Securities Legislation Bill

12 November 2004

Attorney-General

LEGAL ADVICE
CONSISTENCY WITH THE NEW ZEALAND BILL OF RIGHTS ACT 1990:
Securities Legislation Bill:

1. We have considered whether the Securities Legislation Bill (the "Bill") (PCO5451/9) is consistent with the New Zealand Bill of Rights Act 1990 (the "Bill of Rights Act"). We understand that the Bill will be considered by the Cabinet Legislation Committee at its meeting on Thursday, 18 November 2004.

2. We have concluded that the Bill appears to be consistent with the Bill of Rights Act. In reaching this conclusion, we considered potential issues of inconsistency with sections 14, 25(c), and 26(2) of the Bill of Rights Act. Our analysis of these potential issues is set out below.

3. We understand that a subsequent version of the Bill with minor amendments will go to the Cabinet Legislation Committee on Thursday 18 November 2004. Further, we understand from officials from the Ministry of Economic Development (MED) that any changes to the Bill are unlikely to give rise to Bill of Rights Act issues. If any of the amendments do give rise to a Bill of Rights Act issue, we will advise you immediately.

4. The Bill would make several changes to current securities laws including those contained in the Securities Act 1978, Securities Markets Act 1988, and Takeovers Act 1993. Examples of significant changes contained in the Bill include amendments to:

    - ensure that securities and takeovers laws apply to entities and securities market participants that the public would expect to be regulated;

    - simplify the current substantial security holder disclosure regime by requiring disclosure of relevant interest by class and in respect of listed, voting securities only;

    - introduce comprehensive prohibitions against practices involving the creation of a false impression of securities trading activity, price movement, or market information;

    - strengthen insider trading laws by focusing on the threat that insider trading poses to market integrity and confidence in the market, rather than a breach of duty owed to a company;

- improve the quality of investment adviser and broker disclosure, as well as business practices across the advisory industry, by making all disclosures mandatory and requiring that additional disclosures be made prior to the giving of investment advice or the receipt of investment money or property; and

- implement a comprehensive overhaul of the penalties and remedies available under securities and takeovers law in order to deter illegal behaviours and encourage compliance.

ISSUES OF INCONSISTENCY WITH THE BILL OF RIGHTS ACT

Section 14: freedom of expression

5. Section 14 of the Bill of Rights Act provides:

"Everyone has the right to freedom of expression, including the freedom to seek, receive, and impart information and opinions of any kind and in any form".

6. The right to freedom of expression in section 14 extends to all forms of communication that attempt to express an idea or meaning.[1] The right has been interpreted as including the right not to be compelled to say certain things or to provide certain information.[2]

Power to summon witness to give evidence

7. Clause 14 (Power to summon witnesses) amends section 69D of the Securities Act 1978 which empowers the Securities Commission (the Commission) to summon a person to appear before the Commission to:

    - give evidence (including under oath); and

    - provide any documents or information that are now in his or her possession or control that are relevant to the matter.

8. Clause 45 (Power to summon witnesses) of the Bill amends section 31N of the Takeovers Act 1993 to provide the Takeovers Panel with the same power as clause 14.

9. These powers were considered justified in the context of our advice on the Securities Markets and Institutions Bill (passed in December 2002).[3] In our view these amendments do not give rise to any additional issues.

Disclosure Regimes

10. The Bill clarifies the current substantial security holder disclosure regime[4] and the disclosure of relevant interests by directors and officers of public issuers,[5] and makes all investment advisers’ and brokers’ disclosures mandatory by requiring, for instance, investment advisers and brokers to make additional disclosures prior to the giving of investment advice or the

receipt of investment money or property.[6] These provisions compel the provision of information or publication of certain statements, and therefore appear to be *prima facie* inconsistent with section 14 of Bill of Rights Act.

11. Where an issue arises a provision may nevertheless be consistent with the Bill of Rights Act if it can be considered a "reasonable limit" that is "justifiable" in terms of section 5 of that Act. The section 5 inquiry is essentially two-fold: whether the provision serves an important and significant objective; and whether there is a rational and proportionate connection between the provision and that objective.[7]

12. The purpose behind the disclosure regimes is to promote an informed market and open dealings by ensuring that participants in New Zealand's securities markets have access to information concerning the interests of those advising them about their investments, and the identity and trading activities of persons who are entitled to control or influence the exercise of significant voting rights in a public issuer. We consider this a significant and important objective.

13. In our view the provisions setting out the disclosure obligations are also rationally and proportionately connected to this objective. The information sought in relation to substantial securities holders in public issuers is limited to factual information, which is not generally available to the market and the non-availability of which may result in unfairness or market distortion. Again, the disclosure requirements of investment advisers and brokers are largely factual. For example, they will be required to disclose details of their experience, qualifications, whether or not they have a criminal conviction, relevant details about the securities, and any pertinent relationships or interests they (or an associated person such as a business partner or relative) have in relation to an investment.

14. We therefore consider that, while clauses 23 to 26, 30 and 35 are *prima facie* inconsistent with section 14 of the Bill of Rights Act, they are justified in terms of section 5 of the Bill of Rights Act.

Section 25(c): right to be presumed innocent until proved guilty

15. Section 25(c) affirms the right to be presumed innocent until proved guilty. This means that an individual must not be convicted where reasonable doubt as to his or her guilt exists; therefore, the prosecution in criminal proceedings must prove, beyond reasonable doubt, that the accused is guilty. Strict liability and reverse onus offences give rise to an issue of inconsistency with section 25(c) because the accused is required to *prove* (on the balance of probabilities) the defence to escape liability; whereas, in other criminal proceedings an accused must merely *raise* a defence in an effort to create reasonable doubt. Where an accused is unable to prove the defence, then he or she could be convicted even though reasonable doubt exists as to his or her guilt.

16. The Bill contains several strict liability offences and reverse onus offences that require an accused to prove a defence, on the balance of probabilities. In addition, the Bill contains some presumptions – which gives rise to the same

issue – that an accused must rebut to escape liability. These offences give rise to issues of inconsistency with section 25(c) of the Bill of Rights Act.

17. Our analysis of these offences is set out below, with the exception of clause 29 (new section 19ZF substituted: Offences relating to interest register) which we advised you was justified in our advice on the Securities Markets and Institutions Bill (passed in December 2002).

Insider Conduct and Market Manipulation

18. Clause 21 (New Part 1 substituted), new section 11D (criminal liability for false or misleading appearance of trading) makes it an offence for a person to contravene new section 11B (false or misleading appearance of trading) if the person has actual knowledge that the act or omission will have the effect of creating a false or misleading appearance. The offence itself is not a strict liability or reverse onus offence; however, new section 11C (presumption as to false or misleading appearance of trading) creates a presumption that an accused has contravened new section 11B in specific circumstances. An accused must rebut this presumption by proving on the balance of probabilities that the trading in securities occurred, or the offer to trade was made, for a legitimate reason. This presumption gives rise to an issue with section 25(c) of the Bill of Rights Act because an accused who fails to prove (on the balance of probabilities) the legitimate reason could be convicted even though reasonable doubt exists as to his or her guilt.

19. The objective behind the offence is to prevent and reduce the harm caused by manipulative trading practices to both individuals and the market itself. Where securities are traded with no change to the beneficial ownership it can create an appearance of increased turnover in a security that is likely to induce others to buy the security. In situations where enough new investors are attracted, the price of the securities will rise and the manipulator is able to sell at a higher price. The resulting harm is that, in the case of individual investors, they are misled into paying a higher price for the security than is warranted. This may have negative consequences for the New Zealand market's reputation from an overseas investment perspective.

20. We have been advised by MED that there are extremely limited situations where the trading of securities with no change to beneficial ownership may be legitimate and will not result in harm. Therefore, it appears to be appropriate that the onus for establishing this legitimate reason is the responsibility of the accused. It is also relevant, in terms of justification of a strict liability offence, that these are public welfare regulatory (rather than truly criminal) offences.

Disclosure Regimes for Investment Advisers and Brokers, and Interests of Substantial Security Holders in Public Issuers

21. The disclosure obligations for investment advisers and brokers, and for public issuers in relation to interests of substantial security holders created in the Bill are reinforced by offence provisions including some strict liability offences and reverse onus offences:

(a) Investment advisers and brokers disclosure offences - two reverse onus offences (clause 35 – new section 41R: offence of deceptive, misleading, or confusing disclosure, and new section 41S – offence of deceptive, misleading, or confusing advertisement).

(b) Disclosure of substantial holdings in public issuers offences: one reverse onus offence (clause 30 – new section 32: conditions of exemption for trustee corporations and nominee companies), and two strict liability offences (clause 30 - new section 35E: offences relating to substantial holdings registers; and clause 30 – new section 35H: offence for failing to publish information on substantial holdings or disclosures).

22. In considering whether these reverse onus and strict liability offences were justifiable we have taken into account the clear objective behind the disclosure regimes: to promote an informed market and open dealings by ensuring that participants in New Zealand's securities markets have access to pertinent information (as discussed in paragraph 11 above).

23. In addition, we have noted MED's explanation that these offences are vital to achieving this objective. The offences have been framed as strict liability offences or reverse onus offences to ensure that the onus is on an individual or body corporate operating in the securities market industry to take responsibility for their transactions, and meet their obligations under the Bill (e.g: public issuers have an obligation under the Bill to maintain a register, and make it publicly available). We agree that, given the detailed and precise nature of the disclosure regimes set out in the Bill, the reason why an investment adviser or broker, or public issuer has not met a disclosure requirement in a specific situation is particularly within his or her realm of knowledge. It is also relevant, in terms of justification of such offences, that these are public welfare regulatory offences.

Compliance with Commission's Orders

24. Clause 35, new section 42L (offence for failing to comply with Commission's orders) makes it an offence for a person to contravene an order made by the Commission; however a person may not be convicted where he or she is able to prove that the contravention occurred without the person's knowledge or without the person's knowledge of the order (new section 42L (2)(a)).

25. The Commission's enforcement powers (prohibition orders, disclosure orders, and temporary investment adviser or broker banning orders) are intended as a front-line response to securing compliance or preventing contraventions of the Securities Markets Act. MED considers this offence integral to encouraging compliance with these orders. The Commission must follow a detailed process before issuing an order,[8] and this process actively involves the party against whom it is intended the order be made against, and includes notification requirements. Again, this is a situation where the party involved is particularly in possession of the knowledge why they did not comply with the order. It is also relevant, in terms of justification of a reverse onus offence, that it is a public welfare regulatory offence.

Conclusion

26. In our view the limit these presumptions, strict liability offences, and reverse onus offences place on section 25(c) of the Bill of Rights Act is justified in terms of section 5 of the Bill of Rights Act.

Section 26(2): protection against double jeopardy

27. Section 26(2) of the Bill of Rights Act affirms the double jeopardy protection: the right not to be tried or punished for an offence twice.

28. The Bill proposes some amendments to the Securities Act 1978,[9] Securities Markets Act 1988,[10] and Takeovers Act 1993[11] to enhance or introduce pecuniary penalty and civil liability regimes to complement the Commission's ability to issue orders, and the criminal enforcement measures. We have considered whether the potential for a person to be subject to two separate penalties in relation to the same conduct gives rise to an issue with section 26(2) of the Bill of Rights Act.

29. The Bill specifically provides that a person cannot be ordered to pay a pecuniary penalty order and be liable for a fine under the relevant Act for the same conduct.[12] In respect of the civil liability provisions enabling compensation to be ordered in some instances, we draw your attention to the majority decision of the Court of Appeal in the leading case on 26(2), *Daniels v Thompson*[13] that made it clear that this section must be read as referring:

Only to criminal proceedings relating to an offence against the law, for which the person has been tried. What is prohibited is further trial for the same offence, that is a trial which may also result in acquittal or conviction. The provision is not concerned with a trial which may result in a form of civil liability.

30. Therefore, we consider that these enforcement regimes appear to be consistent with section 26(2) of the Bill of Rights Act.

CONCLUSION

31. In accordance with your instructions, we attach a copy of this opinion for referral to the Minister of Justice.

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Acting Chief Legal Counsel	Senior Legal Adviser
Office of Legal Counsel	Bill of Rights/Human Rights Team

cc
Minister of Justice

Footnotes

1 R v *Keegstra* [1990] 3 SCR 697,729,826.

2 RJR MacDonald v Attorney-General of Canada (1995) 127 DLR (4th)1

3 Advice dated 31 October 2001.

4 Clause 30 – New Subpart 3 of Part 2 substituted

5 Clauses 23 – 26 (Amendments to disclosure of relevant interests by directors and officers of public issuers)

6 Clause 35 – New Parts 4 and 5 inserted

7 See *Moonen v Film Literature Board of Review* [2000] 2 NZLR 9, and *R v Oakes* (1986) 26 DLR (4th)

8 Clause 35: new section 42H – Commission must follow steps before making orders, new section 42I – Commission may shorten steps for specified orders, and new section 42J – Commission must give notice after making orders.

9 Clause 4 – New sections 55A – 55G; Clause 5 – Civil liability for misstatements in advertisement or registered prospectus; clause 6 – Civil liability for misstatements by expert; Clause 7 – Civil liability for breach of contributory mortgage regulations; Clause 8 – New Sections 57B to 57E inserted

10 Clause 35 – New Parts 4 and 5 inserted (Part 5, subpart 4) – new sections 42T to 42ZK.

11 Clause 50 – New Subpart 2 inserted – new sections 33E to 43E

12 Clause 11 – New sections 60A to 60F (new section 60F – No pecuniary penalty order and fine for same conduct); clause 35 new section 43Z (No pecuniary penalty order and fine for same conduct); and clause 59 - New heading and subparts 3 and 4 inserted (new section 44K - No pecuniary penalty order and fine for same conduct)

13 Daniels v *Thompson* [1998] 2 NZLR 22, 33

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