likely to cause an untrue admission to be made. If the conduct was not sufficient to warrant exclusion on the application of section 20 then the exclusion of a confession for a breach of the rules alone cannot be permitted, for the reasons argued earlier.

IV. CONCLUSION

The writer has developed a theme that enables the law of confessions in New Zealand to be clearly understood. The indications given by Parliament are that any treatment capable of influencing an accused should be considered an inducement. The extended scope of section 20 enables us to examine directly the reliability of confessions alleged to be affected by some inducement, so far as we are required to. This is clearly making us go further than the Common Law. As the Common Law is also trying to achieve the same end obliquely, it must be regarded as superseded by the direct approach of section 20. This was the view historically held by the courts.

Parliament has attempted to organise our confessional evidence law in a manner that will preserve evidence. It has also made choices as to how far it is willing to go to do that. We should take these basic ideas and expressions of intent and interpret section 20 accordingly. The result of this interpretation, as argued in this article, is that section 20 is THE law of confessions in New Zealand.

The writer has stated that there are difficulties involved in applying the law in its present state. As to the effect of this article on this point, the writer adopts these words:[80]

> . . . if the evident policy of the present legislation is appreciated and allowed to take its proper place in the process of interpretation, much of the difficulty, caused so often by undue literalism, can be avoided and in reality disappears.

The writer has submitted that section 20, in its present form, if properly interpreted, has the scope contended. But, in accordance with the doubts expressed as to the courts' willingness to accept such an interpretation, the writer submits the following draft section adequately puts this paper into a statutory form. In the event of reform of section 20 the writer would submit this section for consideration:

> 20. Admissibility of Confession—(1) Any confession tendered in evidence at any criminal trial or proceeding must be proven, by the Crown, to be voluntary beyond a reasonable doubt.
>
> (2) "Voluntary" in this section means not made as a result of an inducement.
>
> (3) "Inducement" in this section means any circumstances capable of influencing the mind of the confessor.
>
> (4) Where the confession is not voluntary it is admissible if the Judge or presiding officer is satisfied that the inducement was not in fact likely to cause an untrue admission to be made, the onus of so satisfying being on the Crown.
>
> (5) "Confession" means any statement to which the Common Law voluntariness rule would apply.
>
> (6) This section shall operate exclusively on the admissibility of confessions.

80 *Tickle Industries Pty. Ltd.* v. *Hann* (1974) 2 A.L.R. 281,288.

THE CASE FOR ANZ BANK.

For over 140 years, the ANZ Bank has been an integral part of the New Zealand financial scene.

140 years experience that has resulted in a well deserved reputation for its expertise in financial management.

Much of this financial expertise is available in the form of a package of services for the legal profession and its clients.

Services that range from nominee and portfolio management, short term investments through the ANZ Money Market department and ADIS. Arguably the most advanced deposit information reporting service currently available.

In short, no one is better suited to assisting the legal profession with its financial enquiries.

Just call your local ANZ Branch Manager and ask for the evidence.

ANZP1060A

The economics of law: The Sharebrokers Act 1908

Matthew S. R. Palmer*

This article is about the economics of law. It presents economics as a way of thinking — as an approach that can be relevant to the law. Specifically, economic analysis is used here to gain useful insights into the impact of the Sharebrokers Act 1908. The substantive conclusion is that the effects of the Act are not what they might first appear to be. The wider conclusion is that economics can be usefully applied to law.

I. INTRODUCTION

For a number of years, economists have been appointed as professors in several United States Law Schools.[1] This, and a significant volume of international literature,[2] is evidence of established and still growing interest in the application of economic analysis to law. Indeed the movement has even acquired a label: Law and Economics.

Law and Economics has been hailed by some as explaining the basis of the whole Common Law. Others of course, have dismissed it summarily — often as being inherently right wing. This article is written in the belief that neither of these claims are valid: that economics can be usefully applied to the law, but that its limits must be recognised. As a vehicle for examining these wider issues, economic analysis is applied to a specific area of New Zealand law: that relating to share-broking. The analysis is valuable in itself as it yields distinctive insights into share-broking law. It is also valuable in demonstrating generally how an economic perspective can help in understanding law.

II. ECONOMICS AND LAW: THEORY

A. Economics

There are two main fields within the discipline of economics: macroeconomics and microeconomics. Macroeconomics is concerned with broad trends and with

* B.A. This article is based on a paper presented as part of the LL.B. (Honours) programme.

1 E.g. University of Chicago, Yale University, University of Virginia.

2 See especially the Journal of Law and Economics and the Journal of Legal Studies, both published at the University of Chicago; and more recently the International Review of Law and Economics, a transatlantic enterprise.

the inter-relationships between various elements of a nation's economy. Microeconomics is more relevant to Law and Economics. It deals with the behaviour of basic units of the economy such as firms and consumers and involves such things as the pressures of supply and demand in a market. It can be applied to a variety of situations to determine the implications of particular circumstances, for example the imposition of price controls, quotas, subsidies, or taxes. In general, microeconomics examines the behaviour of individual economic units when faced with a limited set of resources available for use. Initial assumptions are made to simplify analysis, and the effects of a change in that initial situation can be traced.

This article goes beyond traditional microeconomics. It uses something that will be called the "Economic Approach" in its analysis of law. This "Economic Approach" is a way of thinking: an economic way of thinking.[3] It is a way of analysing and predicting human behaviour. It is based on traditional microeconomics and inherits many analytical tools from there such as: respect for the use of models and mathematics; general analytical concepts such as that of cost;[4] and an emphasis on the incentives that measures provide, rather than on the measures themselves as a response to something else. However, the assumptions of the Economic Approach are broader than those of traditional microeconomics, in order to take into account more aspects of the real world.[5] Thus the Economic Approach is capable of more general application, including application to "non-economic" topics, and is more realistic. These changes justify the new label.[6]

The essence of the Economic Approach lies in three important assumptions.[7] The first is that all individuals maximise their "utility". The second is that there are frequently significant difficulties in making transactions, i.e. "transaction costs" may be positive.[8] The third is that "property rights" may have significant economic effects. The effect of these assumptions is that the Economic Approach focusses on

3 For general references using what is here called the "Economic Approach", see: Gary S. Becker *The Economic Approach to Human Behaviour* (University of Chicago Press, Chicago, 1976); R. A. Posner *Economic Analysis of Law* (2 ed., Little, Brown & Co., Boston, 1977); and supra n.2.

4 The economic conception of "cost" unlike the accountancy conception, is not limited to purely monetary considerations. To an economist, any difficulty in achieving something represents a "cost". Thus the cost involved in making a transaction includes for example, the difficulty with which the transacting parties can identify each other, the difficulty in negotiating a contract and the difficulty in enforcing a contract. In addition, the concept of "opportunity cost" is important to an economist. The opportunity cost of using a resource in a particular way, is the value of the most valuable alternative use of the resource.

5 See Louis De Alessi "Property Rights, Transaction Costs, and X-Efficiency: An Essay in Economic Theory" (1983) 73 American Economic Review 65-66.

6 This paper uses the label "Economic Approach" because it emphasises the fact that it is an economic way of thinking. Becker also uses this label, supra n.3. Alternative labels are "Property Rights Approach" or "Generalised Theory of Choice".

7 E. Furubotn and S. Pejovich "Property Rights and Economic Theory: A Survey of Recent Literature" (1972) 10 Journal of Economic Literature 1137; and De Alessi supra n.5.

8 The term "transaction costs" is used in this paper and generally in Law and Economics in a very wide sense, to refer to practical impediments to, or "costs" of, behaviour. Supra n.4.

individuals' decisionmaking in response to incentives. It emphasises inherent practical impediments (transaction costs) to "pure" market behaviour and responses to those impediments. And the Economic Approach recognises that it is through property rights that law affects the value of commodities, peoples' incentives, and thus behaviour — that the legal environment effectively lays the ground rules for economic activity.

The Economic Approach to law need not involve mathematics or quantitative analysis. In practice it is often straightforward and seems like logical common sense.[9] Application of the Economic Approach to an area simply involves determining the incentives that all the relevant individuals face. The incentives are examined especially in terms of practical impediments to behaviour (transaction costs), and in terms of the influence of the law (property rights). Behaviour may be predicted from a comprehensive account of all these incentives. The implications of a change in law can be analysed by tracing the impact of the change on incentive structures and then through to individuals' behaviour.

The Economic Approach is thus a general method of analysing and predicting peoples' behaviour. It is systematic and it has a coherent set of assumptions behind it.

B. Methodology: Approach and Structure

The approach in this article is "positive" rather than "normative": it describes what the existing situation is, rather than what it ought to be.[10] The object here is to discover the effects of New Zealand sharebroking law. This is done by applying the Economic Approach. Thus the incentives faced by individuals in the sharebroking sector are examined in terms of their influence on behaviour. Tracing the impact of sharebroking law on individuals' incentives and thus on behaviour, and generalising across all affected individuals yields the effects of sharebroking law.

In terms of structure, this article uses a conceptual distinction developed by the New Zealand Treasury in analysing several economic areas.[11] Treasury identifies two different types of law: law applying generally throughout all economic sectors; and law applying specifically to only one or a few sectors. The former is labelled the "general regulatory framework" and the latter a "specific intervention". The fundamental assumption is that prima facie, the ground rules should be the same for all markets: no market or sector of the economy deserves special treatment. Thus the burden of proof lies with those advocating special interventions.

9 Which is what economics is — common sense applied logically and systematically.

10 Indeed it is contended that economics *cannot* help to assess how effects should be weighed. Its role is to accurately identify them. This contention however, is outside the scope of the article and is not necessary to the analysis.

11 For a published example, see The Treasury *Regulation of Company Takeovers: Treasury Submission to the Securities Commission* (Government Printer, Wellington, 1984). The distinction presented in this paper represents the author's own adaptation and use of ideas advanced by Treasury. The usual disclaimer operates here such that the views expressed in this paper are in no way the responsibility of the New Zealand Treasury.

In this article, the Treasury distinction is used simply to structure the analysis of the effects of sharebroking law. In Part III, the Economic Approach is used to examine the situation that would occur in the absence of sharebroking-specific law. In Part IV, the Economic Approach examines the extra effects of sharebroking-specific law: the Sharebrokers Act 1908.

III. SHAREBROKING: IN THE ABSENCE OF SPECIFIC LAW

Part III examines normal market behaviour modified by those incentives that exist inherently in the activity of sharebroking,[12] and that exist in the relevant law of the general regulatory framework.

A. Market Behaviour

A market for a commodity is simply a place where that commodity is exchanged for something of similar value; money usually, in a modern economy. A market may actually exist, as does a traditional stock exchange, or it may be conceptual, as is a fully computerised stock exchange.

1. *The market for sharebroker services*

A market for sharebroker services can be identified. The commodity which is traded is sharebroker services: especially the service of transacting in securities for others, the provision of investment and financial advice and underwriting. The price of the commodity consists of the brokerage rates and other fees charged for broker services. This price will vary with the quality of the commodity. Quality will consist of, for instance, the quality of advice and the right of access to a stock exchange. Brokers supply the services which are bought by those involved with securities and investment. The price and quality of broker services will be determined by competition in the market: competition between those supplying broker services, and competition between those demanding broker services.

In December 1984 the Government relaxed restrictions on foreign exchange transactions. This significantly reduced the "cost" of trading on foreign stock exchanges, so New Zealand brokers must now compete with foreign brokers in several areas.[13] The market for broker services in New Zealand has thus effectively been widened in extent. In addition the market for broker services is integrally connected with other markets. The market for investment advice is not the exclusive preserve of brokers — they compete against other financial analysts. Also, the market for broker services is significantly interrelated with the market for stock exchanges.

12 The terms "sharebroker" and "stockbroker" are often used almost interchangeably. This article will follow the Sharebrokers Act 1908 in using "sharebroker".

13 There is currently a mood amongst New Zealand Stock Exchange (N.Z.S.E.) members for reform of N.Z.S.E. Rules. Rules that in the past have been seen as necessary safeguards to the integrity of the sharebroking profession are now more likely to be seen as unnecessarily restrictive. This change is one of the increased competitive pressures that has contributed to that mood. For other factors, infra n.15, 16, 18 and the Commerce Act 1986.

2. *The market for stock exchanges*[14]

The concept of a market for stock exchanges is more complex. Prima facie, the commodity is a stock exchange: an organisation which enables its members to transact in securities — usually shares. Property rights analysis, however, indicates that it is the rights deriving from a stock exchange that constitute what is actually being traded. Thus the commodity consists of: access to a range of listed securities; access to the exchange-related services of a range of sharebroker members; and perhaps most importantly, a set of market rules governing the trading and listing of securities. This set of market rules then, is itself part of a commodity in the market for stock exchanges![15]

The price of the commodity consists of the fees charged to those wanting to use it, brokerage rates or listing costs for example. The price will vary according to the quality of the product: the desirability to the buyer of the set of rules and range of brokers and listings. The supplier of an exchange is the body governing it. In practice, this is usually a group of sharebrokers elected by all the sharebroker members (or "owners") of the exchange. The commodity of the stock exchange is "bought" by those wanting to deal in and list securities. Competition in the market for stock exchanges, then, determines both the price and quality of the commodity, including the degree of restrictiveness of exchange rules.

Again, the extent of the market for stock exchanges has been widened by the relaxation of restrictions on foreign exchange transactions. The lower cost of using foreign stock exchanges has increased the competitive influences on New Zealand stock exchanges.[16] Also, other markets influence the market for stock exchanges. The market for stock exchanges can be seen as part of a wider market for "methods of dealing in securities", where stock exchanges compete for business against other mechanisms for dealing in securities — for instance off exchange trading.[17] Changes in the market for securities itself are relevant: as securities become more or less attractive, the derived demand for broker services and stock exchange rules will change.[18]

14 As far as the author has been able to determine, there is no published analysis analysing the concept of a market for stock exchanges.

15 Including rules concerning how to make rules. The method of N.Z.S.E. decision making changed with the Sharebrokers Amendment Act 1981. The voting system now represents individual brokers, rather than operating on a regional caucus basis. This has enhanced the effectiveness of the reformist mood amongst member brokers.

16 Supra n.13.

17 Factors such as convenience, relative anonymity and the amount of information provided, suggest that stock exchanges are attractive (competitive) compared to other methods of dealing in securities.

18 Supra n.13. Recent developments in this area have also increased competitive pressure on brokers. The general deregulation of the financial sector has increased the ability of other financial institutions to offer services which compete as substitutes with those offered by brokers. Associated with this, there has been technological change and innovation in the financial sector. Consequently, the line between different types of securities has blurred and brokers dealing with equities have faced increased competition from debt-type securities.

The relationship between stock exchanges and the market for broker services becomes clearer when the concept of a market for stock exchanges is used. Brokers supply the commodity in both markets. Individually they offer broker services, and as a group they offer the mechanism of the stock exchange. The commodity in each market usually constitutes part of, and thus affects the quality of, the commodity in the other.

B. Inherent Incentives: Transaction Costs

1. *Costs in the market for securities*

The application of transaction cost analysis to the very existence of sharebroker services and stock exchanges illuminates their natures and functions. Broker services and stock exchanges can be seen as responses to transaction costs in the securities market. This provides a wider context within which to understand the markets in which they are commodities.

The transaction costs in the market for securities primarily derive from information. Consider the situation without sharebrokers or stock exchanges. It would be costly for people to acquire information about securities. They would have to devote considerable time and effort to discover the information by which to value securities. Furthermore, for purposes of transactions, considerable time and effort would be necessary to determine the value that other people would place on securities. To actually transact in them, it would be necessary to spend time and effort in identifying others willing to deal at similar prices. Such high transaction costs associated with pure market behaviour suggest that organisational alternatives would be preferable. And indeed the functions performed by brokers and exchanges do provide such alternatives. Brokers specialise in financial information and in transacting for others. Stock exchanges provide a central place for transacting in securities and thus provide information about the nature of a large part of the market for securities. Brokers and exchanges lower the transaction costs in the market for securities. If there were no transaction costs in that market, why would sharebrokers, or indeed stock exchanges be necessary?[19]

It should also be noted that transaction costs themselves are not necessarily fixed over all time. Increased ability to access and process information can be expected to reduce transaction costs and therefore reduce the need for alternatives to market processes.

High transaction costs in the market for securities can thus be seen as being responsible for the existence of broker services and stock exchanges, and thus for the markets for those commodities.

2. *Costs in setting up stock exchanges*

Transaction costs are also responsible for distinctive characteristics in the market for stock exchanges. It is noticeable that in New Zealand, there has never been

19 Compare the markets for securities and for stereos. Transaction costs in the market for stereos are not high enough to make the role of "stereobroker" economic.

more than one sustainable exchange in one "region".[20] The inherent structure and nature of stock exchanges is such that the costs of setting up a competing exchange would be significant.[21] A competing exchange would have to formulate rules which attract both sharebrokers and consumers of sharebroker services from the existing exchange. So the market for stock exchanges within a region is a natural monopoly: there will be only one stock exchange per region. At present, New Zealand as a whole is the relevant region. Most licensed sharebrokers in New Zealand belong to the New Zealand Stock Exchange (N.Z.S.E.).[22] Therefore the rules of the N.Z.S.E., the monopoly stock exchange, constitute the rules of the majority of the sharebroking profession. There have been a few other attempts to establish exchanges, but these have not seriously challenged the position of the N.Z.S.E.[23]

Yet the existence of a natural monopoly does not necessarily mean there is no market. Nor does it necessarily imply economic inefficiency. It is just that competition is more potential than actual.[24] Free entry to the market by bodies facing the same cost structure as the N.Z.S.E. could provide it with competitive pressure. Free entry would set a sort of floor of competitiveness at some level. If the price and quality of the N.Z.S.E.'s product (including the restrictiveness of the N.Z.S.E.'s rules) become too uncompetitive, it becomes economic for others to offer an alternative price-quality combination, i.e. set up a competing exchange. Thus to some extent, the N.Z.S.E. has an incentive to offer a competitive product. The problem in this analysis lies in assessing where the "floor" of competitiveness is. The structure and natural costs of the stock exchange industry may be such that it would take a very highly priced N.Z.S.E. product for competition to occur. If this is so, then although the market for stock exchanges is theoretically contestable, competitive pressures may in practice be limited. The extent to which the N.Z.S.E. would have an incentive to offer a competitive product would not be very great.

Again, the element of change should be noted. The costs in setting up exchanges in New Zealand have not remained unchanged over time. As those costs decrease, more exchanges can be expected to be set up.[25]

20 The limits of such a "region" are determined by yet other costs, such as those of communication. These influence the form of organisational response to transaction costs in the market for securities, i.e. the fact that there cannot yet be a single world-wide exchange. As these other costs are reduced through technological change, the size of a "region" grows. This has happened and can be expected to continue happening in New Zealand.

21 This is not confined to New Zealand, but is an international feature of stock exchanges. Gregg A. Jarrell "Change at the Exchange: The Causes and Effects of Deregulation" (1984) 27 Journal of Law and Economics 273.

22 As at 31 December 1985 there were 211 members of the N.Z.S.E., thirty-two of whom were "country" i.e. part-time brokers.

23 Most recently, Poh Share Trading Ltd. has set up a two-person Auckland office: *The Dominion,* Wellington, New Zealand 23 April 1985, p.15.

24 Note though that competitive pressures emanating from other markets are not abated by the existence of natural monopoly in the market for stock exchanges.

25 Supra n.23.

3. *Costs in measuring quality of broker service*

(a) The market for broker services

An important influence on competition in the market for broker services derives from problems (costs) in measuring quality of service. Such measurement costs constitute transaction costs as they increase the difficulty in transacting.

Microeconomic theory suggests that sharebrokers who provide incompetent or fraudulent service would be forced, through competition, to set prices at a level commensurate with that lower quality of service. Problems with that analysis arise however, when there is difficulty in measuring the quality of service. Consumers may not easily be able to identify what they are buying. The quality of advice may become apparent only after a time lag. Furthermore, brokers offering a lower quality service would have an incentive to disguise its quality. It is also likely that measurement costs will vary according to type of service. A broker's ability to act as an agent in the transaction of securities may be relatively easier to measure than quality of investment advice.

Responses to the problem of measurement costs can be identified. First, microeconomic theory suggests that in the long run, brokers would acquire a reputation indicative of their quality of service. This however, does not address the situation of low quality brokers operating in the short run.

Second, there are incentives for brokers themselves to measure quality of service. Brokers offering good quality service have an incentive to develop signalling mechanisms to distinguish themselves from lower quality service. One such mechanism which can be recognised is the formation of "brand name" organisations.[26] Several competent brokers can form an organisation and invest in a "good name". Such investment could take the form of permanent office blocks, plush offices, guarantees, and putting their names "on the line". Significant unrecoverable investment in a firm's "name" assures customers that that firm intends to remain in business and that it is not in its interests to provide or allow poor service by any of its brokers. Francis Allison Symes & Co., Frank Renouf & Co., Jarden & Co. are all examples of brand name firms.

Third, there are also incentives which act on consumers. Regular clients of sharebrokers could be expected to build up enough knowledge of the market to assess the relative performances of brokers. This in turn would assist the more competent brokers to survive and stand out from other brokers. This is especially relevant in terms of large corporate clients. In fact they could even be expected to form or buy a broking firm themselves if the gains in so doing were significant enough.

(b) The market for stock exchanges

The problem of measurement costs in the market for broker services can also be expected to affect the market for stock exchanges. The "brand name"

26 Yoram Barzel "Measurement Costs and the Organization of Markets" (1982) 25 Journal of Law and Economics 27.

incentives analysed above, could also be expected to operate on brokers in their capacity as "owners" of a stock exchange. A stock exchange could be expected to develop quality-signalling mechanisms. There would thus be an incentive to assure people of the quality of member brokers, which is part of the commodity in this market. Thus stock exchanges have an incentive to formulate rules that restrict the conduct of their broker members. They also have an incentive to have strict membership criteria and to advertise that fact.[27] It could also be said that once such a mechanism to control entry is established, then to the extent that they could control it, there is an incentive for the brokers to abuse it for profit. However, criteria for exchange membership are also part of the internal rules of a stock exchange, which is part of the product in the market for stock exchanges. So this should be seen in the context of the various pressures operating on the market for stock exchanges, as identified already.

C. Legal Incentives: General Regulatory Law

Part IIIC analyses the incentives provided by relevant laws of the general regulatory framework.[28] As a general consideration it should be noted that a law which seeks to prohibit behaviour will merely affect the costs of such behaviour. The extent to which a law deters behaviour depends on individuals' expectations of the probability of being caught and punished and of the severity of that punishment. Relevant to these considerations are factors such as: the degree of rigour in enforcement of the particular law; the workload of the courts; the efficiency of the legal process; the degree of error in decision making by the courts; and the certainty of effect of the law.

1. *The market for sharebroker services*

Several aspects of the law of the general regulatory framework increase the cost to brokers of certain behaviour, by giving the affected client a remedy. This also lowers the cost to clients of not assessing the quality of the broker's service. Note though that it also increases the incentive to disguise the nature of any prohibited behaviour engaged in.

(a) Duties of care[29]

Brokers may be under a duty of care to their clients because of a contractual, fiduciary or special relationship.

The most usual contractual relationship is currently that of agency, where the broker is acting as a client's agent to transact in securities. In this case, the broker has a duty to execute the client's instructions with reasonable care. Future

27 This analysis emphasises the rather strange fact that sharebrokers as "owners" of stock exchanges engage in competition in the market for stock exchanges, which determines the criteria for others to become sharebrokers!

28 Note that this article does not seek to explain the details of all the relevant law, but to identify which law is relevant.

29 This section relies on a fuller discussion of this subject by R. K. Stephenson "The role of the stock broker as an investment adviser — what duty of care?" (1985) 12 V.U.W.L.R. 139. Also, for an account of legal remedies available in respect of a fuller range of sharebrokers' actions, see P. C. Carran "Some Aspects of the Stock Exchange: Its Nature and Functions Part II" (1976) 8 V.U.W.L.R. 203.

sharebroking reforms may mean that the contractual relationship becomes more common, as brokers charge for other services such as investment advice.

Fiduciary relationships, where a broker has the confidence of a client and could abuse it for personal gain, may not occur frequently in sharebroking practice though it does seem to be potentially applicable where a broker owns shares that are the subject of advice.

The special relationship giving rise to an action in tort for negligent misstatement is a more common form of sharebroking relationship, e.g. when investment advice is given without charge. Note that insurance contracts may be able to be taken out for professional negligence, which may affect the incentives faced by the broker. If the insurance premiums do not accurately reflect each broker's risk of breaching a duty, as they probably will not, the incentive to take care will be reduced. An action for the tort of deceit is also available in respect of fraudulent misrepresentation.

(b) The Crimes Act 1961

Part X of the Crimes Act 1961, *Crimes Against Rights of Property,* also prohibits similar behaviour. Provisions that may be particularly relevant to sharebrokers can be found under such headings as: Theft; Crimes Resembling Theft; False Pretences; Personation; Fraud; and Forgery.[30]

(c) The Secret Commissions Act 1910

The Secret Commissions Act 1910 supplements principles of contractual agency and fiduciary duties. Broadly, it establishes offences for: gifts to agents without the principal's consent; failure of agents to disclose pecuniary interests; giving false receipts; and receiving secret reward for procuring a contract. It therefore increases the costs of engaging in these activities.

(d) The Securities Act 1978

The Securities Act 1978 restricts certain activities involving securities. In particular, Part II restricts the offer and allotment of securities to the public and sets out requirements for advertising and for prospectuses. Thus extra costs are imposed on those activities.

2. *The market for stock exchanges*

(a) The Commerce Act 1986[31]

The Commerce Act 1986 is concerned with the general regulation of commercial activity. It can be regarded as part of the general regulatory framework, as it is not targetted at a specific sector or market. Part II: *Restrictive Trade Practices,* prohibits certain trade practices under such general headings as: Practices Substantially Lessening Competition; Price Fixing; Use of Dominant Position in a Market; and Resale Price Maintenance. The Commerce Commission may authorise

30 Especially ss. 222, 224, 229A, 231, 232, 236, 245-249, 250, 252, 253, 255, 257, and 263-281.

31 Of course, the Commerce Act 1986 also affects sharebroker behaviour, in the market for broker services. However, these effects are not as relevant to Part IV of this paper as are the effects on stock exchanges.

a restrictive trade practice in certain circumstances per sections 58-65 of the Act. Under sections 80-82, a person who contravenes Part II is liable in damages for loss or damage so caused, may be ordered by the High Court to pay a substantial pecuniary penalty to the Crown and may be restrained from engaging in the practice by an injunction granted by the High Court.

Obviously, the effect of the Commerce Act 1986 is to increase the costs of engaging in these restrictive trade practices. Due to the fact that the operation of the new Act is as yet substantially untested, the exact extent of these costs is unknown. The new Act however, does seem to represent a significant increase in the costs of engaging in behaviour that could be styled "anti-competitive".

(b) Administrative law

At Common Law, courts can review the decisions of public bodies, bodies with public functions and private bodies. The Judicature Act 1908, as amended in 1972, confirms this ability and facilitates the procedure for its operation. Very briefly, private non-statutory tribunals are subject to judicial review where "personal status and livelihood are jeopardised".[32] They must act "within their powers, fairly and in good faith." If the tribunal has a duty to act judicially, the rules of natural justice must be followed. The decisions of a stock exchange established as a private body could therefore be subject to a court's jurisdiction: for instance its decisions about the admittance of new members.[33]

Administrative law then, increases the costs of making "bad" decisions. There may however, be an extra limitation on that effect. Principles of administrative law may not be widely known.[34] A decision making body itself may not know of administrative law requirements, or it may discount the chances of a prospective plaintiff so knowing.

(c) Organisation options and ownership rights

The options for the form of organisation of a stock exchange are those available to other bodies in New Zealand. The most obvious option available is incorporation under the Companies Act 1955. This was chosen by several New Zealand exchanges before the legislative amalgamation by the Sharebrokers Amendment Act 1981.[35] Other exchanges simply remained unincorporated associations. Another option which has been suggested is incorporation under section 4 of the Incorporated Societies Act 1908.[36]

32 Lord Hailsham of St. Marylebone (ed.) *Halsburys Laws of England* (4 ed. Butterworths, London, 1973) vol. 1. Administrative law, para. 47, p. 51. Remember that Part III does not treat specific law, which is how a public stock exchange would necessarily be established.

33 P. C. Carran "Some Aspects of the Stock Exchange: Its Nature and Functions Part I" (1975) 8 V.U.W.L.R. 71, 72-73.

34 Public surprise about a court having jurisdiction over the New Zealand Rugby Football Union might be evidence of this: *Finnigan* v. *N.Z. Rugby Football Union Inc.* (1985) 8 T.C.L. 26/1. However, that decision might itself have increased awareness of administrative law.

35 Carran Part I, supra n.33, 74-77.

36 Carran Part I, supra n.33, 75.

The more important point here concerns ownership rights, and derives to some extent from these organisational options. Under general regulatory law, a stock exchange is a body corporate (or maybe unincorporate) and is managed by those involved in its establishment. It will be established by those who see advantages in so doing. It is a private organisation, like any other business, with its own internal rules. Its owners (usually sharebrokers) have property rights in a stock exchange, as the owners of any other business have in their business. So according to the law of the general regulatory framework, a stock exchange is simply another private business with all the accompanying rights and obligations. Prima facie then, according to the Treasury distinction, the government should not specifically regulate a stock exchange in a different manner to other business organisations.

IV. THE SHAREBROKERS ACT 1908: A SPECIFIC INTERVENTION

In terms of the Treasury distinction, the Sharebrokers Act 1908 constitutes a specific intervention since it does not apply generally across markets. This article will examine the four groups of sections that constitute the substantive Act.

A. Licensing of Sharebrokers

1. *Law*

Section 3 of the Sharebrokers Act 1908 provides that all sharebrokers must be licensed. Section 2 defines "sharebroker" as "any person . . . who for remuneration sells or purchases shares for or on behalf of or as agent for any other person". All partners in a sharebroking firm must be licensed. All persons acting as brokers in a sharebroking company must be licensed. Section 4 details the procedure for obtaining a licence. If a District Court Judge is satisfied that "the applicant is a fit person to be the holder of a sharebroker's licence", then upon payment of a fee, the applicant shall be granted a licence. Section 6 allows a District Court Judge to suspend or cancel a licence if satisfied that a sharebroker "has within the preceding three years been guilty of dishonest, dishonourable or improper practices".

2. *History*

The licensing of New Zealand sharebrokers was first required by statute between 1871 and 1884. The sections of the current Act governing licensing have remained substantially unchanged since the Sharebrokers Act 1902 which was consolidated in 1908. The rationale for licensing in 1902 was that there should be protection of the "public" against "untrustworthy" sharebrokers.

It should be noted that the general regulatory framework in 1902 was significantly different than it is now. For instance, tort principles of liability for negligent misstatement were undeveloped and there were fewer relevant statutory provisions. In addition market behaviour, especially in such areas as responses to measurement costs, was not as sophisticated as it is now. The costs and benefits of licensing sharebrokers today, should be evaluated against today's general regulatory framework.

3. *Effects*

(a) General limitations

The impact of licensing generally, is limited by the following factors:

(i) The influence of the N.Z.S.E. Rules.

As already analysed, the natural monopoly situation in the market for stock exchanges means that while subject to potential pressures in that market, the N.Z.S.E. effectively determines the criteria for becoming a sharebroker. Yet official licensure of brokers is additional to the N.Z.S.E. criteria. Official licensing requirements will therefore only have effects to the extent that they are not reflected in the rules of the N.Z.S.E. Arguably, there is currently significant overlap.[37]

(ii) Limited coverage.

As a result of the definition of "sharebrokers" in section 2, it is the specific function of transacting on behalf of others, for which brokers are licensed. Persons offering investment advice for example, are not licensed. The effects of licensing then, are only relevant to the extent that sharebrokers engage in their central function.

(iii) Limited criteria.

The criterion for licensing is "fitness". It is likely that a judge would take into account considerations such as whether an applicant has the ability and background to perform sharebroking functions and an honest character record. It seems that such criteria would exclude only those whom investigations can show to be incompetent or dishonest. If the court system operates reliably, the level of licensing restrictiveness appears to be relatively low.[38]

(b) Effects

(i) Information: measurement costs decreased.

Licensing provides information about the licensees. This decreases the cost to consumers of measuring the quality of brokers' services. This effect however, is heavily qualified. First, the extra amount of information provided by licensing is limited by the three general factors above. Licensing guarantees (subject to judicial error) an absolute minimum standard of "fitness" of a broker who intends to transact in securities on others' behalf. Secondly, it should be noted that no other measurements such as ability are explicitly provided, no information about relative standards among brokers is provided and the information only relates to a broker at the time a licence was granted.[39]

37 Currently, possession of an official licence is one of the explicit N.Z.S.E. membership criteria ("N.Z.S.E. Rules", Supplement to the New Zealand Gazette, No. 98, *New Zealand Gazette,* (Government Printer, Wellington, 1983) 2131) and it is probably also implicit in other requirements such as the rule requiring three years prior employment in a sharebroker's office, and in some conduct rules. The extent of overlap is a complicated issue however. If there were no official licensing, would the N.Z.S.E. drop its equivalent rules? Would it make more explicit equivalent rules? Could the Commerce Act 1986 be used to prevent the second option?

38 Note that some degree of error can be expected with any qualitative assessment.

39 Apart from suspension or cancellation of a licence under section 6 there is no provision for continual assessment.

Furthermore, the information provided by licensing should be examined against the situation that would exist without it. As analysed in Part III, information about the quality of broker services is provided by responses to the transaction costs in measuring that quality. These responses include: acquisition by brokers of an accurate reputation in the long run; good brokers signalling their quality through such things as investment in a good name; regular clients patronising good brokers; and stock exchanges guaranteeing the quality of their broker members. Also, by increasing the costs of, and providing remedies for, certain broker behaviour, the laws of the general regulatory framework provide information and decrease the costs of not assessing the quality of broker services. Relevant laws include: contractual, fiduciary and special duties of care; the Crimes Act 1961; the Secret Commissions Act 1910; the Securities Act 1978 and the Commerce Act 1986.

Licensing may add little extra information to that which is already available.

(ii) Less competition: prices increased, innovation decreased.[40]

Application of conventional economic theory to the market for broker services indicates that if this licensing regime is effective at all, some people are prevented from becoming brokers and supplying services. When supply is restricted, prices are higher than they would be otherwise. Some potential consumers will be unable to afford the higher price and so will not buy the service.[41] Also, since brokers are cushioned to some extent from competition, the incentives to innovate usually provided by competition are reduced. For instance, brokers will face less of an incentive to vary and improve their services in the hope of gaining an edge over competing brokers.

These effects may also be extremely limited with respect to this particular form of licensing by the three general limiting factors mentioned: N.Z.S.E. rules, limited coverage and limited criteria. The fact that the criteria for licensing are limited and that the quantitative restrictions imposed by licensing are therefore relatively low is particularly important. It is from the quantitative restriction of supply that the above effects derive.[42]

This form of licensing may not lessen competition significantly.

(iii) Incentives: broker behaviour.

The licensing requirement of section 3 directly prevents certain "undesirable" people from becoming brokers, and so presumably reduces "undesirable" behaviour.

40 See Thomas G. Moore "The Purpose of Licensing" (1961) 4 Journal of Law and Economics 93.

41 So from (i) and (ii), the people who "lose" from licensing are: potential brokers who are excluded from the profession; consumers who will not now buy the service at all; and consumers for whom the lower costs in measuring quality are not enough to compensate for the higher prices. The people who benefit from licensing are: those brokers who charge higher prices; and those consumers for whom the lower costs in measuring quality are enough to compensate for the higher prices.

42 Note that there is one reason why this instance of occupational licensing is not restrictive, which is often absent in other instances: this licensing is not carried out by the profession itself. The judicial process does not face the incentives to restrict entry that members of the profession would face.

It creates an incentive for people who believe that a District Court judge would find them "unfit" to be a broker, not to even attempt to become one. Section 6 creates an incentive for people who are brokers not to be "guilty of dishonest, dishonourable or improper practices". If they are so guilty, they risk losing their licence.

The direct effect is again drastically qualified by the three general limiting factors: N.Z.S.E. rules, limited coverage and limited criteria. Even so however, there is still some absolute minimum standard set.

The two incentives created are also limited: they are dependent on individuals' expectations. In the first case, a person who is objectively unfit to become a broker can gamble on a judge making a mistake. In the other case, expectations of the risk of being caught and punished are influential. Consider also the incentives that would exist without licensing. As noted in relation to (i) above, transaction costs in measuring quality of broker service provide incentives in the market for broker services to more accurately identify the quality of broker service and so reduce the gains to be made by a low quality broker (though gains may still be available). Also, again as already noted, the laws of the general regulatory framework raise the costs of engaging in certain behaviour and thus lower the incentive to do so.

Licensing may set a (low) absolute minimum standard of persons allowed to become brokers. However it may not significantly lower the incentive to try to become a broker or to engage in undesirable behaviour.

(iv) Distortions between markets.

Licensing applies only to brokers who transact in securities. The relative attractiveness of that compared to other activities then, is altered from what it would be otherwise. Thus licensing causes distortions in the relationship between markets. Due to the limited effects of licensing however, this effect will also be limited.

(v) Administrative costs.

Licensing has associated administrative costs. These include the "opportunity cost" of the judge, support staff and the applicant in expending resources on licensing.[43] The costs involved in this particular process of assessment are probably relatively low due to the low level of complexity.[44]

(vi) Legitimacy.

The fact that licensing is provided for by statute and undertaken by a District Court judge may somehow lend an aura of legitimacy to the operation of the profession.[45] This could increase public confidence in sharebrokers and could even

43 Supra n.4. For example, the opportunity cost of the judge is the value of the highest valued alternative activity he or she could otherwise be engaged in.

44 Any move to significantly increase the effectiveness of licensing, e.g. by increasing comprehensiveness of criteria or coverage, could be expected to significantly increase administrative costs.

45 Economists are traditionally reluctant to take into account such unquantifiable concepts as legitimacy. This writer contends that a value free approach must include them as factors, though the weight to be placed upon them is a value judgement.

induce brokers themselves to value their licence more highly. It may also be that licensing provides a degree of reassurance about the standards of brokers beyond that which is justified by the actual process. Such an effect is inherently difficult to quantify and may be particularly susceptible to changing attitudes.

4. *Conclusion on Licensing*

In conclusion, the most noticeable characteristic of the effects of broker licensing is their limited nature. Limitations arise from the particular form of licensing here, but also from the fact that licensing adds little to the market behaviour, responses to transaction costs, and law of the general regulatory framework that would exist anyway. Thus adverse market effects and distortions, and administrative costs cause little concern. At the same time, the actual information provided and the effects on broker behaviour through incentives may be of limited benefit, though some absolute minimum standards may be provided. Perhaps licensing plays a legitimating role, but this is difficult to assess.

According to the Treasury framework, licensing is a specific intervention and its existence must be justified. The above analysis suggests that it is difficult to justify: there seems to be very little extra net benefit added by licensing share-brokers. However, it is easier to state that negative effects are minimal, than it is to assess the degree of extra information and positive incentives provided. In any case, according to the positive rather than normative nature of the framework used in this article, the ultimate decision is left to the policy makers. They should assess the relative importance of the various effects of licensing, based on economic analysis and taking into account economic analysis of alternative specific interventions.[46]

B. Registration of Stock Exchanges

1. *Law and History*

Section 9 of the Sharebrokers Act 1908 provides that all stock exchanges and associations of sharebrokers shall be registered by the Secretary for Justice on payment of $20. A stock exchange must have at least seven members and forward a list of members and a copy of the rules to the Secretary for Justice. Section 10 protects the use of the words "stock exchange". These sections also date from the Sharebrokers Act 1902. Sir Joseph Ward believed that registration would encourage greater confidence in the industry.[47]

2. *Effects*

(a) Administrative costs

The cost of registration to both exchanges and government in time and effort is negligible. Similarly, the monetary charge is negligible.

46 Certification is often raised as an alternative to licensing. This does not involve excluding anyone from the market, but assesses and provides information about their quality of service. Of course it could also involve significant administrative costs. Consideration of such alternatives is however, outside the scope of this article.

47 N.Z. Parliamentary debates vol. 120, 1902; 259.

(b) Information

The government is provided with information about stock exchanges and their rules. However, while this may have been significant in colonial New Zealand, methods of communication have improved. The extra amount of information now provided by the exchanges above what would be available without it, is likely to be very low.

(c) Name protection

Section 10 can be seen as a specific creation of a property right in the name "stock exchange". This right is vested in registered exchanges.

3. *Conclusion on Registration*

The economic effects of registration are far fewer than those of licensing. Again they are limited, though here the reason may be the change in circumstances since 1902. It might be argued that the name protection effect is justified as the proper subject of specific intervention, though the consequences of removing it would not seem great.

C. Establishment of the New Zealand Stock Exchange

1. *Law and History*

Section 3 of the Sharebrokers Amendment Act 1981 establishes the New Zealand Stock Exchange as the successor to the four trading exchanges and the Stock Exchange Association of New Zealand. This was effected on 18 July 1983.[48] Section 4 sets out the N.Z.S.E.'s functions and gives it all powers reasonably necessary to carry out those functions. Section 6 protects the use of the name "New Zealand Stock Exchange".

These sections only date from 1981. Legislation was considered to be the most efficient way of amalgamating the four trading exchanges and the parent organisation, the Stock Exchange Association of New Zealand, into one body. It got over problems of continuity of business and obligations, especially those of renegotiating contracts.

2. *Effects*

(a) Lower consolidation costs

The main effect of these sections is to facilitate an organisational consolidation of New Zealand stock exchanges. Prima facie it seems that savings are made compared with the extra time and effort involved in consolidation by another method.

(b) Costs in changing functions and powers

Section 4 increases the costs to the N.Z.S.E. of changing its functions and powers, since legislation is required. If the N.Z.S.E. was formed under the Companies Act 1955 it would be able to change its functions and powers more easily.[49]

48 S.R. 1983/123: The Sharebrokers Amendment Act Commencement Order 1983.

49 Indeed per the Companies Amendment Act 1983, a company may now abolish its objects and powers and thus avoid its actions being challenged for being *ultra vires*.

Not only does this represent a change from the situation under the general regulatory framework, but it also introduces a difference between the N.Z.S.E. and any other registered stock exchange in the cost of changing functions and powers.

(c) Administrative law

The fact that the N.Z.S.E. is given statutory functions and powers may also mean that it is subject to wider principles of administrative law than if it were purely a private body. The effect of a statutory body acting *ultra vires* for instance, is greater than that of an ordinary company doing so.[50] So section 4 implies another change for the N.Z.S.E. from the situation which would exist under the general regulatory framework. Again this distinguishes the N.Z.S.E. from other stock exchanges.

(d) Name protection

Section 6 creates a property right in the name of the New Zealand Stock Exchange. The law of the general regulatory framework though, would prevent other bodies registering the name, or a name that resembles the name of another body corporate.[51] So registration of the name of the N.Z.S.E. would be protected without this section, though business use of it may not be.

3. *Conclusion on N.Z.S.E. Establishment*

In conclusion, the provisions establishing the N.Z.S.E. seem to constitute a valid specific intervention to the extent that they are technical, since they lowered transitional costs of an organisational change. However, section 4 has the particular effects of raising the costs to the N.Z.S.E., of changing its functions and powers and subjecting it to wider principles of administrative law. These effects constitute changes from the law of the general regulatory framework, and require justification according to the Treasury distinction.

D. Making of Exchange Rules

1. *Law*

Section 11 of the Sharebrokers Act 1908 provides that any registered stock exchange may make rules. They come into effect once approved by the Governor-General in Council and published in the Gazette. Section 7 of the Sharebrokers Amendment Act 1981 provides that the N.Z.S.E. shall make rules (subsection 1); that the rules will include provision for certain matters (subsection 2);[52] and that the rules shall come into force once approved by the Governor-General in

50 Supra n.49 and especially since the Companies Amendment Act 1983 inserted s. 18A into the Companies Act 1955.

51 Section 11 of the Incorporated Societies Act 1908 and s. 31 of the Companies Act 1955 prevent bodies registered under those Acts from taking the name, or a name that resembles the name, of another body corporate.

52 Note that s. 7(2)(i) was repealed by s. 110(1) and the Second Schedule of the Commerce Act 1986.

Council and published in the Gazette (subsection 3).[53]

In the case of *Stock Exchange Association of New Zealand* v. *Commerce Commission*[54] the High Court held that an exemption provision in the Commerce Act 1975 meant that it did not apply to rules made under section 11 of the Sharebrokers Act 1908.[55] Section 43, the statutory exception section in the Commerce Act 1986, exempts in subsection 1, "any act, matter, or thing that is, or is of a kind, specifically authorised by any enactment or Order in Council made under any Act". Section 43(2) provides that it is not specific authority "if it provides in general terms for that act, matter or thing", and then lapses into a badly drafted "notwithstanding . . . " provision. What exactly section 43 means in relation to the Sharebrokers Act 1908 is unclear. Sections 11 and 7(1) constitute general authority for rules made under them, and are therefore not a reason for exemption from the Commerce Act 1986. Section 7(2) probably does constitute specific authority and so exempts rules made under it.[56] However, despite Parliament's intention (presumably), since all rules take the form of Orders in Council, they all appear to be specifically authorised by Orders in Council per section 43 and are thus possibly all exempted from the Commerce Act 1986.[57]

2. *History*

The provisions governing rule making of registered stock exchanges again date from 1902. The mechanism for rules to come into effect seems to have been designed to check stock exchanges' powers. One Honourable member of the

53 Section 7 has been interpreted by the Court of Appeal in the case of *N.Z.S.E.* v. *Listed Companies Association* [1984] 1 N.Z.L.R. 699. This case involved a challenge to the validity of the N.Z.S.E.'s listing requirements on the grounds that they were not formulated in the way that s.7 of the Sharebrokers Amendment Act 1981 requires. The court found however, that the 1981 Act does not require or authorize the rule-making power of the Exchange to be used as a means of regulating listing requirements.

54 [1980] 1 N.Z.L.R. 663 S.E.A.N.Z. was the "co-ordinating" body of the regional stock exchanges that existed before formation of the N.Z.S.E.

55 Section 22(7)(a) of the Commerce Act 1975 provided an exemption to the Act for "a trade practice expressly authorised by any Act". The High Court interpreted that exemption by applying section 4 of the Acts Interpretation Act 1924 which defines "Act" to include rules and regulations made under an Act. The rules of the Exchange were found not to be subject to the jurisdiction of the Commerce Commission since they were expressly authorised by regulations made under the Sharebrokers Act 1908. See C.J. Cook "Expressly authorised by any Act" (1984) 14 V.U.W.L.R. 142.

56 Taking a narrow view, the provisions of s. 7(2) may constitute general authority since they do not specify exactly what the rules are to provide, but merely that there are to be rules concerning certain matters. E.g. s.7(2)(a) "the manner in which a person may become and cease to be a member of the New Zealand Stock Exchange." There is however, a strong contextual argument based on s. 43(3) that s.7(2) does constitute specific authority. Section 43(3) envisages that in the absence of express legislative provision, section 7(2) would provide "specific authority".

57 The "notwithstanding . . . " part of s.43(2) seems to attempt to prevent this. In the writer's opinion, this is not effective because of the peculiar structure of the sentence. Section 43(2) on its face seems to negate specific authority *only* if the Order in Council provides *in general terms* for a rule. The relevant Orders in Council here are specific in authorising each N.Z.S.E. rule (though where a rule vests some discretion in some body, a particular exercise of that discretion can not be said to be specifically authorised!).

Legislative Council pointed to the example of stock exchanges "at Home": "in fact they can almost do as they like".[58] The mechanism for making N.Z.S.E. rules effective seems to be derived directly from the 1902 provisions.[59]

3. *Effects*

(a) Exemption from the Commerce Act 1986.

The effect of section 7(2) is that the rules made in accordance with it by the N.Z.S.E. are exempted from the Commerce Act 1986. In addition, the requirement that all rules of the N.Z.S.E. and other exchanges must be authorised by the Governor-General in Council may exempt those rules from the Commerce Act. This removes the effect that the Commerce Act would otherwise have in increasing the costs of engaging in restrictive trade practices. The government is effectively exempting certain N.Z.S.E. rules and possibly all its rules and all rules of all exchanges from part of its general regulatory framework; at least to the extent that the effects of the Commerce Act 1986 are not also effected by other law. This ought to be justified, according to the Treasury distinction, and the justification is not readily apparent. (Indeed the effect itself is not readily apparent).

(b) Costs and benefits in changing rules.

Another effect of the requirement for government approval is to increase the costs to registered exchanges and the N.Z.S.E. in changing their own rules. They have to seek and achieve government approval and then have the rules put through the bureaucratic process. In the past this has taken many months. The government's investigation can also benefit exchanges though. Scrutiny from the Department of Justice has in the past identified inadequate drafting of N.Z.S.E. rules. This represents legal advice given to the N.Z.S.E. by the government and is thus a cost to the government with no corresponding payment, which would otherwise have been borne by the N.Z.S.E.

In addition, section 7(2) of the Amendment Act increases the costs of changing the rules mentioned there. To do so, an amendment to the Amendment Act would have to be sought, which could be difficult and take time.[60]

(c) Government power and ownership rights.

Another effect of the approval requirement is that the government is given a specific power of veto over rules when they are put forward. Thus the property rights which a stock exchange's "owners" have in being able to formulate rules, are diminished in extent. This also is a substantial change from the situation under

58 N.Z. Parliamentary debates vol. 122, 1902; 394.

59 The original 1981 Bill provided that the N.Z.S.E. could make some internal rules without reference to the Government. However, the Statutes Revision Select Committee recommended that all rules be subject to approval — thus maintaining the previous law. (N.Z. Parliamentary debates vol. 441, 1981; 3756.) The rationale was still that the government, especially the Department of Justice, could thus "vet" the rules. However, these provisions were envisaged to be temporary, pending an expected Securities Commission examination of N.Z.S.E. rules and practices. This examination has not yet occurred.

60 Supra n.52. The repeal of s.7(2)(i) was itself an example of higher costs to the N.Z.S.E. of changing its rules to "unfix" brokerage and move to negotiated rates.

the general regulatory framework. From the government's point of view, it gains a certain measure of direct power over an institution of importance to the economy. From an actual or prospective exchange owner's point of view, the cost of running an exchange is increased by the potential for government veto of management decisions.

The effect of government approval is limited to its extra effect, given the situation without such a requirement. As discussed in Part III, the shape of the market for stock exchanges influences the making of exchange rules, as do principles of administrative law. This limitation may not be great however, as the effects of government approval of rules may be quite different from the effects of administrative law.

4. *Conclusion on the Making of Exchange Rules*

These sections regarding the making of exchange rules may contain the most significant substantive effects of either the principal Act or the Amendment Act. The cost to exchanges (especially the N.Z.S.E.), and to the government of exchanges changing their rules is increased, though there are small compensations for this. More importantly, there are two changes to the situation that would apply in the absence of sharebroking-specific law. The government is given direct power over exchanges' rules: this is a change to the property rights which "owners" of stock exchanges would possess under the general regulatory framework. The possible exemption to the Commerce Act 1986 represents a major, perhaps unintended, exemption from the law of the general regulatory framework.

V. ASSESSMENT OF ANALYSIS

A. Structure: The Treasury Distinction

What is the value of structuring the analysis in this article around the Treasury distinction between law of the general regulatory framework and law consisting of a specific intervention?

It can be argued that the Treasury distinction is too abstract and unreal. It can be difficult to decide in practice whether a law is of the general regulatory framework or whether it constitutes a specific intervention. It can be difficult to decide which laws of the general regulatory framework should be considered relevant. These are simply practical limitations in an analytical device and must be recognised. A more serious criticism is that the Treasury distinction has a normative assumption behind it, viz. a prima facie principle that there should be consistency between laws applying to various sectors of activity. However, in rebuttal it can be noted that as used in this article, the distinction does not attempt to determine which specific interventions are justified, nor does it dictate an economic basis for such a determination.[61] It merely asks for reasons why one sector of the economy should be treated differently from any other.

61 Supra n.10.

Certainly the Treasury distinction focusses attention on the "marginal" effect of the Sharebrokers Act 1908, i.e. its additional effect, given the situation that would exist anyway. The effects of the sharebroking-specific legislation as analysed in Part IV, were shown to be heavily qualified when examined from that perspective. That conclusion would not have been so obvious if the Treasury distinction had been not used. The Treasury distinction also puts several other effects of the sharebroking-specific legislation into perspective. For instance, section 4 of the Amendment Act takes on an added significance when it is considered that it represents a change from the situation under the general regulatory framework in at least two respects. Furthermore, the requirement for government approval of exchange rules appears in a different light when viewed in terms of constituting a change to the ownership rights in an exchange and an exemption from the Commerce Act 1986. Perhaps the most valuable role the Treasury distinction performs though, is a general one. It emphasises that a piece of legislation cannot be seen in isolation. The sharebroking legislation exists against the background of other law. Adding more legislation to the nation's statute books does not necessarily add more law to that which individuals must already consider. The Treasury distinction thus emphasises the need to carefully evaluate legislation in terms of existing legislation.

What of an overall evaluation of the Treasury distinction? It must be remembered that it is after all, only an analytical aid. The test to be applied is therefore whether the Treasury distinction has been helpful here in carrying out the substantive analysis. Taking all the above points into account, this article concludes that it has been. The benefits of using the Treasury distinction outweighed the costs. This indicates that the distinction can be a useful one, though that is not necessarily always true.[62]

B. Approach: The Economic Approach

What is the value of the Economic Approach adopted in this article?

Perhaps the first impression of the Economic Approach is that as stated in Part II, it is a particular way of thinking. Parts III and IV demonstrate that the Economic Approach involves looking at circumstances from a particular perspective, with a particular conception of how individuals behave. It is easier to understand the application of the Economic Approach than its theory. Demonstrating a way of thinking is not too difficult. Explaining it and identifying implicit assumptions and perspectives involved, is more difficult. This does not invalidate the Economic Approach. Indeed, it is especially valuable to be able to identify the assumptions and thus any inherent limitations behind the Economic Approach.

Turning to the particular area analysed here, the application of the Economic Approach did yield insights into the effects of sharebroking law. Applying the Economic Approach in Part III revealed relevant incentives faced by individuals in the sharebroking sector. Those incentives were analysed as deriving from market behaviour, responses to transaction costs, and the law of the general regulatory

62 Note yet again the concept of opportunity cost! What are the alternative structures and analytical aids that could be used? That is a question beyond the scope of this article.

framework. The analysis yielded insights into the process behind activity in the sharebroking sector. With this understanding, the Economic Approach was then applied to the sharebroking legislation to see exactly where it fitted in. What incentives do its provisions create? What costs and benefits does it impose? Thus the effects of the legislation were identified.

An example of this was the making of stock exchange rules:

Part IIIA used the concept of the market for stock exchanges. This identified "market" influences on exchange rules. Since exchange rules are part of the commodity in this market, competition in the market influences them. This means that account must be taken of competition between "sellers" of stock exchanges, and between "buyers" of stock exchanges, of the recently lowered costs of using foreign exchanges, of the fact that other methods of dealing in securities can be used, and of changes in the market for securities.

To this, Part IIIB added transaction costs. Stock exchanges and thus exchange rules only exist at all because of transaction costs in the market for securities. Furthermore, there are transaction costs in setting up stock exchanges which mean that the market for stock exchanges constitutes a natural monopoly, which has implications for competition there, and thus exchange rules. In addition, transaction costs in measuring the quality of broker services create incentives for stock exchanges to formulate restrictive rules, including quality criteria for membership, in order to signal the quality of the broker members of that exchange.

Part IIIC added certain relevant laws of the general regulatory framework. The Commerce Act 1986 increases the cost of formulating rules constituting restrictive trade practices. Principles of administrative law also influence the making of exchange rules. Furthermore, under the general regulatory framework, those who set up private stock exchanges have property rights in their own organisations.

Then in Part IVD, the sharebroking-specific legislation concerning the making of exchange rules was considered. The Sharebrokers Act 1908 effectively exempts certain New Zealand Stock Exchange rules from the provisions of the Commerce Act 1986, and may exempt all its rules and all exchanges' rules. It increases the costs to all exchanges of changing their own rules, and especially increases the costs in relation to certain rules of the N.Z.S.E. It increases the government's costs by its having to scrutinise exchange rules. It also gives the government a power of veto over exchange rules and thus diminishes the value of the ownership rights in an exchange.

It is submitted that the above example clearly illustrates that the Economic Approach yields useful insights into sharebroking legislation.

The specific application of the Economic Approach however, also reveals some potential problems. One criticism that can be made is that the Economic Approach is too theoretical. Indeed, the analysis in this article can be validly criticised for this. However, that is not a necessary consequence of applying the Economic Approach. A comprehensive study would undertake further empirical investigations on which to base and test the predictions and explanations offered by the Economic Approach.

This article has concentrated rather on developing the theoretical implications available from the Economic Approach, which are after all its essence. The point is that empirical study enhances the value of the Economic Approach rather than diminishes it.

The Economic Approach has been valuable here in analysing the effects of law. It has added little in directly determining what the law is. The Economic Approach is not therefore a tool to be used in advising clients, but is rather capable of aiding the understanding of the consequences of law. It could be used in legal argument to demonstrate reasons for a law but its primary use is as a policy maker's tool. Yet even its usefulness as that is limited. This article does not contend that the Economic Approach provides the basis on which to judge between policies. It does contend that the Economic Approach provides a method by which to present, analyse and predict the effects of various policies. It is on the factual basis of that information that a policy maker — a politician for instance, or even a judge — may weigh effects according to some value system, and make a decision between policy options.[63] The Economic Approach may thus assist the formulation of law.

The Economic Approach used in this article draws on the rich interface between Law and Economics. It emphasises that law must be seen against the background of human behaviour. It is behaviour that law influences, and through behaviour that law operates. According to the Economic Approach law is but one (often significant) consideration that individuals take into account in their behaviour. To understand behaviour, law must be examined; but to understand law, behaviour must be examined, which includes examination of the other influences on behaviour. The Economic Approach performs that in a systematic way. It is a systematic and coherent way of analysing influences on behaviour.

VI. SUMMARY

The substantive conclusion of this article is that the effects of the Sharebrokers Act 1908 are not what they might first appear to be. Unexpectedly perhaps, the effects of the licensing provisions — both positive and negative — are very limited. So are those of the provisions for the registration of stock exchanges. While the provisions establishing the New Zealand Stock Exchange may be technically desirable, at least one section (section 4 of the Amendment Act) constitutes two substantive changes to the situation that would exist under the laws of the general regulatory framework. The provisions which have most substantive effect seem to be those regarding the making of stock exchange rules. They effectively exempt some of the New Zealand Stock Exchange's rules from the Commerce Act 1986 and possibly exempt all its rules and all exchanges' rules. They also give the government power over exchanges at the expense of private ownership rights.

63 In the writer's opinion, much of the bad press that Law and Economics has had is due to the proclivity of those who use it to make their own policy recommendations — using their own value system, which has tended to be "right wing".