SOME ASPECTS OF THE STOCK EXCHANGE: ITS NATURE AND FUNCTIONS

This paper discusses some aspects of the Stock Exchange in New Zealand. Part 1 which follows consists of an examination of the nature and function of the Stock Exchange and certain legislative requirements relating thereto and Part 2, to appear later, will deal with the more detailed relationship of broker and client and questions of duty of care and possible further restraints and requirements which could be initiated to regulate further the activities of the stock broking industry.

PART 1

NATURE AND FUNCTION OF THE STOCK EXCHANGE

General

As with much of the law of New Zealand and many of its institutions, the law governing the Stock Exchange and the form of constitution thereof is drawn from the English experience. Therefore, the classic statement of Lord Buckmaster in *Weinberger* v. *Englis*[1] is useful in considering the constitution of any New Zealand Stock Exchange:

> The London Stock Exchange is in reality a building vested in certain proprietors and used for the purpose of carrying on a market for stocks and shares. It is not regulated in any way by charter or statute. The management owes no duties to the public and the business is subject to no regulations except those which from time to time (the Council) think right to impose on those whom they choose to admit. The prestige and authority of the institution depend entirely upon the reputation it has established for honest and efficient business methods. Any group of people who so desired could start another Stock Exchange tomorrow. It is not a public market it is a private market and access to it is obtained through membership.

In this case there was a refusal of the London Stock Exchange to re-elect a member of German birth in 1917 where it was held that in the circumstances of the case no evidence was adduced to show that the exchange had acted arbitrarily or capriciously in refusing re-election of the member. It is the concept of the separation of capital manage-

1. [1919] A.C. 606 (H.L.) at pp. 618-619.

ment from the capital ownership which is the basis of any stock exchange. While a specialised body of persons carry out a particular enterprise using their skills and abilities to make a profit; a separate group of persons merely fund the enterprise by taking up securities[2] in the enterprise.[3] It was with this concept as a background that investors or lenders in an enterprise began to sell their interest in the enterprise to other persons: the difficulty was that in such a private transaction which was not in a controlled market, the buyer was at a serious disadvantage in possibly entering into an investment in an enterprise without reliable knowledge of the worth of the venture. Therefore there arose a specialist person called a "broker" who arranged such transactions and tendered advice on the prospects of the ventures concerned. It was in 1773 that a group of brokers acquired a building in Threadneedle Street which they called "The Stock Exchange". In 1801 the building was closed to the public and rules for the election of members were drawn up. The proprietors of the Threadneedle Street building then shifted to Capel Court and in 1802 a deed of settlement was drawn up. Thereafter the Stock Exchange has developed into a sophisticated private market for all forms of securities, its function being "to provide a fair orderly and efficient market for dealings in stocks and shares and other securities".[4] In other words, it is an organisation to facilitate the flow of capital by giving confidence to the capital market and providing protection to investors.

Protection is primarily provided by the rules of the Stock Exchange, its usages and customs. Because it is essentially a private market it can restrict entry to only those stocks which fulfill certain requirements handed down by the Exchange[5] and by restricting membership as brokers to only those persons who are eligible because of their character and expertise.[6]

I. IS THERE A RIGHT TO RESTRICT MEMBERSHIP?

'brokers are a closed group of professional people whose membership is restricted to those applicants who fulfill the requirements of character and expertise laid down by the exchange involved. An interesting issue arises in whether or not an exchange has the unfettered right to restrict its membership. A distinction can be drawn between a social club and a trading or professional organisation. Whereas the social club can make any rules as to admission, the trading or professional organisation restriction of membership is subject to

2. "Securities" meaning shares, debentures, government stock, units under a unit trust and any other bundle of rights conferred on a person of a similar nature.
3. For a more complete history of the Stock Exchange in the United Kingdom see E. V. Morgan and W. A. Thomas, *The Stock Exchange its History and Functions* (2nd Ed. 1969) and Cooper and Cridlan, *Law and Procedure of The Stock Exchange.*
4. Cooper & Cridlan at p. 8.
5. As comprised in the Stock Exchange Asociation of N.Z. Listing Manual.
6. Rules of the Stock Exchange Association of N.Z.

review. The leading case is *Nagle* v. *Feilden*[7] where the Jockey Club of England, a body having a monopoly control over horseracing on the flat in Great Britain, refused a trainer's licence to a woman on the ground of sex. The question before the Court of Appeal was whether there was a cause of action so that it could be shown that the statement of claim was wrongly struck out; in the Court of Appeal Lord Denning M.R. said, in upholding the appeal,[8]

> The Common Law of England has for centuries recognised that a man has a right to work at his trade or profession without being unjustly excluded from it. He is not to be shut out from it at the whim of those having the governance of it. If they make a rule which enables them to reject his application arbitrarily or capriciously, not reasonably, the rule is bad. It is against public policy. The courts will not give effect to it.

Further, reference was made to the already quoted case of *Weinberger* v. *Englis.*

An extension to the right to restrict mmebership was discussed in *Blackler* v. *New Zealand Rugby Football League (Incorporated)*[9] which concerned a professional player and not a member of a social club and dealt with the question whether, once a person has gained admission to a professional or trade body, does that body have an unfettered discretion as to the control of its members? It was held that a rule requiring the clearance of the League to a player before he could play in another country was void as being an unreasonable restraint on trade:

> It places in the hands of the respondent a complete unfettered discretion to withhold its consent or to refuse a clearance in respect of any of its players. It is unrestricted in point of time and place. It is no answer for the respondent to say that it exercises its wide powers in a reasonable manner.[10]

Clearly, from the above cases, it can be seen that any restrictions as to membership of an exchange must be of themselves reasonable terms in the circumstances and any exercise of discretion thereunder must also be reasonable. Note also obiter dicta in *Weinberger* v. *Englis* as to the associated question of compliance with the rules of natural justice.[11]

Apart from the considerations of common law, reference must be made to the Race Relations Act 1971 and in particular to s. 23 thereof, and to s. 33A, Property Law Act 1952 which could conceivably be applicable to the stock broking industry.

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7. [1966] 1 All E.R. 689.
8. Supra at p. 693.
9. [1968] N.Z.L.R. 547.
10. Per North P. at p. 556.
11. [1919] A.C. 606, 620, 632.

II. CONSTITUTION OF THE EXCHANGE

The quoted statement of Lord Buckmaster is no longer wholly applicable as both in New Zealand and in the United Kingdom there is indirect external regulation of the Stock Market. In the United Kingdom controls are the Companies Act 1948 with requirements as to prospectuses, the Prevention of Fraud (Investments) Act 1939, and 1958, Stock Transfer Act 1963, Monopolies and Mergers Act 1965, and the City Panel on Takeovers and Mergers. In New Zealand we have the Sharebroker's Act 1908, the Secret Commissions Act 1910, the Companies Act 1955; Overseas Takeovers Regulations 1964 and the Commerce Bill introduced in 1974 which may become law. All these would regulate to some extent the operations of the Stock Exchange and the question necessarily arises whether or not further control by statute is desirable. Australia has its Securities Industry Act in each of the States except Tasmania and South Australia, and in the United States of America is the powerful regulatory body, the Securities Exchange Commission. Consideration of this question will be given in the course of this paper as aspects of the Stock Exchange are discussed.

The constitution of the New Zealand Stock Market is as follows:—

At the top and overseeing all activities is the Stock Exchange Association of New Zealand of which the 5 Exchanges at Auckland, Wellington, Christchurch, Dunedin and Invercargill are members. All stockbrokers are a member of one of the exchanges, there being approximately 250 stockbrokers in the country.

Legal Status

The actual legal status of the Stock Exchange Association of New Zealand and two of the member exchanges, Wellington and Dunedin, deserves discussion. At first sight neither the Association nor its member exchanges have any means of becoming incorporated except under the Companies Act 1955 and this is exactly what the member exchanges of Christchurch, Auckland and Invercargill have done. Section 9 of the Sharebrokers Act 1908 provides that every stock exchange or association of sharebrokers shall forward a list of its members and copy of its rules to the Secretary for Justice who is to register it under the Act. However, registration does not of itself give the exchange any status of incorporation. A stock exchange would not be registerable under the Industrial and Provident Societies Act 1908 as being a "society for carrying on any industry business or trade" in terms of s. 2(1) Industrial and Provident Societies Amendment Act 1923 and coming within the limitations of registration expressed in s. 33(2) and (3) Statutes Amendment Act 1939. In order that a stock exchange come within the limitations, it must be a bona fide co-operative society. It has been suggested that a society is co-operative if its main purpose is the mutual benefit of its members.[12] In *McGregor* v. *Pihama Co-*

12. 21 Halsbury's Laws of England (3rd ed.) p. 9.

operative Dairy Company Cooper J. stated when referring to the meaning of a co-operative company that,

> I do not know of any judicial interpretation of the term, but co-operative company is generally understood to mean one in which the business is confined to the members of the society . . . [13]

It is submitted that as the stated general object of the Stock Exchange Association of N.Z. in r. 2 of its rules is to generally promote the interests of members and the interests of the public transacting stockbroking business with members, it cannot be said that such an organisation is a bona fide co-operative one. The main purpose is not the mutual benefit of its members, but is equally for the benefit of the public transacting stockbroking business with members. The business of the association is not confined to the members as it does have dealings with the public as, for example, with regard to listing requirements for companies. However, it is possible that a stock exchange could incorporate itself under s. 4 Incorporated Societies Act 1908 as, for example, the objects of the Stock Exchange Association of New Zealand come within s. 5(c) of the Act in that the association is established inter alia for the protection of regulation of some trade business industry or calling . . . "and is not associated for pecuniary gain".[14] Whether the courts will ever be asked to rule on the question is in doubt as no exchange has attempted registration under that Act. Notwithstanding this, the more important questions of contractual and tortious liability remain. There appears to be no reported proceeding against the Association or its member exchanges but the problem would seem to be one which could easily arise and with the members personally liable, but only to the extent of their subscription, for acts they may be held to have authorised. The merits of incorporation deserve more consideration by the Association and the Wellington and Dunedin exchanges. These bodies, being unincorporated associations, may not be liable for the acts of their committees and officials where a lack of authoritity is present. An action would need to be brought against those members personally who committed the breach and it must be of some concern for the responsible officials to know that the association may even be precluded by the courts from indemnifying them from liability.[15] The problem is that an unincorporated association lacks a legal status separate from its members. Each contract entered into by the committee of the association would have to be considered on its own facts as to whether it binds not only the signatories thereto but also the rest of the members. The enquiry is two-fold. First, was it intended by the contracting parties that the contract was with the members and not the signatories only. Secondly, on the rules of agency, did the signatories have the authority of *all* the members to act on

13. (1907) 26 N.Z.L.R. 933, 938.
14. See *The Definition of Gain For the Purpose of Incorporation.* D. J. White (1970) 5 V.U.W.L.R. 536.
15. See Baxt, *The Dilemma of the Unincorporated Asociation* (1973) 47 A.L.J. 305, at 311 to 313.

their behalf. The case law on the subject is not always consistent and any person contracting with such an association is well-advised to ensure an adequate personal guarantee to cover any contingency arising which may require proceedings to be brought. It is procedurally difficult to bring proceedings against the common fund of an unincorporated association to say the least. Because the common fund belongs to all the members jointly, it is necessary to bring a successful action against *all* the members before any recompense out of the common fund is available to the litigant. Because the ownership is joint, severance of each member's share is difficult and if one member is not liable an action against the fund would not succeed. It is not practicable to bring an action against all members of an exchange jointly or to sue them all individually.

However, r. 79 of the Code of Civil Procedure appears at first to offer the answer in allowing a representative action to be brought by suing one or more persons as representing all the persons having the same interest. But new members will normally not have the same interest as others in respect of an earlier contract or obligation; they would be able to raise different defences since they are not parties to the original contract and therefore no representative action could be brought. Unless the people concerned all have the same *legal* interest in the proceedings the representative action will be unsuccessful. This point was successfully raised in *V.U.W.S.A.* v. *Government Printer*.[16] The problems with such an action where there is a fluctuating membership were well illustrated in *Barker* v. *Allanson*[17] where a representative order was refused by the Court because most of the membership had changed since the incurring of the liability.

There has been some difference of judicial opinion as to whether or not it is possible to make an order for defendants to be sued in their representative capacity in an action for tort. In *Campbell* v. *Thompson*[18] such an order was granted on the grounds that the two members named in the writ were persons who could fairly be taken to represent the members and that all the members had the same interest in resisting the claim. However such order was restricted to members at the date of the accident from which the action arose. Because each member may stand in a different position to the plaintiff in an action in tort and thus be able to raise different defences it may be seldom that a representative order will be given.[19]

The concept of co-ownership of the common fund can therefore prevent a deserving plaintiff from recovering against such a fund because of the difficulties in commencing a representative class action. Where the membership does not fluctuate (as is assumed to be the case with the Stock Exchange Association of New Zealand) then so long as

16. [1973] 2 N.Z.L.R. 21, 24.
17. [1937] 1 K.B. 463.
18. [1953] 1 All E.R. 831.
19. See *Mercantile Marine Service Association* v. *Toms* [1916] 2 K.B. 243 as an example where an order was not granted.

personal liability can be attributed to the members, it is likely that an action would be successful. However, where membership fluctuates (as is assumed to be the case with the Wellington and Dunedin Exchanges) then not only are there agency problems but also difficulties in binding new members to an existing contract and releasing retiring members. Where there is no provision in the rules imputing express acceptance of the obligation by a new member, novation of the contract would appear impossible. Liability of members of an unincorporated association in tort would again depend on the rules of the agency. A representative or class action would be necessary should this be the case.

Internal Rules: General

The Association acts "generally to promote the interests of members and the interests of the public transacting stockbroking business with members and more particularly to promote uniformity in stockbroking, underwriting, and company flotation transactions and to provide a governing authority to regulate the dealings of stock exchanges one with another and of members one with another and the dealings of exchanges and their members with the public and to function in any manner necessary to carry out such object or objects incidental thereto."[20] The Association therefore acts in a supervisory capacity and as a co-ordinating body. All statements issued to the press relating to the Stock Exchange emanate from the Association and much of the financial pages of the country's newspapers issues from the Association. By its rules the Association controls the activities of the Exchanges and their member brokers.[21] The rules of the Association are not effective until gazetted.[22] It is understood that it can take up to ten months from the drawing up of a new rule to its gazetting. The delay could cause problems in preventing the Association from dealing quickly with any new problem. The Association cannot make regulations under its rules for this purpose either except that the executive may make regulations for the purposes of the establishment and operation of a Fidelity Guarantee Fund.[23] The Association also records its decisions and rulings on all matters of importance. These "collected decisions", as they are known by stockbrokers, are considered binding in an analogous manner to the common-law precedent system. Should any broker dispute any collected decision, the Association would rely on r. 83 which binds the

20. Rule 2, Stock Exchange Association of N.Z. rules.
21. The rules cover inter alia: conditions of membership, nature of exchanges, complaints charges and disputes, defaulting members, accounts, brokerage and fees, advertising, contracts, quotations, defaults in completion of a contract, prospectuses, fidelity guarantee fund.
22. Section 11, Sharebrokers Act 1908. Although the requirement that rules have to be approved by the Governor-General and be gazetted before becoming effective applies only to registered Stock Exchanges, it is submitted that this includes the Stock Exchange Association of New Zealand as under s. 10 of the Act it is unlawful for any association of sharebrokers or others to use a style or title into which there enters the words "Stock Exchange" unless the association is registered under the Act.
23. Rule 145, Stock Exchange Association of N.Z. rules.

broker to "good stockbroking practice", the committee of the Association being the sole judge of such practice.[24]

Such a rule provides powerful ammunition for the Committee of the Association to regulate the affairs of brokers. The Committee itself comprises a President, Vice-President and delegates from each of the exchanges (1 delegate for 20 members).[25] It should be noted that the rules of natural justice are not bypassed as rr. 52 and 53 provide for a complete hearing of any complaint, charge or dispute against any broker or exchange. Rule 58 provides an appeal procedure whereby "the committee may adopt such procedure as it deems fit for the conduct of an appeal." This is subject to the right of the appellant to require that the appeal shall be dealt with by way of a complete rehearing of the complaint or charge. Consequently the rules provide for the effective internal regulation of brokers and exchanges so long as the Committee of the Association does not act against the interest of the public by protecting its members, no matter how desirable it may seem to the Committee. So long as public confidence continues to be apparent in such a system, it would seem to be desirable to continue as before because it is a specialised area which is being dealt with and it requires specialists to deal with the problems which arise. However, a cautionary rider must be added to this statement as the public may never find out about a particular dispute or complaint unless it affects the market or a member of the public in the market. In this situation it is arguable that the temptation at the very least is present to smooth it over without informing the public in any way. To overcome this and retain public confidence in the system, it may be desirable to provide for the automatic publication of any complaint or charge and its outcome after investigation and any hearing which is carried out.[26]

The Exchanges

Rule 39 provides that " . . . each exchange shall manage its own local affairs, and adjust differences between its own members". Rule 81 provides that each exchange is to incorporate into its rules a rule

24. Rule 83: Where any dispute arises or complaint of charge is being investigated or any decision is to be made as to which any of these Rules are silent then such decision complaint or charge shall be dealt with and decision made in accordance with good stockbroking practice and where such exists in accordance with the established custom in New Zealand. The transaction out of which a decision is made shall be deemed to be a transaction to which these Rules apply. The Committee shall be the sole judge as to the existence and terms of an established custom in accordance with this Rule and the sole judge as to what is good stockbroking practice in accordance with this Rule where any ambiguity arises as to the meaning and effect of these Rules, the sole judge as to the interpretation of these Rules.
25. Rule 13, Stock Exchange Association of N.Z. rules.
26. Rule 65 provides for the publication and circulation of a statement of findings "amongst all members". Note s. 51 of the Law Practitioners Act 1955 wherein it is provided that any order of the Disciplinary Committee for the striking off, removal from or restoration to the roll of practitioners or the suspension from practice of a practitioner shall be published in the *Gazette*.

that its members shall be deemed to be bound by the rules of the Association[27] and that if there is any conflict between the rules of an exchange and the rules of the Association, the latter shall prevail. Therefore each exchange has as its rules the rules gazetted.

For the purposes of this paper reference will be restricted to the rules of the Christchurch Stock Exchange Ltd as the rules of all exchanges are similar. The objects of the Christchurch Stock Exchange Ltd are "to provide regulate and maintain a suitable building room or rooms in Christchurch for the promotion and facilitation of dealing in stocks, shares, bonds, debentures and negotiable securities, underwriting and company flotations, to establish just and equitable principles in the transaction of business, to adjust controversies between its members; and to maintain uniformity in its rules and usages. Its funds are to be applied only for the purpose and objects herein set forth."[28]

The rule relating to violations of rules and penalties is wide, r. 58 providing "The Committee shall take cognisance of *all violations of these rules whether in letter or spirit*. Any member found by them to be guilty of such violation, or who may fail to comply with any decision or ruling of the Exchange or of the Committee, or who, in the opinion of the Committee is or has been guilty of conduct unworthy of a member shall be liable to be fined or suspended . . . or expelled". As with much of the practice of stockbroking, this rule incorporates a provision to comply with the "spirit" of the rules as well as complying with their "letter". As with r. 83 of the Rules of the Association, customs and usages play an important part in governing the business of stock broking. Even if a stockbroker is aware of all usages, customs and all that is necessary in carrying out the spirit of the rules, a layman certainly cannot ever hope to become familiar with these aspects of stock broking and therefore cannot know when the spirit of the rules is broken. This is accentuated by the fact that the collected decisions of the Association are confidential to brokers and the layman is excluded from any guidance to be gained from them.

Rule 59 empowers the Committee to "notify or cause to be notified to the public that any member has been expelled or has become a defaulter or has been suspended, or has ceased to be a member" but such power is to be exercised in the "absolute discretion and in such manner as [the Committee] may think fit". Such a rule is unsatisfactory and it would be better to require that all such defaults, expulsions, suspensions and cessation of membership be automatically published in the Gazette.

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27. See for example Rule 4, Rules of the Christchurch Stock Exchange Ltd. gazetted in *The New Zealand Gazette* (1972) 13 July 1938.
28. Rule 3: Rules of the Christchurch Stock Exchange Limited. The rules deal inter alia with: membership, transfer of membership, allowing authorised clerks to act as agents of members on the floor of the exchange, defaulters, suspension and expulsion, failure of non-members to meet engagements, management, violation of rules, funds, disputes, complaints and charges.

The Sharebroker

At the base of this hierarchy is of course, the sharebroker who was well described by Street J.;[29]

> The occupation of sharebroking demands high standards of integrity. In carrying on his occupation a shareholder acts, not for himself but for his client. His remuneration is his brokerage, or commission. Clients, some with great, others with little business acumen and ability to protect themselves, seek and act on his advice and permit him to handle their money and their shares. Those clients are entitled to expect from a broker not only competence, but also integrity and absence of conflicting personal interest. His position is one of trust and responsibility. By the traditions of their occupation, brokers have aspired to the status of an honourable profession. The price they must pay for this status is that they forswear all compromise of their integrity and that they repudiate the creation of personal interest which could bring them into conflict with their duty to their clients.

This description clearly highlights what must be some of the important areas for consideration in examining how best to advance the interests of the public and listed companies as well as those of the stockbroker himself. Before progressing further it is pertinent to point out that in New Zealand there are no jobbers as there are in the United Kingdom. A jobber is a person who "buys and sells securities as a principal on his own behalf and has no relations with the public . . . a jobber deals only with fellow members of the Stock Exchange and he deals only on his own behalf. He may be described as a wholesaler in securities".[30] The argument for having this system is that it helps retain public confidence in the Stock Exchange as it ensures the buyer gets his stock at the best price available as the jobbers are in open competition with each other. No person can act as both broker and jobber, thereby ensuring that the broker is solely acting on behalf of his client and not in any way acting as a principal. His function is to buy and sell stock as agent for members of the public. The division of functions within the Stock Ecxhange has never occurred in New Zealand where the market is a lot smaller and intimate. Brokers can act as principal on their own behalf, or as agent for a client. The situation, in some aspects, is analogous to that in the legal profession where in New Zealand there is no split between barrister and solicitor, although the trend towards specialisation is becoming more apparent. With a relatively low turnover on the New Zealand Stock Exchanges, it would seem difficult to justify the "jobber" system in this country. It would add nothing to public confidence as brokers seldom act for both buying and selling parties or as a principal. In all transactions on the floor of a New Zealand Stock Exchange, the members are deemed

29. *Bonds and Securities (Trading) Pty. Limited* v. *Glomex Mines N.L.* [1971] 1 N.S.W.L.R. 879 at 891.
30. Cooper and Cridlan, *Law and Procedure of the Stock Exchange* at p. 102.

to be principals to each other and therefore a selling broker does not know to whom he is selling his share or stock or whether they are reliable and can pay. His recourse is to the buying broker, not the client. Therefore, the same protection is afforded to the client of either selling or buying broker as selling brokers are in free competition with each other. If the ultimate buyer does not pay on settlement, then, under r. 100, the selling broker is protected in his dealing as the buying broker is treated as a principal and will complete payment personally, retaining the right to recover any loss from his client.[31] Thus what a sharebroker does is

> to buy and sell a commodity on the market. It is true he does not expect to have to pay for it himself or to be responsible ultimately to satisfy the contract himself, as he is a buyer and seller in the market for an undisclosed principal to whom he looks to indemnify from liability . . . The stock-broker is remunerated by a commission which he receives from his principal, the person who takes the liability off his shoulders.[32]

It is this relationship which will be examined more closely in the ensuing pages.

III. THE LICENSING OF SHAREBROKERS

A "sharebroker" is defined by s. 2 of the Sharebrokers Act 1908 as meaning, "any person and includes a firm and a company (other than a bank selling or purchasing shares for its customers in the ordinary course of its business), who for remuneration sells or purchases shares for or on behalf of or as agent for any other person". Any such person as defined by s. 2 must be licenced within terms of s. 3 of the Act. Every person who commits a breach of s. 3 is liable for each offence (being the act of being a sharebroker) to a fine not exceeding $200.[33] Where a land agent sells shares in a business or in a flat owning company as opposed to the business or flat itself, he is prima facie within the terms of s. 2 and therefore liable under s. 3 of the Act. The only reported case in point is *Allen* v. *Anderson*[34] where the respondents signed an authority as "owner" appointing the appellant as land agent to sell a certain service station owned by a company of which the respondents were sole shareholders. The respondents' shares in the company were later sold to a person introduced to them by the appellant who then sued for commission. The respondents raised as a defence by way of cross appeal that if it were contended that the sale of

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31. Rule 100: Brokers and Principals — In contracts between members for the sale and purchase of shares and stocks, they shall be held to be principals to each other, unless a written arrangement to the contrary is made between buying and selling brokers at the time the contract is made.
32. *Christopher Barker & Sons* v. *Inland Revenue Commrs* [1919] 2 K.B. 222 at 229.
33. Section 3(2) Sharebrokers Act 1908.
34. [1969] N.Z.L.R. 951.

shares had been brought about by the appellant then there must have been a sharebroking transaction made illegal by s. 3 of the Act, since the appellant was not a sharebroker. This defence was rejected by Turner J. as the transaction was a sale of a business as far as the appellant was concerned even though the mode of completing it was as a sale of shares. Because the appellant was in no way responsible for its completion in this manner the learned Judge held that he could not be affected by it as he had in no way played the part of a sharebroker. However, this will not always be the case where a land agent is concerned and in the case where he acts as agent for the express purpose of selling (or buying) shares in a business or flat owning company, he will be caught by the definition in s. 2 of the Act and the transaction will be void under s. 3 thereof. In principle this situation is submitted to be unsatisfactory as the Sharebrokers Act 1908 is primarily directed to the control and regulation of brokers on the stock exchange. This is especially the case where real estate agents are already controlled by the Real Estate Agents Act 1963 and the nature of the type of transaction mentioned above remains in substance a sale of a business or flat. In these circumstances it is submitted that it is desirable that a provision exempting land agents in such transactions be incorporated in the Sharebrokers Act 1908.[35]

In order to obtain a licence an applicant must make application to the Magistrates' Court, which application shall be heard by a Magistrate who *shall* grant a licence if satisfied that the applicant is a "fit person to be the holder of a sharebroker's licence" and the prescribed fee of $30 is paid.[36] No test is laid down in the Act as to who is a "fit person to be a holder of a sharebroker's licence". If the Magistrate is satisfied as to this requirement, he is obliged to grant a licence if the fee is paid. Therefore, it would seem that little, if any, real or effective vetting of applicants takes place. There is no requirement to provide referees as to character and there is no advertising requirement providing for objections by members of the public. Indicative of the lack of interest in this area is the fact that the only amendment to the Act was in 1967 when the fee was increased from £5 to $30.[38] Another shortcoming with the Act is that there is no requirement for a sharebroker to display his licence, nor is there any requirement of the Magistrates' Court to keep a schedule or list of licencees for reference to by members of the public. It is only in a proceeding against a person acting as a sharebroker without a licence that he is deemed unlicensed unless he produces a licence or proves he is licensed under the Act.[39] Although s. 6 provides that where it is proved to the satisfaction of a Magistrate, "that any sharebroker has within the preceding three years been guilty of dishonest, dishonourable, or

35. Cf. the situation of solicitors in respect to sale of land in s. 3(1)(a) Real Estate Agents Act 1963.
36. Section 4, Sharebrokers Act 1908.
37. Cf. Law Practitioners Act 1955 and Law Practitioners Admission Rules 1957.
38. Section 2, 1967 No. 118.
39. Section 7.

improper practices, it shall be lawful for the Magistrate to suspend or cancel the licence of that sharebroker", no guidelines are laid down in the legislation as to what constitutes dishonest, dishonourable or improper practices. Also, there appears to be no caselaw which deals with the section and it would appear to be unused in practice. The reason for this is, it is suggested, two-fold.

First, the standards of the sharebroking profession are such that any disciplinary proceedings are unnecessary and secondly, the sharebroking profession effectively governs its own behaviour by its own rules.

Complaints, Charges and Disputes

The rules of the Stock Exchange Association of N.Z. deal with complaints, charges and disputes in detail; there is provision for hearings, appeals, penalties, costs and statements of findings.[40] The grounds for any complaint are wide as under r. 52 the Disciplinary Committee has power to enquire "into any charge made . . . " Rule 68 provides for a statement of findings to be circulated to all members but does not provide for publication to the general public. Here, the principle of disclosure is not adopted, it being considered that the professional well-being of sharebrokers is better protected by silence. It would seem preferable to have some minimum form of publication of any major complaint which should, in the interests of the public be brought to its attention. As a condition precedent to an action by a member against any other member, upon any matter arising out of any transaction of stockbroking to which the rules apply, r. 70 provides that the dispute shall first be determined under the rules and any action shall only be for the enforcement of any decision given under the rules. Also, in any such action no member can dispute the correctness of the decision or the fact that it was given in accordance with the rules.

On several occasions the courts have considered similar provisions purporting to oust completely the jurisdiction of the courts on questions of law. In *Baker* v. *Jones*[41] the rules of an association stated inter alia that the central council was, first, to be the sole interpreter of the rules and to act on behalf of the association regarding any matter not dealt with by the rules and secondly the final arbiter in all cases and under all circumstances. Lynskey J. held that as the association was unincorporated it had no legal entity and the relationship between the members was contractual. Certain limitations were imposed by public policy on making any contract, including the limitation that the parties cannot oust the courts jurisdiction. The council can be made the final arbiter of fact and can leave questions of law to the courts but it cannot make it the final arbiter on questions of law so as not to be subject to examination by the courts. Accordingly the rule in question was held

40. Rules 51 to 70.
41. [1954] 2 All E.R. 553.

contrary to public policy and void.[42] Similar considerations can be raised in respect of r. 70 which purports to make the decision of the committee final and indisputable as to questions of law. The validity of the rule must depend on the interpretation placed on the phrase "correctness of such decision". It is submitted that in not being permitted to dispute such "correctness", questions of law are being excluded from the courts and the rule accordingly is void. However, the further argument may be raised that the aspect of the rule which is objectionable on grounds of public policy may be severable from the rest of the rule to leave it enforceable. Such an argument has merit in the instant case where the objectionable words are separately expressed from the other words in the rule.[43] Therefore, only in the event of the court considering the entire rule valid, will members be confined to their rules for recourse against each other except in matters of enforcement. Such a situation does not affect the public except that because of the confidential nature of the findings on any dispute, the public remain unaware that a member may be acting improperly.

The disciplinary rules were amended and gazetted as recently as the 16th January 1975. An attempt has been made in the new rules to give an element of autonomy to the committee by providing that it will consist of a chairman who is a barrister and solicitor of not less than 7 years standing, as well as not less than two, or more than seven members. However, an open discretionary power is left in the Council of the Stock Exchange Association of New Zealand, "from time to time to remove from office any member of the Disciplinary Committee". The potential for abuse is present in allowing the Council to dismiss any "troublesome" member of the disciplinary committee without giving cause for such dismissal. It is suggested that should the argument for an outside regulatory body similar to the Australian Corporate Affairs Commission succeed, then prior approval of appointment or dismissal of members should be sought from the Commission, the alternative being to completely remove the disciplinary function from the hands of the industry. This proposal could be unsatisfactory in that it could result in enforcement of disciplinary procedures by ill-informed persons, unfamiliar with the industry. Some membership of stockbrokers must be desirable. Should no Commission eventuate, prior approval of appointments and dismissals could be vested in the Minister of Finance.

Comparison with Australian Legislation

As a comparison to our Sharebrokers Act 1908, the Securities Industry Acts of the States of New South Wales, Victoria, Queensland

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42. See also the obiter dictum of Ungoed-Thomas J. in *Re Davstone Estates Ltd's Leases* [1969] 2 All E.R. 849.
43. See: *Bennett* v. *Bennett* [1952] 1 All E.R. 413, 417 and *Re Davstone Estates Ltd's Leases* supra.

and Western Australia may be considered.[44] The Securities Industry Act 1970 (New South Wales) establishes a Corporate Affairs Commission which is charged with the administration of the Act. Under s. 5C wide powers of investigation are conferred on the Commission for the purpose of ascertaining whether a licence holder has complied with the Act. The Commission can inspect not only the books and records of the licencee but also those of any banker or dealer in so far as they relate to the licencee. Under s. 5C(i) the Commission may require a licencee to "disclose to it in relation to any purchase or sale of securities the name of the person from or to or through whom or on whose behalf the securities were bought or sold and the nature of the instructions given to the dealer or authorised trustee corporation in respect of that purchase or resale".

The Commission under s. 5D(2), "may make such investigations as it thinks expedient for due administration of the Act" where it has "reason to suspect that any person has contravened a provision of this Act, or has been guilty of any fraud or offence against this or any other Act or law with respect to trading or dealing in securities". Notwithstanding these two powers which can cover not only any dealing in securities but also any investigation which is considered expedient where there is reason to suspect fraud or any other offence however minor, such discretion being vested in the Commission, s. 5D(2) states that "the Minister may, where it appears to him to be in the public interest so to do, by instrument in writing —

> appoint a person as an inspector to investigate any matters concerning trading or dealing in securities and to report thereon in such manner as the Minister directs . . . "

The decision as to what is in the public interest is left for the Minister to determine and conceivably could cover virtually any minor misfeasance by any person coming under the Act. To further assist in any investigation under s. 5DA, the Minister can gazette certain orders which inter alia provide for the restraining of a person acquiring or disposing of specified securities.

Section 5F empowers the Supreme Court to make certain orders where it appears to the Court that a person has or will contravene the Act with respect to trading or dealing in securities or the conditions of his licence. The most important orders prevent such a person carrying on business, restrain the person from acquiring, disposing, or dealing with any specified securities; appoint a receiver of the whole or any property of a dealer and declare any contract relating to securities to be void or voidable.

Accordingly, the Commission, Minister and Courts have wide

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44. For the purpose of this paper reference will be made to the Securities Industry Act 1970 (New South Wales) as the various statutes may be considered uniform in intent but the wording of some provisions differs from State to State: see Paterson & Ednie, *Australian Company Law* 2nd Ed. Vol. 4, p. 115.

investigating and injunctive powers which enable them to oversee the securities market. These powers are worded in the Act in such manner as to enable the particular body concerned to act quickly without having to wait for further authority or carrying out any lengthy process before acting. Such provision is necessary as the primary objective of the Commission is to act as a watchdog to ensure the Act is complied with and to "freeze" any transaction which is discovered to be in contravention of the Act. It is arguable that such a Commission with similar powers should be incorporated into any enlarged companies office which is established. The use of qualified personnel in such an office would be advantageous as the investigator would obviously need to have accounting expertise and such persons would necessarily be employed in any enlarged companies office.

Licences

Part IV of the Act provides for licensing and here is seen a division of licences into particular categories of dealers, investment advisers,[45] dealers representatives and investment representatives. The provisions of this part of the Act are an improvement on the New Zealand Act as discussed above. The New South Wales Act provides that application for a licence is to be made to the Commission.[46] Such a specialised body would appear to be preferable to the Magistrates' Court in New Zealand; persons familiar with the industry, its standards and requirements are to consider the application. The granting or renewal of a licence is made where after consideration of the character and financial position of the applicant and the interests of the public, the Commission is of the opinion that the applicant is a fit and proper person to hold a licence.[47] The New Zealand Act should contain similar provision.

Any change of address of the principal place of business of a licence holder must be notified to the Commission and the cessation of business must also be communicated.[48] Should some form of Commission as is established in the Australian States be created in New Zealand, a similar provision would seem to be necessary to facilitate the carrying out of the Commission's functions. However, there seems little useful purpose in such a provision for a sharebroker in New Zealand. If an investment advisor's licence were created the provision would be useful as conceivably this would include a person other than a sharebroker. It is unlikely that a sharebroker, by changing his place of business would create confusion or prejudice the interest of the public. But the concept expressed in s. 4 of the Moneylenders Act 1908 would seem to apply in the case of an investment advisor, who would not be subject to

45. Cf. Investment Advisors Act 1940 (U.S.A.).
46. Section 13(1) Securities Industry Act 1970 (N.S.W.) cf. The Securities Exchange Act 1934 and Prevention of Fraud (Investments) Act 1958, ss. 1 to 9 (U.K. & U.S.A.), both of which require licensing of dealer and broker.
47. Section 14 Securities Industry Act 1970 (N.S.W.)
48. Section 17A Securities Industry Act 1970 (N.S.W.).

the strict rules of the Stock Exchange Association of New Zealand, and therefore some other form of control over his activities would be necessary.

With the growth of the New Zealand capital market as distinct from the more restricted field of the stock exchange, together with the increase in sophistication and diversification of its application, there has been a corresponding growth in the number and diversity of investment advisors. From the individual's and small companies holding themselves out as investment advisors to the large mutual funds, investment corporations and trustee companies, there is a range of choice sufficient to meet all needs. Investment brokers and similar persons are a growing group of commercial advisors who are not directly controlled by legislation. The Companies Act 1955, Unit Trusts Act 1960 and the Syndicates Act 1973 can be said to provide some measure of protection as to the security offered as an investment but the fact remains that there is no control or minimum standard set down to ensure that the investment advisor is the competent person he holds himself out to be. It has been suggested that the Syndicates Act 1973 was an over-reaction by the legislature in attempting to regulate this area in what can be conservatively termed an "excited investment market", without really tackling the major problem of how to control the advisor in it. The collapse of not only some large investment concerns but also several smaller ones must bring home to the unwary that perhaps any advice tendered when they made their investment was not the best. Regulation of the investment advisor in such a situation merits further consideration from the legislature.

The Act also provides for a register of licences which any person may inspect on the payment of a fee. This provision is desirable, providing an easy place of reference as to whether any particular person is qualified to carry on the business of sharebroker or investment advisor. This provision should be incorporated in the New Zealand Act.

Qualifications

The problem reduces to the fact that sharebrokers can be said to be members of an industry; a private market functioning to ensure that the prospective investor is fully informed on all matters necessary to enable him, with the help of any advisors available, to assess for himself the merits of the proposition. There is a distinction between an industry as such and a profession. It has been mooted that more professionalism must be injected into the industry to retain the confidence of the investor who often is relying on the broker to advise or assist in the investment of a large portion of that person's savings. In the evidence given before the Jenkins Committee[49] it was suggested that an Institute be formed which, with demands for competence amongst its members would automatically raise and maintain the standard of

49. Great Britain Board of Trade Committee of Enquiry on Company Law 1960.

trading to a satisfactory and safe level. With compulsory membership and examination resulting in qualification as a broker, it was considered that the investor would be safeguarded from persons who were no doubt of integrity but unsuitably qualified to practise as a broker or advisor.[50] In the New Zealand context it is suggested that what could be advantageous is a minimum standard of qualification by passing a prescribed course and examination set up by the Stock Exchange Association of New Zealand, before any person could become entitled to a licence. By doing so, the licence would be invested with more than the fact that the licencee was a person of fit and proper character; it would be evidence that he was qualified and capable of carrying out his occupation.

IV. DISCLOSURE OF INTERESTS IN SECURITIES

Perhaps one of the most interesting and possibly desirable provisions of the New South Wales legislation is the part headed "Division 2 Records", Section 20A of which deems the division to apply to dealers, investment advisors, their representatives and financial journalists. A "financial journalist" is defined as meaning "a person who in the course of his business or employment contributes advice concerning securities or prepares analyses or reports concerning securities for publication in a bona fide newspaper or periodical".[51] The primary obligation placed on the persons affected by the division is that they maintain a register of securities in which they have an interest.[52] A security means any security in a public company or quoted or dealt with in a Stock Market in Australia.[53] Notice of the register and the place at which it will be kept must be given to the Commission and a financial journalist must also give particulars of his employer and any newspapers and periodicals to which he contributes.[54] The Commission can of course require production of the register and take copies of same.[55] The Commission is also empowered to require the proprietor or publisher of a newspaper or periodical to supply it with details of any journalist who contributed any advice or prepared any analysis or report.[56] The Commission may supply a copy of a register or part thereof to any person who in the opinion of the Commission should in the public interest be informed of the matters disclosed in the register or extract.[57]

The objective of these comprehensive provisions would appear to be to prevent any fraudulent or dishonest practice being carried out by a

50. See Memorandum by the Association of Stock and Sharebrokers in Appendix XXIV, Minutes of the Jenkins Committee and Minutes of Evidence of the Jenkins Committee at pp. 537, 538.
51. Section 21A(2) Securities Industry Act 1970 (N.S.W.).
52. Ibid., s. 20B(1).
53. Ibid., s. 20A(3).
54. Ibid., s. 20C.
55. Ibid., s. 20E.
56. Ibid., s. 20F.
57. Ibid., s. 20G.

person interested in a particular security. A sharebroker or investment advisor can easily recommend a security he is interested in to clients. Competitive buying will force the price up and the interested sharebroker or advisor can dispose of his interest at a profit. Possibilities for the rigging of a false market do therefore exist.

Also, the financial journalist has the ability to affect the price of securities by communicating his opinions or analysis to a wide section of the public. By requiring a register of securities the Commission can discourage the misuse of private information. However the provisions are subject to several criticisms:

First, they may inhibit the free and imaginative reporting of the market by financial journalists. This criticism can also be applied to the broker and advisor who, because of an interest in a security, may be reluctant to deal on behalf of, or advise a client with respect to, the security. Such a criticism can be countered by the argument that the honest journalist, broker or advisor taking heed of his fiduciary or responsible capacity will have nothing to fear from the provision.

Secondly, it can be argued that such a provision is unnecessary with respect to journalists, as in New Zealand most reports on the stock market emanate from the Stock Exchange Association of New Zealand. Such an argument does not account for the growing number of financial journals, independent reports, or analyses of the market.

Thirdly, there is the problem that although a register is kept, the Commission will not be aware of its contents and any changes therein unless it exercises its power to inspect the register. Unless a master register is kept by the Commission with an obligation on the dealer, adviser or journalist to file a copy of any changes in any security in which he is interested within a stated time limit, the Commission may remain unaware of any changes unless it has a strict inspection programme.[58]

This relates also to a fourth criticism that the Commission is invested with a discretion as to whom may be supplied with a copy or extract of a register. This discretion is based on "the public interest", a most difficult term to interpret[59] and quite obviously in the context used it can mean virtually anything. If the principle of disclosure is going to be used then it would seem preferable to disclose to the whole public the contents of a register rather than attempting to prevent any unnecessary disclosure of a person's investments. The shareholdings and charges of a company are disclosed on the record of the company

58. cf. the requirements of ss. 101, 102 Companies Act 1955.

59. E.g. A matter of public or general interest "does not mean that which is interesting as gratifying curiosity or a love of information or amusement; but that in which a class of the community have a pecuniary interest, or some interest by which their legal rights or liabilities are affected": per Campbell C.F. *R* v. *Bedfordshire (Inhabitants)* (1855) 4 E. & B. 535, 541, 542.

in the Companies Office for all to inspect and if the disclosure principle is to work satisfactorily, so should a register of interests in securities.

Therefore, it is suggested that after consideration of the provisions in the New South Wales Act, the conclusion is reached that the principle embodied there is desirable but that it could be better enacted and carried into practice by requiring the actual disclosure to the Commission within say, 14 days of the change of interest and that all members of the public should be free to inspect the master register held by the Commission.

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