CORPORATE LAW REFORM IN NEW ZEALAND

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INTRODUCTION

Ladies and gentlemen good afternoon.

I must say I feel a little like a lost sheep on this panel with the two Law Commission gurus who have spoken before me and also having to stand in as a commentator at somewhat short notice for my partner John Lusk, who unexpectedly had to be overseas this week. However, I am relieved to find myself pretty much in agreement with much of what Jack and Peter have had to say so maybe there's no need for me to comment in too much detail.

Accordingly, I will limit my comments to a couple of areas: financial reporting, takeovers, directors' duties. But before commenting on those areas I would possibly make a few introductory comments about objectives and perspectives in approaching corporate law reform. There is a need to consider law reform with a clear understanding of objectives rather than in the context of a knee jerk reaction to crisis such as the 87 crash.

OBJECTIVES

The Government's policy objectives in respect of corporate and security law reform in New Zealand can, I consider, be summarised as follows:

(a) In respect of company law the objective, I suggest, is to provide a flexible, cost efficient and simple method of incorporation, clearly identifying the duties and powers arising within a corporate structure.

(b) In respect of securities law the policy objectives are:

- Maintaining an internationally competitive capital market and facilitating local business activities;
- Promoting and having the confidence of investors and the integrity of the capital market.

Company law reform - the Companies Bill is widely seen as moving in the direction of satisfying this objective. However, as Jack has highlighted, in the securities law reform area we have a way to go. New Zealand for some time was described as a "wild west", unregulated market which was not internationally competitive and would not attract capital. This view was really given currency by the former chairman of our Securities

Committee, tagging the market as such in an interview with the ***Wall Street Journal***. I do not necessarily agree that was ever a fair description of the market.

- Our company law, while a little old is fundamentally similar to British law;
- Our accounting standards were and are as good as in other jurisdictions; David Tweedie has confirmed them as such;
- Our disclosure regime for new issues under the Securities Act is quite effective although reasonably simple;
- We have a fairly good judicial system right through to appeals to the Privy Council;
- Since the crash our Stock Exchange rules have been updated;
- We have had the introduction of insider trading and nominee disclosure regime.

I suggest that the recent substantial offshore investments into Robert Jones, McConnell Dowell, Brierley and Magnum would tend to suggest that investors really do not have any concern with our legal framework. Rather I consider the reasonably low level of investment in the equity markets in recent times both by local participants and overseas participants has been caused more by high real interest rates and investors' assessment of our economic fundamentals rather than any concerns with the regulatory environment.

Also a more regulated market does not necessarily create an effective competitive capital market. One only has to look at Luxembourg - a relatively unregulated market - to see it has developed into a sizeable securities market with, for example, traders fleeing from the more restrictive regulatory environments in the US and the UK. Also Australia, which by contrast to New Zealand is much more regulated but with its recent spate of collapses of the entrepreneurial groups, appears to have inherited the "wild west" tag.

Moving from the internationally competitive market objective to the objective of promoting investor confidence and the integrity of capital markets, I consider that the level of integrity is largely a consequence of how adequately regulation is enforced. Without an effective enforcement regime no amount of regulation will give you market integrity.

All this is not to say that in some areas our regulatory regime is not in need of review to promote investor confidence. The Companies Bill about which Jack has spoken is an excellent example of that and the provisions in that Bill such as clauses 151 - 152 relating to minority shareholders' access to information and the provisions for derivative and representative actions should certainly go some way toward promoting investor confidence.

PERSPECTIVES

With regard to perspectives from which corporate and securities law reform should be viewed I think there are really two broad perspectives.

- Firstly there is the financial and economic perspective. This stresses the efficiency within which corporate and security markets operate and requires law reform proposals to be evaluated by balancing the costs and benefits of regulation.

- The other perspective is the equity perspective which stresses the importance of promoting investor confidence in the market and the fairness of the market. The focus of the equity perspective should in my view be clearly on equality of opportunity rather than necessarily equality of outcomes. In other words it can be seen as trying to ensure through adequate disclosure regimes a philosophy of equal information and access to information rather than protecting investors from reasonably informed decisions. Regulation cannot remove the risk of investment or corporate involvement.

These perspectives are not mutually exclusive and I think it is important in considering corporate law reform and securities law reform to bear these perspectives in mind.

FINANCIAL DISCLOSURE - COMPLIANCE WITH STANDARDS

Clause 177 of the Companies Bill as drafted provides that the financial statements of a company must give a true and fair view of:

- the state of affairs of the company;
- its profit or loss; and
- a statement of its cashflows.

The clause puts the onus of establishing that the financial statements comply with this obligation on directors. A further sub-clause in the bill empowers regulations to be made in respect of this matter.

In addition to the proposals in the Companies Bill there are proposals in the Russell Committee Report and the Securities Commission Report on Capital Structure and Financial Reporting. In essence the Russell Committee proposed that financial statements would be required to comply with accounting standards although the Securities Commission would have the power to grant exemptions. The Securities Commission Report differed somewhat in that compliance with standards would not be mandatory but non-compliance would be required to be noted and referred to the Commission who could direct preparation of new financial statements. In essence the Commission could really second guess the directors on the matter.

In my view any regulation in the financial disclosure area must recognise that no two businesses are the same and that business is a dynamic scene. I do not think accounting standards should be reduced to black letter law which I presume is one of the motives behind the power to regulate in clause 177. Standards need to be more flexible. For example SSAP8 Accounting for Business Combinations casts a far wider net than clauses 181 - 185 of the Companies Bill relating to group accounts. Nor do I think compliance with accounting standards should be mandatory.

However, I consider that if the Companies Bill is to place the onus on directors for presenting true and fair accounts it is appropriate that it gives some guidance as to what constitutes true and fair. The type of regime I would favour would be one which would see the Companies Bill recognising compliance with generally accepted accounting principles (GAAP) as ***prima facie*** evidence of true and fair and where directors, for their own properly considered reasons, elect not to comply with GAAP, that should be firstly noted and secondly fully explained in the notes to the accounts in a way which demonstrates the significance of departure and its impact on the company's position, result and cashflow.

I do not consider the Securities Commission or any other body should second guess the directors' decision in this matter. The important thing is that the market is informed of the departure and the impact of it and it is up to the directors to decide whether in the particular circumstances of any situation, they consider their presentation is the best method of presenting statements showing the true and fair view.

You will observe that I would support compliance with GAAP as opposed to simple accounting standards. GAAP would, of course, imply all relevant New Zealand accounting standards, and where matters are not covered by accounting policies then compliance would have to be consistent with basic conventions and principles underlying accounting standards and the need to have some authoritative support. This is designed to ensure there is some integrity in accounts where there is an absence of a standard on a particular point, eg sales with put options.

TAKEOVERS

Again, there has been a lot of comment, discussion and investigation of takeover regimes.

One area where there was a lot of concern is in respect of transactions with associated persons or changing the nature of the business of companies. This has largely been regulated in the new Stock Exchange Code. Also the derivative action regimes contemplated in the Companies Bill give some protection.

In respect of the sorts of matters referred to in clause 336 of the Companies Bill, the various procedural matters which are to some extent covered in the Companies Amendment Act 1963 such as:

- minimum notice periods;
- minimum acceptance periods;
- directors' recommendations;
- access to independent advice etc.

There would be much disagreement that those matters should be incorporated in a takeover code of some form or another. Whether that code needs to be enshrined in legislation or could form part of the Stock Exchange Code I don't have strong views on. Additional matters not covered, but requiring consideration are:

- rules constraining self serving defences - poison pills, golden parachutes;
- integration with the minority protection rights in the Companies Bill;
- improved enforceability of the Stock Exchange Code.

However the real hard issues are mandatory bids and equal price rules.

Clearly there are two distinct positions on these issues, each supported by competing analysis. The first position is that differential pricing disadvantages minorities. The second is that paying more for large blocks of shares is merely a reflection of economic reality.

In respect of equal price rules I can see the argument for a pre-bid price rule for a limited period but it is in the context of mandatory offers that I have some difficulty.

I have not seen any empirical evidence which suggests that forcing acquirors to bid for all the shares in a company once a certain threshold has passed assists Government's economic growth objectives or indeed necessarily protects minority shareholders. I would be interested in comments from our Australian friends as to whether the shareholders left in Elders-IXL (now Fosters Brewing Group) would rather Harlin had not been forced to make the bid it did. Similarly, with the benefit of hindsight, would the shareholders who accepted Brierley's mandatory bid for Mt Charlotte at 75 pence per share, now be feeling a little disquiet when they realise Brierley has onsold those shares to Singaporean interests at 85 pence per share.

I do not think it is a fair argument that mandatory bids are appropriate simply because they have been adopted in other jurisdictions. There is not any internationally recognised model for takeovers.

A mandatory bid rule could have unusual consequences in a small volatile economy such as New Zealand. The net effect of it would mean that probably our top 10 companies are immune from anything other than takeovers by overseas parties because of the lack of capital depth in our market. A mandatory bid rule in the New Zealand context, rather than being a protection for minorities, would in effect be a protection for the existing management of our leading companies.

The other point about a mandatory bid rule in the New Zealand economy is that it may forestall some of the private sector industry rationalisation that has taken place and been driven by an influential shareholder holdings around the 30% level. I think there are examples in the meat, apparel and media industries.

DIRECTORS' DUTIES

Generally I support the prudent business judgment test as a primary test for establishing the standard of care for directors in exercising their powers and the Law Commission proposals were in my view the more appropriate model in this regard.

I do not think the directors' duties should be cast so widely as to effectively remove the concept of limited liability. Clearly directors should be accountable for their fundamental duties of acting in good faith and in the best interests of the company and the opportunity should not be missed to codify the duties of directors in a manner which is accessible to and understandable by laymen.

However, proper balance and judgment is needed to encourage good people to sit on the boards of our companies. The standards must be as high as would be expected of other professionals. Not that they are that high when you consider doctors have very little accountability with the era of accident compensation and no fault concepts. Indeed they can bury their mistakes. Politicians can do horrendous things to our economy without any accountability other than losing the seat. Directors can be voted off too. Teachers can ruin the lives of our children without any accountability. I am quite happy to see directors have higher standards of accountability than these persons. However, in the absence of fraud or gross negligence there is a need for balance to protect the last deep pocket in town. As I have said I favour the business judgment test.

Mr Chairman I think my time is up and I know you are keen to provide adequate opportunity for questions so I won't go on any further.