

# VOID TRANSACTIONS UNDER THE SECURITIES ACT 1978

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The Securities Act 1978 provides legislative safeguards for investors. One of these safeguards is for an issuer to provide certain disclosure documents. The principle underlying this safeguard is that investors ought to be informed of the securities, and the market, they choose to invest in. As stated by Richardson J in *Re AIC Merchant Finance Ltd*,

the broad statutory goal [of the Securities Act 1978] is to facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers ... the Act is aimed at the protection of investors.<sup>1</sup>

The protection of investors is perhaps, *prima facie*, exemplified by section 37: failing to disclose relevant information to prospective subscribers can result in any allotment of securities deemed to be invalid and of no effect.<sup>2</sup>

People who invest, or are thinking of investing, in securities in New Zealand are protected by certain provisions of the Securities Act 1978.<sup>3</sup> An issuer who offers securities to the public and fails to meet the minimum disclosure thresholds stated in the Act ought to expect the very real risk of any consequential allotment made being invalidated and of no effect.<sup>4</sup> However, an issuer who has made an allotment of securities that contravenes section 37 does not, in practice, find its allotment invalid and of no effect. This is manifestly apparent where the Securities Commission enters into an 'enforceable undertaking' with an issuer who has contravened section 37 of the Act.<sup>5</sup> This often takes on the appearance of validating and making effective an allotment which is invalid and of no effect under section 37(4).<sup>6</sup> The dilemma here is that, on the one hand, the Act explicitly states that any allotment of securities in contravention of any of the provisions of section 37 shall be invalid and of no effect, and on the other hand an enforceable undertaking can result in a void allotment made valid and of effect. It is worth noting that in 2004 there were wide-ranging amendments to the Securities Act 1978, and these amendments occurred as part of an Omnibus Bill. Section 37 and section 37A (which relates to voidable irregular allotments) survived the 2004 amendments intact. 'Enforceable undertakings' entered into by the Securities Commission with issuers who have breached section 37 have, prior to the 2004 amendments, been evidence of that an allotment of securities that are void are not actually 'void.' Further, the 2004 amendments included a number of qualifications to section 37, and these amendments have

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\* The author would like to thank Professor Barry Barton for direction in refining the article for publication, and Jonathan Easthope for critique and assistance in producing the final draft.

1 [1990] 2 NZLR 385 (CA).

2 Adapted from s 37(4) Securities Act 1978 and *Re AIC Merchant Finance Ltd*, *ibid*.

3 The Securities Act 1978 will be referred to from here on as 'the Act'.

4 Securities Act 1978 s 37.

5 Securities Act 1978 s 69J.

6 See, for example, South Pacific Energy Limited and Calgary Petroleum Limited: Enforceable Undertaking with the Securities Commission, 21 February 2005, available <[www.sec-con.govt.nz](http://www.sec-con.govt.nz)>.

caused further confusion as to what the meaning of 'void' under the Securities Act 1978 actually means.

The distinction between a void allotment and a voidable allotment seems to have become blurred to the point where, in terms of the Securities Act 1978, void means something other than being invalid and of no effect. This article examines the impact of the 2004 Amendments<sup>7</sup> to the Act on section 37. Of particular interest is whether section 37(4) means 'void,' or whether it means something less than 'void.'<sup>8</sup> In truth, this problem in the securities legislation has its parallels in other fields of law. In contracts we encounter it in conditional contracts and in dealing with illegal contracts. In administrative law, we meet it in arguments that administrative action is void, voidable, or simply invalid.

Section 37(4) provides 'any allotment made in contravention of the provisions of ... section [37] shall be invalid and of no effect'. An impression that could be reasonably gleaned from this provision is that an allotment of securities failing to meet the required disclosure standards is invalid and is of no effect. In *Cowles v Syndicated Investigations Limited*<sup>9</sup> Master Venning (as he was then) commented on the meaning and effect of section 37(4). The Master, in very clear terms, observed that section 37(4) provides that any allotment of securities in contravention of section 37 is invalid and of no effect. No steps need to be taken by a subscriber, or the issuer, under section 37 to avoid an allotment in contravention of section 37. Such an allotment is void ab initio as opposed to voidable. This observation is echoed in a decision by the Privy Council in *Christchurch Pavilion Partnerships No 1 v Deloitte Touche Tohmatsu Co Ltd*.<sup>10</sup> An offer of securities failed to meet the subscription threshold stated in the registered prospectus.<sup>11</sup> It was held that the terms set out in section 37(4) expressly and clearly stated that any allotment in contravention of section 37 was necessarily invalid and of no effect.

A casual observer could be forgiven for forming the impression that a contravention of the section 37 requirements necessarily results in an allotment being invalid and of no effect. The case law, as well as the statute, appears to demand exactly that. However, this is not always the case. Perhaps it is timely to consider an observation by Kirby P in the Australian case of *Hurst v Vestcorp*.<sup>12</sup> This case is of interest to the Securities Act 1978 because the New Zealand Government has entered into, and recently commissioned a review on, a Memorandum of Understanding on business law co-ordination with Australia.<sup>13</sup> This Memorandum of Understanding is an attempt to harmonise the securities and commerce legislation between New Zealand and Australia.<sup>14</sup> It is prudent to take from Australian case law those observations made and experiences seen in relevant commercial and securities cases before their courts. Kirby P was

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7 Securities Amendment Act 2004.

8 Compare the construction of Section 37 Securities Act 1978 (void) with Section 37A Securities Act 1978 (voidable).

9 (1998) 8 NZCLC 261 581 (HC).

10 (2002) 2 NZCLC 262 812 (PC).

11 Securities Act 1978 s 37(2).

12 (1988) 6 ACLC 286.

13 Press Release from the Minister of Commerce, P Hodgson, 25 July 2005, available <[www.beehive.govt.nz](http://www.beehive.govt.nz)>. The Memorandum of Understanding was signed by the Governments of New Zealand and Australia in 2000. The review has identified eight areas of interest for better coordination between New Zealand and Australia, including 'Seeking greater compatibility in disclosure regimes for financial products'.

14 Ibid.

concerned that statutory invalidity of a transaction could have dire consequences for innocent third parties. To insulate innocent parties from such injustice, the learned Judge proposed that a court may be prudent to consider four principles: (1) that the transaction is such that the statute demands the offending transaction be void, but (2) that this is not always the case, particularly where (3) the statute adequately provides machinery to meet its objects, while being ever mindful of the possible consequences upon innocent third parties, and (4) that the proscription ought not be extended beyond those transactions clearly in breach of the statute.<sup>15</sup> These principles aim to mitigate the impact that a strict interpretation of an invalidating provision may have upon innocent third parties. With this in mind, it is useful to consider the application of section 37 of the Securities Act 1978 before and after the 2004 Amendments.

The law surrounding allotments that contravene section 37 appears to be somewhat anomalous. This is evidenced by the discretion the Securities Commission exercises against issuers contravening section 37. Often the Securities Commission approaches an issuer in breach of the Act and the parties come to an undertaking that will remedy or resolve the breach.<sup>16</sup> Where there has been a contravention of section 37, any undertaking between the Securities Commission and the contravening issuer is something other than the allotment being 'invalid and of no effect'. The undertaking is commonly made under section 69J of the Act. The result is that the contravening allotment now becomes voidable, rather than void. It is submitted that an undertaking by way of section 69J makes voidable an allotment that is deemed void by section 37(4). A change from an allotment being void to being voidable is not, however, difficult to resolve in light of the related case law.

While these cases appear to take strict approach to the issue of invalidity under section 37(4), the overall scheme of the cases does not support such a proposition. *Cowles v Syndicated Investigations Limited*<sup>17</sup> stated that an allotment contravening section 37 is void *ab initio* as opposed to voidable. The Privy Council in *Christchurch Pavilion Partnerships No 1 v Deloitte Touche Tohmatsu Co Ltd*<sup>18</sup> stated that an allotment in contravention of section 37 is necessarily invalid and of no effect. Read together these cases provide support to the proposition that an allotment contravening section 37 is an illegal contract. The Court of Appeal in *Re AIC Merchant Finance Ltd*<sup>19</sup> followed this reasoning to provide relief to subscribers of an issue that contravened section 37. The Court founded its reasoning on an *obiter* statement by Cooke J (as he was then) in *Harding v Coburn*.<sup>20</sup> This statement provided that an unlawful contract is a condition precedent to seeking relief under the Illegal Contracts Act 1970. The Court had no difficulty finding that the Illegal Contracts Act 1970 applied to contraventions of section 37.

There is an interesting discussion by Richardson J in *Re AIC Merchant Finance Ltd*<sup>21</sup> about the relationship between validation of an illegal contract and the provision of relief from an illegal contract. He said:

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15 (1988) 6 ACLC 286, 299.

16 See for example South Pacific Energy Limited and Calgary Petroleum Limited: Enforceable Undertaking with the Securities Commission, 21 February 2005.

17 (1998) 8 NZCLC 261 581 (HC).

18 (2002) 2 NZCLC 262 812 (PC).

19 *Re AIC Merchant Finance Ltd* [1990] 2 NZLR 385 (CA).

20 *Harding v Coburn* [1976] 2 NZLR 577, 584 (CA).

21 *Re AIC Merchant Finance Ltd* [1990] 2 NZLR 385 (CA).

... section 7 [of the Illegal Contracts Act 1970] cannot be employed to negate the effect of a provision of the Securities Act ... it follows that an allotment which is invalid under section 37(4) cannot be validated under section 7 [of the Illegal Contracts Act 1970].<sup>22</sup>

An allotment contravening section 37 is invalid. Relief can be provided under the Illegal Contracts Act 1970, but the allotment remains invalid and of no effect. The framing of section 7(1) of the Illegal Contracts Act 1970 provides the court a wide discretion in providing relief and includes, amongst other things, validation of the contract in whole or part. It is submitted that Richardson J in *Re AIC Merchant Finance* provided that section 4 of the Securities Act 1978 proscribes absolutely the validation of an allotment in contravention of section 37 under section 7 of the Illegal Contracts Act 1970. The scope of the relief available does not include validation of an allotment in contravention of section 37. Should the Court in *Re AIC Merchant Finance* have meant to have provided that the validation of an allotment contravening section 37 could be effected under the Illegal Contracts Act 1970, then Richardson J would not have stated 'that an allotment which is invalid under section 37(4) cannot be validated under section 7 [of the Illegal Contracts Act 1970]'.<sup>23</sup> The practice of the Securities Commission in exercising its jurisdiction under section 5(5) and section 69J of the Act could be viewed as being *prima facie* at odds with the way in which the law has developed. An allotment that is invalid and of no effect by dint of contravening section 37 ought not be validated, but rather ought to be the subject of relief according to the equity of the circumstances. This is what both the courts and section 69J undertakings have achieved.

The current Securities Act 1978 was amended during April 2004. The Bill which gave rise to the amendments was divided from an Omnibus Bill introduced by the Government and titled the 'Business Law Reform Bill'. The amendments of note for this article are found in Part II of the Act. They are sections 4(5), 37AA, 37AH, and 37AI.

Section 4(5) provides that '... Nothing in the Illegal Contracts Act 1970 applies to sections 37 and 37A.' The scope of this amendment was to provide some basis for capturing issuers in jurisdictions other than New Zealand who may contravene section 37 or section 37A.<sup>24</sup> It is submitted that this amendment has contributed nothing to the effectiveness of the Act against parties in jurisdictions other than in New Zealand. An equally effective mechanism would have been to have amended the principal Act to read 'The Illegal Contracts Act 1970 applies to sections 37 and 37A.' However, the drafters of the Bill which amended the Securities Act 1978 during April 2004 also provided relief provisions which can be found in Part II of the Securities Act 1978. These provisions are '37AA: Applications for relief orders in respect of section 37', '37AC: Court must make relief order in certain circumstances', and '37AH: When Court may make relief order in respect of Section 37'.

Section 37AA provides for applications for relief orders. It sets a tripartite statutory threshold to be met for any relief order in respect of section 37. There must be a contravention of section 37, the contravention of section 37 can be retrospective, and there must be at least one subscriber. Where the security in question has been repaid under section 37(5) or section 37(6), the subscriber may not have standing to apply for a relief order.

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<sup>22</sup> Ibid at 393.

<sup>23</sup> Ibid.

<sup>24</sup> Brian Connell MP (National-Rakaia) *Hansard* 6 April 2004 p 12425; Stephen Franks MP (ACT) *Hansard* 6 April 2004 p 12426.

It is submitted that the wide scheme provided by section 37AA for determining standing to apply for a relief order where allotments contravene section 37 is beneficial to the administration of the Act. The provision empowers subscribers who have been exposed to allotments that contravene section 37 to recognise whether or not they have standing to apply for a relief order. In this sense section 37AA supports the purpose of the Act, which is to protect investors.

Some relief orders are mandatory. A court must make a relief order where the application of section 37 to the allotment of the security has been made by certain persons. These persons include a subscriber, a security holder, and an issuer. Where the issuer is the applicant for a mandatory relief order, the consent of the subscriber or the security holder must be obtained. Where the issuer has contravened section 37 of the Act by failing to comply with the terms of an exemption issued under section 5(5), the issuer has standing to apply for a mandatory relief order subject to certain conditions. These conditions are focussed around the subscriber. The issuer must give notice of the contravention to the subscriber, and the subscriber ought not to have objected to the making of a relief order. Application of a mandatory relief order can include contraventions of section 37 that have occurred regardless of time, and can be sought in conjunction with a discretionary relief order.

A difficulty with section 37AA is the manner in which its provisions have been framed. The jurisdiction captured by the section appears to, in section 37AA (1), include any circumstance relating to the application of section 37. The specific wording is 'in respect of the application of section 37 to the allotment of the security'. The provision is not limited to contraventions of section 37. However, section 37AA (2) relates exclusively to contraventions of section 37 regardless of time. The difficulty is further compounded when exploring the legislative history of the part; there appears to be a curtain of silence over the reasons behind the drafting of the provision in the manner in which it was enacted. It is submitted that the purpose of the mandatory relief order is to fill the 'void' left by section 4(5) in denying any relief from contraventions of section 37 by way of the *Illegal Contracts Act 1970*.

Discretionary relief orders under section 37AH may also be considered. Section 37AH appears, at face value, to be the most significant amendment made to the *Securities Act 1978* by the *Securities Amendment Act 2004*. Its terms not only echo, but widen, the principles seen in section 7 of the *Illegal Contracts Act 1970* and the law developed by the courts in the application of section 37. This is particularly the case for contraventions of section 37, as captured by section 37(4). The court has a discretion to make any relief order that it considers 'just and equitable' to make in the application of section 37. Clearly, this includes validating an allotment that is void, if the court considers that it is just and equitable to do so. As seen in sections 37AA and 37AC, this section applies to contraventions of section 37 irrespective of when the contravention occurred. The discretion of the court under this section is unfettered. There is a list of matters to which the court must have regard when considering a relief order under section 37AH. The provision endows an unfettered discretion upon the court. The provision states the court must have regard to, amongst others, 'any other matters that the Court thinks fit' when considering a relief order in terms of section 37. As with section 37AC, it is submitted that the scope of section 37AH ought to fall within the ambit of section 37(4), namely, that a contravention of section 37 must exist. The effect of section 4(5) is thus provided for in the machinery provisions of sections 37AA, 37AC, and 37AH, amongst others. An allotment which is, by virtue of section 37(4), deemed to be invalid and of no effect, allows a party with standing, to apply for relief from the invalidity.

The provisions of sections 37AC and section 37AH can be compared. They both appear to capture a larger range of matters than void irregular allotments alone. There is scope within the drafting of these provisions to interpret ‘in respect of the application of section 37 to the allotment of the security’ to go beyond those allotments that are irregular and also void. It may or may not capture situations where an allotment has not been made. For example, a disgruntled subscriber who fails to secure an allotment because of section 37 may have standing under section 37AA to bring an application to the court to seek a mandatory relief order. The relief order sought by the subscriber may be the allotment of the securities. The scope of the relief orders available to the court are not provided under section 37AC. It may be that the court issues a declaration stating a specific kind of relief, or that the relief sought has to be provided for in the application to the court for mandatory relief. Common sense dictates that the applicant ought to state the scope of the relief sought. The provisions of section 37AC are silent. Whether the legislative intent was to provide the court with as wide a jurisdiction as possible when considering the options for mandatory relief orders, or whether the drafters never turned their mind to this, is something I have not been able to ascertain. The difficulty with a mandatory relief order is best seen in light of section 37AH. Here the statutory provisions empower the court with a wide discretion when considering relief orders. In light of the contrasts between the jurisdictions of the court to issue relief orders, an applicant would, it is submitted, be prudent to do so under section 37AH. The court’s jurisdiction under section 37AH is more reflective of an equitable one than under section 37AC. This is made out on the statutory terms.

The statutory scheme of section 37AH is in accord with the existing body of case law. One common thread running through the cases decided under section 37 is that of a sense of equity. The courts look to find an outcome that is just and fair between the parties. In *Re Dingwall & Paulger Ltd (in rec); Steel v New Zealand Guardian Trust Co Ltd*,<sup>25</sup> Ellis J held that equitable principles were at work which estopped an issuer from claiming funds held in trust for subscribers were part of an allotment that was invalid and of no effect. The relief provided the subscribers was found in the Illegal Contracts Act 1970. In *Westpac Financial Services Ltd v Securities Commission*<sup>26</sup> Doogue J in the High Court exercised an equitable discretion available under the Illegal Contracts Act 1970 to validate an allotment that had fallen foul of section 37. It appears that both parties came to the court with clean hands, the oversight that resulted in the contravention being unintentional and trivial. In *Re AIC Merchant Finance Ltd*<sup>27</sup> the Court of Appeal also employed equitable principles in finding that relief under the Illegal Contracts Act 1970 was available to subscribers of an allotment contravening section 37. The Illegal Contracts Act 1970 provides that the court can grant ‘such relief ... as in its discretion thinks just’,<sup>28</sup> and further when considering the relief to be given to have regard to ‘such ... matters as it thinks proper’.<sup>29</sup> This clearly provides the court with a wide discretion as to the relief available to a party to an invalid allotment. The fit that the Illegal Contracts Act 1970 has with the Securities Act 1978, as amended, is, as noted above, nowhere closer than in section 37AH.

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25 (1990) 5 NZCLC 66780.

26 (1996) 7 NZCLC 261106.

27 [1990] 2 NZLR 385.

28 Illegal Contracts Act 1970 s 7(1).

29 Illegal Contracts Act 1970 s(3)(c).

We have seen that an allotment that contravenes section 37 of the Securities Act 1978 is deemed to be invalid and of no effect.<sup>30</sup> However, the Illegal Contracts Act 1970 has provided a firm basis to provide relief where adherence to the strict letter of the law would deliver injustice to innocent parties. Kirby J was concerned that statutory invalidity of a transaction could have dire consequences for innocent third parties. This concern has been echoed in New Zealand judgments, including that of Fisher J in *DFC Financial Services v Abel*.<sup>31</sup> The concern of the courts has been to ensure their treatment of the equity of the case before them is not shackled by narrow or strict interpretations of invalidating provisions. The Securities Act Amendment Act 2004 provided machinery for the courts to provide relief directing out of the Securities Act 1978. Of particular note are sections 37AC and 37AH. The difference between these may be illusory, but it is submitted that an applicant seeking relief under one of these provisions would be wise to seek it under a discretionary relief order. The machinery of the provision endows the court with any extremely wide ambit to do justice between the parties, particularly where a subscriber has suffered losses following an allotment that contravenes section 37.

The question whether void means void, or is something else, has never really been in question. As noted, Kirby J was concerned that a strict approach to an invalidating provision could cause hardship and injustice to innocent third parties. It is submitted that it is not only innocent third parties that can be dealt an injustice by a narrow interpretation of an invalidating provision, but also innocent parties to an allotment. Void, in terms of the Act, has never strictly meant void; it has always meant something else. That something else is now manifested in sections 37AC and 37AH in particular. An allotment which contravenes section 37 may appear invalid and of no effect, but this is not the case at all. The allotment is subject to inquiry by the courts, enforceable undertakings with the Securities Commission, and other mechanisms of resolution now available under the Securities Act 1978.

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30 Securities Act 1978 s 37(4).

31 [1991] 2 NZLR 619.