities which the regime intends to govern.

If the Supreme Court were to face a case similar to Blue Chip under the FMCA, it is anticipated that given the purposive approach adopted in the Blue Chip case, the Court would likely come to the same conclusion under either definition.

Further, under sections 562 and 563 of the FMCA, the FMA has the power to "call-in" a security which on the basis of its form might escape the net, if this is deemed necessary or desirable to promote the purposes of the legislation. It is also able to re-designate a financial product from one category to another with prospective effect.[180] The FMCA does not give a clear indication as to when such a declaration would be made, however as noted by Shelley Griffiths, "one would assume that it would be from the FMA's own market intelligence, from requests by would-be investors and from offerors seeking certainty as to the nature of the product they were offering."[181] Chapman Tripp issued a guidance note on the FMCA in which they noted that "these powers would be exercised where a product does not fall neatly within one category, or where the economic substance of the product requires it."[182] The note then went on to give the example that if a "Blue Chip" type scheme arose, such a scheme could be brought under the ambit of the Act, even if it was structured as an investment in land and would ordinarily be excluded.[183] Thus even if the Court felt unable to draw a product into the regime on the basis of a purposive approach, the FMA could use this power to call-in a product under the regime. However, this cannot be done retrospectively.

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[180] Financial Markets Conduct Act, ss 562 and 563.
[181] Griffiths, above n 176, at 1184.
[182] Roger Wallis, above n 167.
[183] Roger Wallis, above n 167.

Conclusion

Ultimately this paper has aimed to establish that the wider purposes of securities market regulation, in promoting the confident participation of investors and issuers alike in efficient, transparent and equitable financial markets, have underpinned the New Zealand securities market since the inception of the Securities Act in 1978. This purpose has been shown to be upheld by the provisions of the Securities Act, and has been adopted into New Zealand law in the express purpose of the recently enacted Financial Markets Conduct Act.

The establishment of this link between the purposes of the Securities Act and its successor the FMCA ensures the decision of the Supreme Court in *Hickman v Turner and Waverley* remains relevant given the changing of the guard with regard to the legislation governing the New Zealand securities markets. Whilst the Supreme Court's judgement left a lot of questions unanswered in its journey to a decision, it has been suggested that the destination they eventually arrived at did accord with the general spirit of the legislation. As such the case is likely to have ongoing significance, in determining that interpretations under the generally similar provisions of the FMCA will have a similar "investor-centric" focus and preference for "substance over form."

Sections 562 and 563 of the FMCA appear to specifically endorse the more broad-brush approach as was applied by the Supreme Court in Blue Chip. This indicates that whilst the decision may have accorded with the spirit of the legislation, Parliament may see the function of conducting what is in essence a "sniff test" as better carried out by a government agency such as the Financial Markets Authority. Thus it will be interesting to note the interplay between the influence of the FMA and the Court, as the ramifications of both the Blue Chip case and introduction of the FMCA become clearer.

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