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Chair
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FINANCIAL MARKETS (REGULATORS AND KIWISAVER) BILL

Introduction

1. This submission is made by the Legislation Advisory Committee (LAC).

2. The LAC was established to provide advice to the Government on good legislative practice, legislative proposals, and public law issues. The LAC has produced and updates the Legislation Advisory Committee Guidelines: Guidelines on the Process and Content of Legislation (LAC Guidelines) as appropriate benchmarks for legislation. The LAC Guidelines have been adopted by Cabinet.

3. The terms of reference of the LAC include:

   (a) to scrutinise and make submissions to the appropriate body on aspects of Bills introduced into Parliament that affect public law or raise public law issues:

   (b) to help improve the quality of law-making by attempting to ensure that legislation gives clear effect to government policy, ensuring that legislative proposals conform with the LAC Guidelines, and discouraging the promotion of unnecessary legislation.

4. The LAC considered the Bill at its meeting on 15 October 2010. It has two concerns about the Bill which it wishes to place before the committee. These concerns relate to the Financial Markets Authority's power to bring proceedings in the name of investors (clause 34), and the limited appeal rights from decisions of the Financial Markets Authority (clauses 113 and 156) and from decisions of the Securities Markets Rulings Panel (new section 40ZH of the Securities Markets Act).

Power to bring proceedings on behalf of investors

5. A new power in Part 3 subpart (3) of the Bill (clause 34) empowers the Financial Markets Authority to exercise any person's right of action against a financial market participant (including its directors), an auditor, or a Securities Act "expert" who makes an expert statement in a prospectus or other offer document. Civil proceedings subject to this power include any civil proceedings under any of the financial markets legislation, such as enforcement of the directors' duties in the Companies Act, as well as any proceedings alleging fraud, negligence or breach of statutory duty, that arise out of an investigation by the Financial Markets Authority. The power is modelled on section 50 of the Australian Securities and Investments Commission Act 2001. A similar power existed for a period in New Zealand under the Securities Markets Amendment Act 2001 that enabled the Securities Commission to exercise a public issuer's right to bring an action in cases of insider trading, but this was repealed in 2006.

6. We note that the Minister of Commerce, in the first reading speech on the Bill made on his behalf, recorded that this is a significant new power and that he will be particularly interested in submissions made to the Committee on this specific matter.

7. We wish to draw the Committee's attention to some key differences between the proposed power in the Bill, and the Australian power:

   - The Australian power allows the Australian Securities and Investment Commission (ASIC) to commence proceedings on behalf of a company with or without the company's consent, but on behalf of another entity or person *only with their consent.*

   - The Australian power does not allow ASIC to take over proceedings that have *already been commenced.*

   - The Australian power does not include the *recovery of litigation costs* from a person on behalf of whom an action is brought by ASIC.

8. The LAC is concerned about the fairness of expecting a private litigant to pay the costs of litigation that is conducted in the public interest and without their consent. It is questionable whether the private benefit sought from civil litigation conducted by a private litigant could necessarily be obtained in the course of litigation that is conducted in the public interest, and yet the private litigant could be required to fund the public interest litigation. The incentives

for settlement of any particular case as against prolonging litigation may be quite different depending on whether the litigation is conducted by the regulatory authority or by a private individual. The nature of any settlement achieved may also be quite different depending on whether the litigation is being conducted in the public or the private interest.

9. The view of the LAC is that the Australian power is a more appropriate balance between the public interest (as determined by the regulatory authority) and the private rights of action of investors. The LAC submits that the power should be amended to be consistent with the Australian power in these respects.

Appeals

10. The Bill departs from the usual safeguard of providing at least two levels of appeal, firstly a right of review or appeal on the merits, and then a further right of appeal on points of law. The LAC guidelines note that appeal rights function to serve both a private and a public purpose (paragraph 13.1.2). The private purpose is to provide redress to a particular party affected by a first instance decision that was made wrongly. The public purpose is to maintain a high standard of decision-making by public bodies by allowing scrutiny of first instance decisions. Limiting appeal rights in the Bill would remove the opportunity to correct material factual errors. The LAC guidelines suggest that an appeal by way or rehearing usually strikes the appropriate balance between providing sufficient flexibility to achieve error correction and the need for appeals to be resolved expeditiously (paragraph 13.4.1). It should be noted that appeals by way of rehearing do not necessarily involve a rehearing of all the evidence again; in fact the appellate body must refrain from a general retrial as there is a presumption that the first instance decision is correct and will only be overturned if it was not supportable on the evidence, or the first instance decision maker was plainly wrong (paragraph 13.4.2).

11. The Bill would limit appeals from decisions of the Financial Markets Authority under the Securities Act (such as its powers to prohibit offers and allotments) and the Securities Markets Act (such as its powers to obtain information and give directions to exchanges, as well as its powers to make prohibition, corrective and disclosure orders) to appeals on points of law only (see clauses 113, 156). The Bill would also limit appeals from decisions of the Securities Markets Rulings Panel to appeals on points of law only. In the case of appeals against monetary orders made by the Rulings Panel (for example compensation, refunds, and pecuniary penalties) the type of order and its amount can be challenged, but not necessarily the decision of the Panel that forms the basis for the order. (See proposed section 40ZG of the Securities Markets Act).

12. The Rulings Panel has the power to make a wide variety of orders under proposed new section 40Z of the Securities Markets Act, including publication orders, education orders, probation orders, orders affecting listing, orders affecting authorisation to participate, remedial action orders, compliance orders, monetary orders (including pecuniary penalty orders) and costs orders,

although the range of orders available to the Panel in any particular case depends on the particular securities markets rules or regulations.

13. The LAC submits that the broad decision-making powers of the Financial Markets Authority and the Rulings Panel and the significant impact the exercise of these powers could potentially have on financial market participants, should be balanced by the general availability of merits appeal rights. The LAC notes that the monetary jurisdiction of the Rulings Panel is comparable to or greater than that of the District Court, as the Rulings Panel can order compensation and refunds up to $200,000 (section 40Z) as well as pecuniary penalty orders of up to $500,000 or higher (section 40ZA). The LAC suggests that these decisions should be subject to general appeal rights, as they would be if they were decisions that had been made in the District Court.

14. We agree with the view expressed by the English Law Commission in a consultation paper recently published on Criminal Liability in Regulatory Contexts:

> We believe that it is now well understood that legislation must provide recourse to the courts in cases where civil penalties or other kinds of set-back to someone's interests have been imposed by a state-sponsored agency. The *very minimum requirement* [emphasis added] is that there should be an appeal on a point of law against the imposition of such measures.

15. The English Law Commission notes the model established by Part 3 of the Regulatory Enforcement and Sanctions Act 2008 (RESA), which requires regulatory provisions imposing civil sanctions to provide for appeal rights that include errors of fact and law, as well as unreasonableness. The UK Financial Services and Markets Act 2000 does not come under RESA; however it is worth noting that that Act does itself provide in Part IX for two levels of appeal. First, decisions of the Financial Services Authority can be referred to the Financial Services and Markets Tribunal for determination and referral back to the Authority. The Tribunal can consider any evidence relating to the reference. There is then a right of appeal on a question of law from decisions of the Tribunal to the Court of Appeal.

16. In New Zealand, the limited appeal rights model is used in the Electricity Industry Act 2010 to limit appeals from decisions of the Electricity Authority and the Rulings Panel to questions of law only (section 64); however this can be contrasted with the broader merits appeal rights from decisions of other bodies such as the Takeovers Panel, the Commerce Commission and the Real Estate Agents Tribunal.

17. The main argument against merits appeal rights in this context is the need for market certainty and the risk that broader appeal rights would delay final decision-making and contribute to uncertainty in the financial markets. This is the basis for limited appeal rights from decisions of the New Zealand Markets Disciplinary Tribunal currently operated by the New Zealand Stock Exchange. The LAC's view however is that, if the Disciplinary Tribunal is to be reconstituted as a statutory entity, it should be subject to the minimum

standards of public law-making, such as adequate appeal processes. The LAC suggests that one method of controlling appeals would be to introduce a leave filter, whereby merits appeals could be subject to the leave of the Court.

18. We hope that these comments are of assistance to the Committee in its deliberations on the Bill.

Sir Geoffrey Palmer SC
Chair
Legislation Advisory Committee