20 December, 1984

REPORT OF THE SECURITIES COMMISSION

ON

SOVEREIGN GOLD MINES LIMITED

Securities Commission,
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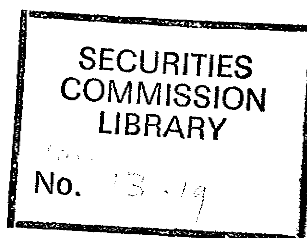
P O. Box 1179,
Wellington.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20 December 1984

REPORT OF THE SECURITIES COMMISSION on an enquiry into some aspects of the affairs of SOVEREIGN GOLD MINES LIMITED

INTRODUCTION

1. The company now named Sovereign Gold Mines Limited ("Sovereign") was incorporated on 4 May 1983. It offered 10 million ordinary shares of 25 cents each ($2,500,000) to the public through a prospectus dated 10 June 1983, and allotted the shares in July 1983. On 29 June 1984, receivers were appointed by the debenture holders. Sovereign is still in receivership.

2. By letter dated 18 July 1984 solicitors acting for Francis, Allison, Symes & Co, ("FAS") organising brokers and underwriters to the public issue, invited the Commission to conduct an investigation into certain matters on the grounds both of public interest and the interest of the Commission in evaluating existing shareholder protection mechanisms. Another request for an investigation by the Commission was received contemporaneously from Messrs Hyde-Harris and Hunt, two directors of Sovereign.

3. On 19 July 1984 the Commission decided, pursuant to section 10 of the Securities Act 1978, to obtain evidence about the following matters:-

i) The circumstances and terms of the offer or offers of shares in the capital of Sovereign to the public:

ii) The terms of the registered prospectus dated 10 June 1983 and the state of facts referred to therein:

iii) The supply of information to the market concerning Sovereign since that date:

iv) The means by which the market was informed of Sovereign's current position and the response of the New Zealand Stock Exchange to the information:

v) Trading in Sovereign's shares from 1 April 1984, with particular reference to allegations of insider trading.

4. The Commission held public hearings into the matter at its offices in Wellington on Thursday, 23, and Friday, 24 August, and on Friday, 21 September 1984. Evidence was taken from:-

John Dudley Ball	Manager	NZI Share Registry Services
Michael Jeremy Laurenson) Garth Ireland) William John Perham)	Partners	Francis Allison Symes & Co.
Anthony John Keenan	Chairman	Sovereign Gold Mines Limited
Philip Anthony Hyde-Harris	Director	Sovereign Gold Mines Limited
Keith Clarence Hunt	Director	Sovereign Gold Mines Limited
Brian Asa Boustridge	Director	Sovereign Gold Mines Limited

Winston John Butterfield	Director	Sovereign Gold Mines Limited
Stephen Leslie Franks	Solicitor	Chapman Tripp
James Max Duddington Willis	Solicitor	Bell Gully & Co.
John Gordon Lewis	Valuer	Harcourts Edward Rushton & Co.
Peter Antony Cox	Chartered Accountant	Arthur Young.

5. Counsel appeared for some of the witnesses, viz:-

Mr C.R. Carruthers	for	FAS
Mr A.R. Galbraith	for	Mr Keenan
Mr J.A. Cadenhead	for	Mr Boustridge
Mr C.B. Atkinson QC	for	Mr Butterfield
Mr K.G.L. Nolan	for	Arthur Young
Mr J.G. Barnes	for	Mr Willis and Bell Gully & Co.

We are grateful to the witnesses and their counsel for their time and trouble in presenting their evidence. We especially wish to mention the fact that the witnesses from FAS and Mr Willis co-operated fully with the Commission and answered as openly and fully as possible all the questions which were put to them, including those which might be regarded as critical of their conduct.

6. The Chairman prepared a draft report for consideration by the Commission and those who had given evidence. A copy of the Chairman's draft was sent to each witness and

counsel on 8 November 1984 with notification that the Commission would consider the draft at its meeting on Thursday, 15 November 1984, and that if it was desired to comment on the draft the Chairman wished to be advised of that fact before that date. Some witnesses and counsel requested further time to consider the matter, and all requests for additional time were allowed. In the result, comments were received from the following:-

Mr. Willis and Messrs. Bell Gully & Co. by their solicitors, Buddle Findlay, by letters dated 13 November, 22 November and 27 November.

Arthur Young, by letter dated 14 November.

Mr. Keenan, by personal statement and by submission of his counsel, Mr. Galbraith, each dated 14 November.

W.H.B. Smith & Son, chartered accountants of Hokitika, by letter dated 26 November.

FAS, by their solicitors, Chapman Tripp, by letter dated 29 November.

Mr. Hyde-Harris, by letter dated 1 December, supported by an Affidavit by Mr. N.F.J. Thinn of Greymouth, barrister and solicitor.

A copy of the draft was sent to the New Zealand Stock Exchange, and acknowledged on 23 November. The Commission

considers that all parties have had an adequate opportunity to present their evidence and opinions to the Commission.

TERMS OF REFERENCE 1.

The circumstances and terms of the offer or offers of shares in the capital of Sovereign to the public.

7. At the beginning of 1983 Mr Willis visited the West Coast on the instructions of a mineral resources company to see whether there was a package of mining privileges plant and equipment available for purchase with a view to public flotation. While there he met Mr Butterfield, half-owner of a company named Jaybe Mining Limited ("Jaybe") and Messrs Hyde-Harris and Hunt, owners of a company then named Sovereign Gold Mines Limited. No deal was made on this visit.

8. In February 1983 Messrs Hyde-Harris and Hunt put the idea to Mr Brian Boustridge, half owner of a company called Lamplough Mining Limited ("Lamplough"). Mr Keenan, a Greymouth solicitor acting both for Jaybe and Lamplough, was involved in the discussions. Messrs Hyde-Harris, Hunt, Boustridge and Keenan visited Mr Willis in Wellington in late February to develop the idea. Mr Willis agreed to act for them after clearing the point with the mineral resources company. He asked Messrs Hyde-Harris and Hunt to assemble further information, including details of the various licences and licence applications and plant and equipment proposed to be included, and a feasibility study as to the financial prospects of the proposed company and its structure.

9. Certain information was prepared and produced at a further meeting in Wellington on 15 April 1983. Mr Willis advised that it was of prime importance to obtain an underwriting commitment as early as possible. He introduced Messrs Hyde-Harris and Hunt to FAS and another firm of sharebrokers.

10. Both firms of brokers expressed interest. Each was told by Mr Willis that they were in competition for the job of organising broker and underwriter, and that it was desired to obtain an early underwriting commitment. FAS agreed to examine the proposal in detail and collate information for a draft prospectus, but Mr Willis retained the primary responsibility for preparing the prospectus as well as the legal work.

11. In response to some expressions of concern about fees, Mr Willis indicated to the promoters that if the issue of shares was underwritten and a prospectus registered, his firm's fee would be likely to be of the order of $35,000, but if the issue could not be underwritten, and did not therefore proceed to a prospectus with all the additional work involved, the fee would (because of the lesser work and responsibility) not be likely to exceed $5,000.

12. At this stage Mr Willis was acting for Sovereign and the promoters, some of whom were interested also as vendors to and contractors with Sovereign. Mr Willis was aware of the potential conflicts of interests. In his evidence, Mr

Willis discussed the difficulties confronting solicitors who act in this class of work, in which many diverse interests must be reconciled. The Code of Ethics of the New Zealand Law Society offers only the following guidance on the matter:-

> "1.1.3
> <u>Acting for More than One Party</u>
>
> (1) A practitioner acting in any matter shall not act for any other party in the same matter without the prior consent of both parties.
>
> (2) Where a practitioner is acting for both parties in any matter wherein a difference or conflict of interest arises between them, it shall be the duty of the practitioner to advise each party of this right to seek independent advice and the practitioner may no longer act for both parties; He may, however, continue to act for one party unless and until by reason of information derived by the practitioner from the other, that other may be prejudiced.
>
> (3) In this rule, 'practitioner' includes any partner, employee or employer of the practitioner."

13. Mr Keenan's role and responsibility at this time was that of Lamplough's and Jaybe's solicitor. He accepted instructions to assist Bell Gully & Co in certain matters such as ascertaining the status of the mining licences and applications, searching water rights for the licence areas to ensure that Sovereign would have the benefit of these, and drafting:

    (a) A schedule of the mining licences and mining licence applications for inclusion in the prospectus;

    (b) Explanatory notes to that schedule;

(c) A form of agreement for the sale and purchase of the licences and plant from the vendors to Sovereign.

14. Mr Keenan's draft of the agreements provided for an immediate cash payment for the plant, and for the issue of shares as consideration for, and at the same time as, the transfer of the licences. The draft agreements were altered by Mr Willis, acting for and on the instructions of the promoters, to provide for additional cash payments to the vendors on the grounds that the company was to be afforded immediate access to the licence areas and the right without further payment to win gold.

15. An independent valuation of various items of plant was made. It was included in the prospectus. But no independent valuation of the licences was obtained. Counsel for FAS informed us that FAS considered that any meaningful valuation of a licence would be unobtainable without carrying out a reserve proving investigation almost as expensive as mining, that the geological report included in the prospectus went as far as usual in providing information for the market to value the licences, and that the concept reflected in the prospectus of paying cash for the tangible plant sold by the vendors and issuing shares for the transfer of the licences dealt with the matter naturally inasmuch as the shares would have little value if the licences themselves proved to have little value. We think it would have been better if

these points had been made in the prospectus. The facts remain that the consideration for the licences was set by the vendors in consultation with the directors of Sovereign and their professional advisers, and that the vendors were companies in which directors of Sovereign had interests.

16. FAS agreed to seek outside directors for the new company. Initially their view was that there should be at least two outside directors, one of whom would act as Chairman, but the gentlemen FAS invited to join the Board declined to do so. Shortly before the prospectus was settled it was decided that the board would comprise:-

Mr Keenan, Executive Chairman
Mr Hyde-Harris, Deputy Chairman and Managing Director
Mr Hunt, Non-Executive Director
Mr Boustridge, Executive Director
Mr Butterfield, Non-Executive Director

17. Each of these gentlemen, with the exception of Mr Butterfield, had been involved with the preparation of the float. Each, with the exception of Mr Keenan, was interested in the sale of licences and plants to Sovereign. They had all expressed, to a greater or lesser degree, some unwillingness to act as directors, though they accepted office. They agreed to act on the understanding that Mr Willis of Bell Gully & Co., and Mr Perham of FAS, would be present at board meetings to assist the directors.

18. The preparations included an undertaking from Messrs Hyde-Harris and Hunt restraining them from competing with Sovereign for a period of 3 years. It is understandable that such an agreement should be sought from Mr Hyde-Harris, who was to be the Managing Director of Sovereign. It is less clear why it should have been thought necessary to obtain such an undertaking from Mr Hunt, who was not to be an employee. These two had undertaken many ventures together. Mr Perham of FAS thought it would have been pointless to obtain an undertaking from one without a corresponding undertaking from the other. Mr Willis drew a Deed of non-competition agreement in which Messrs Hyde-Harris and Hunt, in consideration of the allotment to each of them of 300,000 fully paid shares, agreed not to carry on any gold mining business in the territory (defined as the provincial district of Westland) for a period of three years except with the prior written consent of all of the directors of Sovereign. The Deed provided that Sovereign would not seek listing or quotation rights on the official list of the Stock Exchange of New Zealand for these shares for a period of 12 months following the date of issue and allotment. The Deed was executed on 31 May 1983.

19. On 24 May FAS sent a letter to other brokers advising of the proposed offer of shares in Sovereign and inviting applications from the brokers for firm allocations. The letter contained certain information about the proposed

offer but did not contain a draft prospectus nor any information as to the identity of the directors. Replies were requested by 12 noon on 3 June. In reply, some brokers refused to take a firm allocation, others accepted a firm allocation on conditions such as "subject to prospectus", and others gave unqualified acceptances.

20. On 25 May FAS approached a panel of 12 sub-underwriters to seek support for the issue, which was given. On 31 May FAS executed an underwriting agreement with Sovereign, which was accepted by Sovereign on the same day.

21. The first meeting of the newly reconstituted Board of Sovereign was held on 31 May. All the directors were present, and Messrs Perham and Willis were among those in attendance. The minutes showed that the directors disclosed their interests in various ventures. In particular Messrs Hyde-Harris and Hunt disclosed their interest in Sovereign Gold Mines (Investments) Limited, the Kelly Lease near Charleston and the Hardy Lease at Maori Gully. They did not disclose, nor did anyone check the point, that the Kelly lease was not within the provincial district of Westland. The Hardy lease was within that area. No attempt was made to secure the written consent of each of the directors, as required by the Deed of non-competition agreement signed on the same day. It did not occur to Mr Willis, nor apparently anyone else, to check the terms in which the non-competition agreement was referred to in the prospectus.

22. On 10 June 1983 Sovereign's prospectus was registered at the Companies Office at Hokitika.

TERMS OF REFERENCE 2.

The terms of the registered prospectus dated 10 June 1983 and the state of the facts referred to therein

23. The prospectus offered 10 million ordinary shares at 25c each, payable in full on application, and 5 million separately transferable options, granted on the basis of one option for every two shares subscribed, for no additional consideration. An option entitles the holder to subscribe for one ordinary share in the company at 25 cents prior to 30 June 1986.

24. The prospectus contained the usual introductory statements and the following sections:-

Directory, in which the directors, secretary, auditors, underwriting and organising brokers, share registrar, solicitors to the company and bankers are identified, and the address of the registered office of Sovereign was stated:

Directors' Statement:

The Directors, which contains a brief personal description for each director:

Details of the Issue:

Summary of agreements with vendors and promoters, which contains a brief description of the contracts made with

Sovereign for the acquisition by Sovereign of various mining privileges and other assets:

Schedule of Mining Licences, which contains a brief description of 4 mining licences and 5 applications for mining licences which Sovereign was intended to acquire. The Schedule discloses the name of the present registered holder or applicant in each case, and there are notes on particular points relating to each licence:

Solicitors' Report, by Bell Gully & Co. with reference to the 2 preceding sections, viz. the Summary of Agreements with Vendors and Promoters, and the Schedule of Mining Licences:

Independent Geologist's Report, by P.M. Hancock & Associates, which contains a brief description of each licenced area and some inferences regarding the presence of gold. The geologist defined as his terms "measured ore reserves" of which there were none, "indicated ore reserves" of 91,000 m^3, and "inferred ore (not reserves)" of an unspecified volume:

Auditor's Report, by Wilkinson Wilberfoss, which is in the usual terms required under the provisions of the Companies Act 1955 which were then in force:

Accountants' Report, by W.H.B. Smith & Son, in which they say, with reference to the projection of income and earnings set out in the Directors' Statement, that "the

assumptions are reasonable and the calculations properly compiled":

Plant Valuation Report, by Harcourts Edward Rushton & Co. giving an independent expert's valuation in situ of the plant that Sovereign has agreed to purchase:

Statutory Information, containing other information required under the Companies Act 1955.

25. Viewing the document as a whole, we have reached the conclusion that the prospectus did not give a full and clear account of the proposal and the facts relevant to it. Our opinion is based on the evidence presented to us on the following matters:-

(a) The description of the assets Sovereign was to acquire (paras. 26 to 28 below);

(b) The tenure of mining privileges (paras. 29 to 33 below);

(c) The operating capability of Sovereign (paras. 34 to 36 below);

(d) The agreement to issue shares to Messrs Hunt and Hyde-Harris (paras. 37 to 40);

(e) The description of some of the directors (paras. 41 to 45).

Purchase of Business

26. The prospectus was registered before Part II of the Securities Act 1978 and the Securities Regulations 1983 came into force. It had to comply with the provisions of the fourth Schedule of the Companies Act 1955 (now repealed). Clause 19 of Part II of the Schedule required that:

> "If the proceeds, or any part of the proceeds, of the issue of shares or debentures are, or is to be applied directly or indirectly in the purchase of any business, a report made by accountants (who shall be named in the prospectus) upon -
>
> (a) The profits or losses of the business in respect of each of the five financial years immediately preceding the issue of the prospectus; and
>
> (b) The assets and liabilities of the business at the last date to which the accounts of the business were made up".

27. The development of this matter was described to us by Mr. Keenan in his written statement dated 14 November 1984, as follows:-

> "At the time of the initial discussions with the promoters, the vendors, FAS and Mr Willis the intention was for Sovereign to purchase the shares in and accordingly take over the business of Jaybe, Lamplough and Sovereign Gold Mines (Investments) Limited. The advantage to the vendors in a transaction in that form would have been the receipt of capital rather than income. We were advised by Mr Willis concerning the requirements of the Fourth Schedule. When enquiry was made it became clear that there would be difficulty in the time then available in meeting the requirements of the Fourth Schedule as certain of the companies' records were not readily available or in a satisfactory form. As an alternative it was then decided that Sovereign should purchase only the plant and the licences. We were advised by Mr Willis that this did not constitute "the purchase of any business" in terms of the Fourth

> Schedule. Mr Willis expressed the considered view that the sale of a business contemplated the transfer of all assets and liabilities. Certainly the nature of the transaction was a different one from that which had been originally contemplated and I had no difficulty at the time in accepting his advice."

28. The prospectus contained statements suggesting a continuity of operations, of which the statement we will quote in para 33 is a fair example. Viewing the prospectus as a whole, we conclude that it is equivocal and misleading inasmuch as it contains suggestions that Sovereign had acquired and was carrying on established operations notwithstanding the fact that deliberate attempts were made to confine the acquisitions to the purchase of bare assets. The legal distinction between the purchase of a business and the purchase of bare assets is an important one affecting the content of the prospectus. The distinction can be one of some nicety, but one matter is perfectly clear. If the purchase relates to bare assets, the prospectus should not suggest a continuity of operations.

Mining Privileges

29. The lawful authority to carry on mining operations on any land is prescribed in the Mining Act 1971. There is a number of kinds of mining privileges, the main one being a licence. Section 145(1) of the Act provides that no mining privilege may be transferred, leased, mortgaged, pledged, or otherwise disposed of or dealt with without

the consent of the Minister. Section 87(2)(b) provides that it is the holder of a mining licence who is the owner of all minerals lawfully mined from the land under the licence. Without a mining licence, there is no authority to extract gold, nor any property in gold extracted. In these circumstances the status of applications for mining privileges and for consent to the transfer of existing mining privileges, are matters of critical importance for companies formed to exploit them.

30. It was suggested to us that de facto practices have developed, especially on the West Coast, whereby purchasers of licences have begun operations under agency or tribute agreements pending transfer of the licences. The legal advisers say they relied on those practices. With the advantage of hindsight, we think it was inadvisable for them to present an issue to the public based on practices which must be regarded as questionable at law. We note that counsel for the legal advisers, in his final submissions to us, again with the advantage of hindsight, accepted that view. (See his submission quoted in para. 49 below). The other persons involved could not be criticised for relying on their legal advisers in this technical matter.

31. The prospectus contained a schedule of mining licences and mining licence applications, with a number of notes attached (page 11). The notes detailed the current

position relating to each licence and gave a number of dates at which it was anticipated that the Minister's consent to the transfer of the licence to the company would be obtained. The latest such date was 28 August 1983. In fact, only one licence had been vested in Sovereign when the company went into receivership. That was mining licence 32/1510, known as the "Harper Licence", for which a memorandum of transfer was entered by the District Land Registrar, Hokitika, on 29 March 1984.

32. The prospectus also contained a solicitor's report which read in part:

> "We are satisfied that the summary of agreements with vendors and promoters contained in the prospectus, and the schedule of mining licences (together with the note forming part of that schedule) fairly and accurately state the content of the relevant agreements and the status of the licences and licence applications.
>
> Where it is stated that the applications for mining licences are pending we are unable to express a view as to the likelihood or otherwise that such application will be granted. All transfers of licences referred to in the agreements and any other transfers of such licences are in all circumstances subject to the consent of the Minister of Energy and in some cases the consent of the Minister of Forests. We can express no opinion as to whether or not such consents will be forthcoming".

These two paragraphs seem to us to be mutually inconsistent. The first indicates some assurance that Sovereign will obtain the necessary licences. The second introduces qualifications that negate any such assurances. More importantly, the report does not describe the consequences of a failure to obtain Ministerial consent.

33. We think it is important to appreciate that this was not the proposal of a company formed to undertake exploration work in areas yet to be defined. This prospectus held out rights to take over, for substantial considerations to be found from the proceeds of the issue, the assets and operations of others. Indeed, Sovereign was described as a going concern - as the Directors' statement includes the following remark, "The areas the company has been mining and will continue to mine have a proven history of gold recovery". The words are not consistent, in our opinion, with the conditional nature of Sovereign's rights under the vending agreements, or the fact, revealed elsewhere in the prospectus, that Sovereign had been formed only 5 weeks earlier.

Sovereign's operating capability

34. The viability of Sovereign depended on the throughput of auriferous material. Various statements about this were made in the prospectus.

> "... the directors have concluded that separate operating plants (up to seven initially) spread over a number of areas will minimise the effect of production loss through machinery breakdown and will enable maximum utilisation of all units in the most productive areas." (Page 3)

> "9.25 cents per share ($925,000) will be used to purchase additional plant and equipment to ensure that the company has a minimum of seven operational units by the end of its first year together with the necessary backup and exploration equipment." (Page 5)

> "The mining interests purchased by the company pursuant to the agreements referred to in this

prospectus give the company a basis of business using three mining and recovery units. The directors intend to move quickly to expand the number of operations units to seven." (Page 6)

"The directors aim to achieve the following targets during the company's first three years of operation:

Operational Units by year end

1st Year	2nd Year	3rd Year
7	8	10"

"The directors have done a series of sensitivity analyses on the profitability of the operation and have assessed that with eight operation units operating in gold concentration areas of 170 milligrams per cubic metre, the breakeven operational level is approximately $US300 per ounce." (Page 6)

The projections were supported by an acccountant's report included in the prospectus which contained the following passage:

"As you have advised that the proposed issue has been underwritten we have assumed that the issue will be fully subscribed, and that the net proceeds after the payment of vendor's interests, fees, and other costs will be available to directors and will be applied to the purchase or construction maintenance and general working of at least seven alluvial gold mining and recovery units." (Page 18)

35. In fact, Sovereign never operated more than four units.

36. It appears from the evidence that the throughput per unit never approached the figures set down in the assumptions on which the forecast in the prospectus was based. Of these assumptions the accountant's report stated: "In our view the assumptions are reasonable". The evidence we heard does not support this view.

The promoters' shares

37. The agreements to issue shares to Messrs Hyde-Harris and Hunt as consideration for the non-competition agreement were referred to more than once in the prospectus. Under the heading "Vendor Shares" the following appeared:

> "A total of 3,860,000 shares for 25 cents each, each credited as fully paid, have been issued to the vendors and promoters of the Company in consideration of the transferring by the vendors of certain interests held by them and the agreement of the promoters not to compete with the Company. All such shares will be categorised in the capital of the Company as vendor shares and application for listing or quotation rights for such shares will not be sought for a period of 12 months from the date of allotment ." (Page 5)

Under a description of "the promoters" there was this:-

> "Messrs P A Hyde-Harris and K C Hunt are both Directors of the Company and have had substantial other gold mining interests. In consideration of Messrs Hyde-Harris and Hunt entering into an agreement with the company whereby they have agreed not to compete in the gold mining business with the company for a period of three years the company has agreed to issue each of Messrs Hyde-Harris and Hunt 300,000 shares in the capital of the company, such shares to be credited as fully paid." (Page 10)

38. We think a reader of the prospectus would understand that neither of these two gentlemen was to engage in the gold mining business anywhere in New Zealand except on behalf of Sovereign for a period of three years. In fact, the Deed of agreement referred only to the provincial district of Westland. Possibly the Deed could be rectified to extend to New Zealand, but that raises issues we do not enter upon.

39. Mr Hunt devoted much of his time to the interest which he shared with Mr Hyde-Harris at Addison Flat, which is not within the provincial district of Westland. He also utilised some of Sovereign's plant on that site in circumstances which have led to Court proceedings. We do not discuss matters pending in Court. Moreover, it was not part of our enquiry to ascertain whether or not this outside activity by Mr Hunt had any bearing on the untimely receivership of Sovereign. We do express our disquiet about the lack of care evident in this matter. Mr Willis told us that he was "terribly disappointed" when he learnt about the outside interests of Messrs Hyde-Harris and Hunt. He learnt about them at the directors meeting on 31 May, but he proceeded with the registration, 10 days later, of a prospectus containing the statements we have quoted in para. 37.

40. Mr Keenan, in a written statement dated 14 November 1984, emphasised that the statement in the prospectus was that Messrs Hyde-Harris and Hunt were "not to compete" with Sovereign. He said, "They would not have been competing by mining gold elsewhere, as the market for gold and Sovereign's ability to sell its gold would not be affected by such activity. They could only compete in obtaining licence areas." We do not accept that view of the matter, as we believe that investors would understand that Sovereign would have the single-minded support of these gentlemen, not merely their abstention from competing activities.

The description of the Directors

41. Almost as soon as the prospectus was filed questions began to be asked concerning the acceptability of the board, which contained no well-known figures, and the past experience of some of its members, in particular Messrs Hyde-Harris and Hunt. These two gentlemen had for some time been involved in a variety of entrepreneurial ventures on the West Coast. One of the ventures, Answer Access Limited, had failed shortly after Hyde-Harris and Hunt had sold their interests in the company. The failure involved a loss of some $50,000 to creditors. Mr Hyde-Harris had disclosed to Bell Gully & Co, FAS, and his co-directors that he had had a conviction for an offence not involving dishonesty in his youth. He did not disclose to them, (nor did he disclose to us in his oral evidence, although he had every chance to do so) that he had changed his name by deed poll and that under his former name of de Jong he had been convicted for other relatively minor offences. The prospectus refers to him as Hyde-Harris.

42. The Companies Act 1955 contains a series of provisions designed to establish the identity of directors. Section 200 places an obligation on every company to keep at its registered office a register of its directors and secretaries, including particulars of any former Christian name or surname in each case. Section 200(7) provides

that if any default is made in complying with any provision of section 200, the company and every "officer of the company who is in default" shall be liable to a default fine.

Section 461 provides that every person who, with respect to a document required by or for the purposes of the Companies Act 1955 or the Companies Amendment Act 1963 -

> ... "(b) Omits or authorises the ommission therefrom of any matter knowing that the ommission renders the document false or misleading in a material particular -
> commits an offence against this section."

Section 463(2) provides that the expression "officer who is in default" means any "officer of the company who:

(a) Knowingly and wilfully authorises or permits the default, refusal or contravention mentioned in the enactment; or

(b) Knew or ought to have known of the default, refusal, or contravention and did not take all reasonable steps to secure compliance by the company with the requirements specified in or imposed under the enactment."

43. The register of directors and secretaries for Sovereign contains no mention of any former name of Mr Hyde-Harris. Consequently, we will ask the Registrar of Companies to bring a prosecution against Mr Hyde-Harris under section 200 of the Companies Act 1955.

44. Concern about the identity of the Directors was expressed to FAS by a number of brokers who had accepted firm

allocations, particularly in Auckland. FAS took legal advice on the question whether they could withdraw from their underwriting agreement. The agreement provided for a variety of circumstances entitling the underwriter to withdraw, including:

> "(a) A material change in the circumstances of the company concerning its management, personnel or assets which substantially prejudices the issue;
>
> (b) The publication or circulation of any information relating to the company, its management or assets which substantially prejudice the issue ..."

FAS was advised that, in the event of any claim against them by the promoters and/or directors, the burden would be on FAS to establish the accuracy of any facts on which they wished to rely to determine the agreement. When the matter was raised with Mr Willis in his capacity as solicitor for Sovereign and certain of the directors, he told FAS that if they chose to determine the underwriting agreement his firm would advise their clients to sue FAS for damages. At that stage the persons most concerned, viz. FAS and Mr Willis, were not aware of Mr Hyde-Harris' former name or convictions under that name.

45. Having regard to the legal advice, FAS decided to proceed with the issue, and informed the brokers who had taken allocations that they would likewise be held to their agreements. In the event one broker refused to accept his allocation, and no action was taken against him. Another

did not pass on any shares to clients, but sold the allocation as soon as dealings began.

The offer closes

46. The prospectus contained a statement that "The issue will open at 10 a.m. on the 4 July 1983 and will close at noon on the 1 August 1983 unless earlier subscribed". When the issue had been open for a week FAS contacted the sub-underwriters, advised them of the level of subscriptions that had been received, and discussed with them the desirability of their making application to the issue so that the issue could be closed. Some of them did so. Others were advised that there would be a shortfall and were called on to take up their share of the shortfall. On 12 July the directors reported to the Stock Exchange that "the public issue of 10 million 25c shares together with the 5 million options has closed fully subscribed". This report was literally true, but it conveys a false impression of what in fact happened. The public subscriptions were less than the offer, and the balance was made up by subscriptions from underwriters. It was submitted to us that the report conformed with market practice, but the parties who made that submission believed that the practice should not be continued. We comment on this in paragraph 74.

47. With rumours concerning the viability of Sovereign and the appropriateness of its directors continuing after the

issue was closed, FAS decided to support the market for a period. FAS acquired a shareholding which, together with the shares acquired pursuant to the underwriting agreement, amounted to nearly 10% of the capital of Sovereign.

COMMENTS ON THE FACTS ASCERTAINED UNDER TERMS OF REFERENCE 1 AND 2

48. Having regard to the facts mentioned so far, the Commission has decided to comment on the following matters:-

(a) Should the issue have gone to the public? (paras. 49 to 53);

(b) Responsibility for the preparation of the prospectus (paras. 54 to 64);

(c) The solicitor's role and duty (paras. 65 to 67);

(d) The sharebroker's role and duty (paras. 68 to 69);

(e) Commitments before the prospectus is available (para. 70);

(f) Issuing company's tenure of mining privileges (paras. 71 and 72);

(g) Valuation of assets (para. 73);

(h) Reporting the results of a public offer (para. 74).

Should the issue have gone to the public?

49. In their written comments dated 27 November 1984, counsel for Mr. Willis and for Messrs. Bell Gully & Co. made the following submission:-

"4.02 The strong conclusion the writer took away from the hearing was that this was not an issue of shares which was ready to go to the public. This conclusion was based on a general feeling which emerged from hearing and reading all the evidence but in particular on the following specific aspects:-

(a) The operations which were taken over by Sovereign had not been particularly successful, had not been operating long enough to establish a satisfactory history of successful operation, rate of processing of earth and extraction of gold. The periods of experience of the operators were short and none of them were really professionals but rather amateurs with a limited experience in this field.

(b) The increase in the operational units from 4 to 7 which is made a feature of in the prospectus (and was probably critical to initial profitability) was not provided for in any practical way e.g. conditional contracts to purchase equipment and provision for the $925,000 to be set aside and specifically earmarked for this purpose.

(c) The mining rights of the Company were too inchoate. Although this state of affairs does not seem to have contributed in any way to the Company going into receivership (in that the Company at all times had access to the areas the subject of the unvested and incomplete mining rights), we think it is inappropriate to put an issue before the public where the Company does not have a vested and complete legal right to <u>any</u> of the areas in which it proposed to work. This aspect naturally becomes fundamental when a company goes into receivership."

This submission raises very important questions.

50. We discussed the policy of the Securities Act 1978 in our publication entitled "Proposed Recommendations for Securities Regulations", Government Printer, Wellington, 20 March 1980. We pointed out that, like most overseas

jurisdictions, our Legislature had adopted the disclosure philosophy and had not adopted the concept of merit regulation. Neither the Commission nor the Registrar of Companies acts as a censor prohibiting well-described proposals from being put before the public. On the contrary, so long as the prospectus contains a fair description of the proposal and the material information relating to it, the right to place the prospectus before the public is, we believe, established by the legislation. The decisions on the merits of investment proposals are made by investors, not by some authority purporting to act in their interests. Every investment proposal carries the risk of failure, and we believe that it is important to ensure that investors remain the assessors of such risks. The function of the securities legislation is to ensure that investors are given the facts and expert opinions relevant to the assessment of those risks.

51. The confusion about the role of persons engaged in preparing a prospectus that has emerged from this hearing is well indicated by the following submission made on behalf of FAS through their counsel by letter dated 29 November:-

> "7. Some aspects of the propositions about the role and nature of prospectuses may surprise the market and should be recognised as novel. In particular, the market would be surprised about the impression conveyed from a number of comments in the report, that a prospectus is prepared as a service to investors. Stated bluntly a prospectus is prepared for the floating company and its promoters. It is a marketing document to raise money for the company. Quite properly the law imposes certain minimum

> disclosure requirements for a prospectus and those requirements are buttressed by the demands of good practice and prudence. The latter require disclosure to the extent that extra information reduces the uncertainty which is the primary discouragement to investment. Nevertheless it should be emphasised that the market generally would not expect a prospectus to be a "candid or full" investment appraisal. The responsibility of those preparing a prospectus is to be accurate and honest and to comply with the law. The responsibility is not to be impartial or to act in the interests of all potential investors, except to the extent that any market participant wishing to have a long business life has a vital interest in avoiding the damage to its reputation which would flow from association with a document that is deliberately or carelessly misleading. Responsibility to investors arises in the advisory role which the market treats as separate."

52. We do not agree with the submission quoted in para. 51. In our opinion, the scheme of the requirements of the Securities Act regarding prospectuses is built on the proposition that a prospectus should contain a full and candid description of the proposal and of all material matters that are relevant to it. We dealt with the subject at length in our publication mentioned in paragraph 50, and we think it is sufficient for present purposes to quote the second general principle we stated in paragraph 3.1 of that publication, viz:

> "As public offerings are feasible only on the basis of terms propounded by the offeror, a particular object of the law relating to public offerings is to secure that the public is informed fairly and in good time both of the terms of the offer and of the information relevant to making decisions about it.'"

53. Accordingly, we do not express a conclusion on the submission quoted in paragraph 49. In examining a

prospectus, we are not concerned with the question whether, on its merits, the proposal should have been allowed to go to the public. We are concerned with the question whether the proposal and the relevant information about it are contained in the prospectus, so that investors are enabled to judge the merits. The relevant question, using the submission as a basis, is whether the prospectus made fair disclosure of the facts about the matters mentioned in the submission. We have already expressed the view that it did not (para. 25 et seq.).

Responsibility for a prospectus

54. The Securities Act 1978, which did not apply to Sovereign's prospectus, contains provisions defining the liability of issuers, directors, persons who have consented to be directors, promoters, and experts who make statements in the prospectus. Some provisions are new and have not been considered by the Courts. We see no need to amend them arising out of the evidence in Sovereign's case.

55. The persons mentioned in para. 54 are normally advised by professional experts. The experts, such as lawyers, accountants, auditors and consultants, are expected to bring to their tasks the objectivity and sense of responsibility that distinguish professionals from mercenaries. These qualities provide important safeguards

to the investing public. The Commission expects these groups and their professional bodies to maintain their professional standards. We look critically at the work done, and we will, as envisaged by section 10 of the Securities Act, comment in appropriate cases.

56. In this connection we think it is appropriate to refer to the recent developments of the common law holding experts liable in tort independently of contract to people who are affected by their work.

57. The scope of this branch of the law was described by Lord Morris of Borth-y-gest in Hedley Byrne & Co Ltd v Heller & Partners Ltd [1964] AC 465, 502-3 "If someone of a special skill undertakes, quite irrespective of contract, to apply that skill for the assistance of another person who relies on such a skill, a duty of care will arise. The fact that the service is to be given by means of or by the instrumentality of words can make no difference. Furthermore, if in a sphere in which a person is so placed that others could reasonably rely upon his judgement or his skill or upon his ability to make careful inquiry, a person takes it on himself to give information or advice to, or allows his information or advice to be passed on to, another person who, as he knows or should know, will place reliance on it, then a duty of care arises".

58. There have been warnings in subsequent decisions against regarding Hedley Byrne as laying down hard and fast rules

as to when a duty of care arises. For example Lord Diplock in Mutual Life & Citizens Assurance Co Ltd v Evatt [1971] AC 793, 809 said:-

> "The metes and bounds of the new field of negligence of which the gate is now opened ... will fall to be ascertained step by step as the facts of particular cases which come before the courts make it necessary to determine them."

59. In Anns v Merton Borough Council [1978] AC 728, 751-2, 49, Lord Wilberforce suggested an approach which has found widespread approval since. The approach involves asking two questions:

    i) Is there a sufficient relation of proximity between the alleged wrongdoer and the person who has suffered damage?

    ii) Are there any considerations which ought to negative, reduce, or limit the scope of the duty or the class of persons to whom it is owed, or the damages to which a breach of it give rise?

These tests raise the question whether a professional involved in the preparation of a prospectus owes a duty of care to a potential investor for economic loss which is caused by negligence of the professional?

60. In relation to solicitors, the duty has been described by Megarry V-C in Ross v Caunters [1980] Ch 297, 372:-

> "In broad terms, a solicitor's duty to his client is to do for him all that he properly can, with, of course, proper care and attention. Subject to giving

> due weight to the adverb "properly", that duty is a paramount duty. The solicitor owes no such duty to those who are not his clients. What he does for his client may be hostile or injurious to their interests; and, sometimes, the greater the injuries the better will he have served his client".

But it has been held that where special reliance is placed by a third party on a solicitor there seems no reason in principle why a liability in tort should not arise. Richardson J said in Gartside v Sheffield Young & Ellis [1983] 1NZLR 37, 49:-

> "The duty to a third party is an independent duty which marches with a duty to his client. In principle this is no different from the many tort cases where persons who have assumed duties of care under contract have found that strangers to the contract who are adversely affected by their work can hold them liable for loss sustained from their want of care. The duty arises from the proximity of the relationship."

61. We think similar principles can be applied to other professionals who participate in the preparation of a prospectus, but there are some special features under present law. Experts named in the prospectus are liable for statements to which they attest. With this exception a prospectus is regarded at law as the statement of the directors and promoters, and it is they who by signing it vouch for its accuracy and accept liability. Would it blur this desirable state of things if professionals who drew prospectuses were also held responsible to investors for their negligent work?

62. Relevant to this is the consideration mentioned by Richardson J in Gartside at page 51:-

> "Insofar as an action in negligence may be viewed in social terms as a loss allocation mechanism, there is much force in the argument that the costs of carelessness on the part of the solicitor causing foreseeable loss to innocent third parties should in such a case be borne by the professionals concerned, for whom it is a business risk against which they can protect themselves by professional negligence insurance and so spread the risk, rather than be borne by the hapless individual third party".

63. We think there can be little doubt that the first of Lord Wilberforce's tests is satisfied, inasmuch as there is sufficient proximity between a solicitor drawing a prospectus and an investor subscribing for the securities to raise a prime facie presumption of a duty of care on the part of the solicitor. His Lordship's second question presents more difficulty, but on balance we give weight to the view that the sanction of a negligence suit provides a desirable incentive for lawyers and others concerned with the preparation of prospectuses to ensure that they apply reasonable standards of care and skill in their work.

64. What could present more difficulty is the question of causation of loss. Where an investor has lost his money he may be heard to say that, had he known the truth on this, that or another point he would not have invested. We think this must be left for resolution in the Courts in the ordinary way, and we do not propose any statutory intervention.

The solicitor's role and duty

65. Mr Willis took a leading role in preparing and making the offer of Sovereign's shares to the public. The idea of a public flotation was his (para. 7), he introduced it to the promoters (para. 7), he introduced it to the sharebrokers (para. 9), he developed it and retained control of the preparation of the prospectus (para. 10), and he made an arrangement on behalf of his firm for a fee dependent on the result (para. 11). All of this amounts to an entrepreneurial involvement that is not, in our opinion, consistent with the role of a professional legal adviser. It interested us to note that whenever the interests of Sovereign and the promoters diverged, as on the matter of payment under the vending agreements (para. 14) and the matter of implementing the Deed of non-competition agreement (para. 39), on which it would be natural for Mr Willis' views to be decisive, the interests of the promoters were preferred. As a result, an unsatisfactory legal situation with respect to the mining privileges developed (para. 31).

66. We accept Mr Willis' observations that a solicitor acting on a public flotation is expected to reconcile many interests which otherwise might be in conflict. To require separate representation for each interest would increase the costs and delay. But we believe that practitioners acting on public flotations should have more

guidance than that given by the rule in the Code of Ethics quoted in para. 12, and we will discuss this matter with the New Zealand Law Society.

67. We also consider that the time has arrived to review the law and practice about contracts for fees, including contingency fees. The Ontario Law Reform Commission has recently (1982) examined the matter in their "Report on Class Actions", Vol.111, p.725. We will ask the New Zealand Law Society to consider this matter also.

The sharebroker's role and duty

68. In some overseas jurisdictions the underwriter buys the entire issue and resells it to the public. In such circumstances he makes extensive and careful checks of the underlying facts from a standpoint that is quite independent from, and indeed inherently antagonistic to, that of the vendors and promoters. Usually he engages solicitors to advise him independently on the legal issues that arise in settling the terms of the prospectus. In New Zealand the practice is for the underwriter largely to have unloaded the risk to sub-underwriters and other brokers when he enters into a contract with the issuer. The pressure on the underwriter to act as an independent censor of the prospectus that is relied on overseas is usually not present in respect of issues in New Zealand. Where, as is usually the case in New Zealand, the

underwriter is also the organising broker, his function in that role is to market the issue, and his temptation will be to tell the market what he thinks it will want to hear, rather than to test the scope, accuracy, and fairness of the prospectus.

69. The facts raise a serious question whether the practice in New Zealand provides a sufficient check of the content of prospectuses. Some additional effort motivated by self-interest appears to be needed. We will discuss it with the New Zealand Stock Exchange.

Commitments before prospectus

70. Sub-underwriters and brokers who accepted firm allocations entered into their commitments to FAS before seeing the prospectus. Some of them say now that if they had seen the prospectus they would not have committed themselves. Having regard to the exemptions of underwriters and sub-underwriters, close business associates, habitual investors and others in section 3(2) Securities Act 1978, we regard this matter as one of domestic concern to the Stock Exchange. We have discussed the matter in detail with them, with the result that in future commitments will be entered into on the basis of the prospectus. The Exchange is issuing a practice note on the matter and, in a minor respect, the Commission will issue an exemption notice to enable brokers to implement the new practice.

Tenure of mining privileges

71. Some companies make public floats before obtaining any mining privileges - their objects are to prospect for likely areas and to apply for licences over areas selected after the flotation. Of course there is nothing wrong with this, and the position should be made plain in the prospectus.

72. Where the company does not hold mining privileges, even where it has agreed to buy them, we regard it as misleading to state or suggest that the company is mining in its own right. The lawful authority to mine proceeds only from a mining licence, and section 145 Mining Act 1971 seems to us to have the effect that mining operations can be carried on only by or on behalf of the licensee.

Valuation of assets

73. The valuation of certain items of heavy plant and machinery was made on an in situ basis, and the valuer told us that a valuation for removal would have been much lower. The right of Sovereign to keep the plant in situ was therefore important, and depended on obtaining a mining privilege. In our opinion, the valuer's report should have given valuations on the removal basis as well as the in situ basis.

Reporting the result of the public offer

74. We do not think it is appropriate to report that an issue has been fully subscribed when it has been filled by applications from underwriters and sub-underwriters. We will ask the Stock Exchange to adopt a rule to the effect that the report of the result of the offer should disclose the number of shares applied for by the public and by underwriters and sub-underwriters separately.

TERMS OF REFERENCE 3.

The supply of information to the market concerning the company since 10 June 1983.

75. Sovereign adopted the practice of making quarterly statements to the Stock Exchange. Such statements were released on 8 September and 9 December 1983, and 19 March and 21 June 1984.

76. The September statement gave details of expected and actual gold recovery and gold sales proceeds and an approximation of gold concentration for the period to 31 August. Recoveries were 16% ahead of budget, but costs of operating were slightly greater than initially projected. Management was confident that costs were now well in hand and that the results of the financial year ending 31 March 1984 would be close to budget. It was said that results to the end of October would be announced on 3 November.

77. The next statement was made on 9 December. It gave figures for gold recovered, cubic yards of alluvial gravel processed and average concentration for the three months to end November. While the recovery level and concentration costs were lower than expected, operating costs were likewise lower than expected. Overall recovery was approximately 3 months behind schedule primarily because of the extended time to evaluate excavators and

the lead time delays in deliveries of rotary screens and on site commissioning.

78. The March statement gave monthly figures for gold recovered, ground processed, and gold concentration for December January and February. While these results represented a satisfactory performance for the quarter, management was targeting to improve the amount of ground processed and low profitability ground.

79. The June statement reverted to quarterly figures. Gold recovered was 29% higher than the previous quarter. Yardage processed was also given, but it was left to readers to calculate the concentration. Before commissioning more gold units the directors believed that it was prudent to optimise current production levels with the existing four gold recovery units. Eight days later Sovereign was in receivership.

80. In reviewing the matter of periodic disclosure, the following points emerge:-

    (a) As far as possible periodic statements should be standardised, so that direct comparisons can be made between each statement.

    (b) It is little use making comparisons with "budget" unless "budget" is itself disclosed.

    (c) There is a clear danger of misleading the reader when recovery and sales figures are given without

reference to profitability. As the events showed at all material times Sovereign was losing money.

(d) In the first year of a venture it is useful if comparisons are drawn with prospectus forecasts.

(e) We think that reporting more frequent than quarterly is appropriate in the case of a mining venture.

81. The New Zealand Stock Exchange is reviewing the listing requirements in relation to mining companies and we shall take up these matters with the Exchange.

82. In early May 1984 management expressed to the Directors concern as to the liquidity position of Sovereign. It was proposed that draft accounts for the 6 months to the end of January 1984 should be prepared for a board meeting to be called in May. The board and its advisers considered that insufficient information was coming to the board. A major creditor asked for the appointment of two outside directors. Mr Keenan, by now resident in Auckland, desired to resign.

83. At the next meeting, held in June, the directors decided to engage Messrs W.G. Cox and M.E. Dormer as investigating accountants to undertake a full evaluation of Sovereign with a view to their becoming directors. Their report, tabled on Thursday, 28 June, expressed concern as to Sovereign's solvency. At that stage, no audited financial statements had been prepared.

84. On Friday, 29 June, the directors advised the Stock Exchange that they had requested an independent financial evaluation and requested that the Stock Exchange put a "report pending" against the listed securities. Later that day the directors decided to invite the secured creditors to appoint a receiver, and an announcement to that effect was made to the Stock Exchange on Monday, 2 July, requesting the Stock Exchange to suspend trading in the securities of Sovereign until further notice.

85. The Executive of the Stock Exchange declined the request, taking the view that suspending quotation of Sovereign's securities would not prevent trading and would only serve to deprive shareholders and option holders of a market should they wish to trade following the announcement. The fact that Sovereign was in receivership had been announced and share and option holders could make their own decision as to what to do with their investment. The shares would be quoted "(in receivership)".

The President, Mr Aburn, a partner in FAS, took no part in the decision.

86. We accept that the fact that a receiver has been appointed does not necessarily make it desirable to suspend trading in the securities. But we would like to see the Exchange make more use of the power to suspend trading where the facts are so confused that maintenance of an informed market in a company's shares is not possible. We consider

that this was such a case, and that trading should have been suspended on 29 June until the Directors had made a statement on the state of affairs.

87. On other grounds the Exchange suspended quotation of the shares on 13 July because of the doubts as to the share register. We will discuss this in the next section. At the time of writing the shares remain suspended.

TERMS OF REFERENCE 5.

Trading in the Company's shares from 1 April 1984, with particular reference to allegations of insider trading.

88. The listing requirements of the New Zealand Stock Exchange contain a provision 256(1) relating to mining companies which includes the following:

> "Where securities of a mining company are issued to vendors for a consideration other than cash that issue shall be conditional upon:
>
> (a) the securities including those issued on the exercise of vendor options, or any interest or right in respect of them, not being sold, assigned or transferred, and quotation not being granted, until 12 months after securities issued to members of the public have been granted quotation or until 12 months from the date of allotment whichever is the longer. All such certificates shall be endorsed "vendor securities";
>
> (b) An agreement being entered into between the vendor and the company providing for breach of the conditions referred to in paragraph (a) above being enforceable by the company;
>
> (c) The relevant certificates being held by a bank or recognised trustee company until the Exchange authorises their release and the company obtaining for the capital Exchange a certificate from the bank or trustee company concerned stating that the certificates are so held, ...".

89. The minutes of the first meeting of the directors of Sovereign, held on 31 May 1983, show that the directors resolved:

> "that shares be issued to the respective vendors in the agreements, in the quantum set out in the agreement, and to pay the quantum of cash as set out in those agreements".

90. On 3 October 1983, the Chairman, Mr Keenan, sent the Share Registrar a telegram asking him to print share certificates for the vendors of licences and for Messrs Hyde-Harris and Hunt under the non-competition agreement and to send the certificates to Messrs Hannan and Seddon (the firm of solicitors in Greymouth of which Mr Keenan was a partner). Of the first category the telegram said:

> "All of the above shares are issued to vendors as described in the statutory information in the prospectus. Hannan and Seddon will ensure that:-
>
> (a) The share scrip is held in trust on behalf of the company until same is properly transferable to the vendors in terms of their agreements for sale and purchase and
>
> (b) When their share scrip is properly transferable that it is lodged with the ANZ Bank - Greymouth in terms of the Stock Exchange Regulations."

With respect to the shares to be issued to Messrs Hyde-Harris and Hunt the telegram said: "The above shares are the property of Messrs Hyde-Harris and Hunt pursuant to the non-competition agreement".

The Registrars printed the certificates and sent them to Messrs Hannan and Seddon.

91. Nobody appears to have looked at the non-competition agreement to have checked what the status of these shares was nor to have checked back to the prospectus to see how they were described in that document. A reference to the listing requirement referred to in para. 88 would have made it clear that these were "vendor securities".

92. Mr Hunt sold in excess of 114,000 shares in Sovereign during the early part of 1984 and used some of the "vendor securities" to meet the commitment to deliver them. This involved a breach of the Deed of covenant and the listing agreement, but it is fair to point out that Mr Hunt had more than enough other shares available for sale.

93. On 9 July 1984 the Stock Exchange sent a telex message to Sovereign inquiring whether, and if so when, the vendor shares had been issued and allotted and whether the share register was a correct record of the present issued and allotted capital of the company. The Chairman of Sovereign advised the Exchange that a statement was being prepared, but on 13 July the Exchange suspended the quotation of the shares. "Because of the uncertainty which exists regarding the number of shares on issue, the Exchange does not consider that the market could properly assess the true value of the shares at present".

94. On 18 July the directors of Sovereign telexed the Exchange with a statement only partially answering their questions. A telephoned inquiry from Mr Gill, the Executive Director of the Stock Exchange, produced a further telexed message from the directors on 23 July concluding "The company has never resolved to issue shares to vendors other than to Harper and Jaybe Mining Limited". This statement may be compared with the facts set out in paras. 89 and 90 above.

95. At our public hearings, we asked the witness for the Share

Registrar whether he has a duty to satisfy himself that any conditions precedent to the issue of shares had been satisfied before he proceeds to issue shares. He answered in the negative, on the grounds that his duty is merely to carry out the instructions of the directors. A review of the law on the point is required, including the question whether, in the case of new company flotations, an independent share registrar should be appointed. The Commission will revert to this matter when we open a formal review.

96. In accordance with usual practice the Stock Exchange supplied to Sovereign when it became listed a copy of its guidelines for securities transactions by directors of listed companies. Those guidelines are not mandatory, but it is suggested by the Stock Exchange that they should be used by listed companies in framing their own rules. Mr Keenan, the Chairman of the company, was aware of the existence of the guidelines, but no rules for director's share trading were settled by the board.

97. The company kept a register of director's shareholdings pursuant to section 195 of the Companies Act 1955. The register was deficient in several respects. The opening entries were dated 6/10/83, the closing entries 11/6/84. No information was shown in the register pursuant to section 195(2) which provides "where any shares or debentures fall to be or cease to be recorded in the said

register in relation to any director by reason of a transaction entered into after the commencement of this Act and while he is a director, the register shall also show the date of, and price or other consideration for, the transaction; provided that where there is an interval between the agreement for any such transaction and the completion thereof, the date shall be that of the agreement."

98. The register of directors shareholdings includes the following information:-

Date	Holding of Shares	Holding of Options
A J Keenan		
06/10/83	120,000	310,000
11/06/84	45,000	160,000
W J Butterfield		
06/10/83	73,000	286,500
11/06/84	78,000	293,500
P A Hyde-Harris		
06/10/83	300,000	250,000
11/06/84	300,000	150,000
K C Hunt		
06/10/83	300,000	250,000
11/06/84	185,000	27,000
B A Boustridge		
06/10/83	40,000	270,000
11/06/84	Nil	270,000
Lamplough Mining		
06/10/83	1,680,000	-
11/06/84	1,680,000	-

Sovereign Gold Mines (Investment)

06/10/83	1,320,000	200,000
11/06/84	1,320,000	16,400

Jaybe Mining

06/10/83	300,000	-
11/06/84	600,000	-

99. Of the changes in shareholding, the sale of Mr Keenan's shares, of the greater part of Mr Hunt's shares, and of Mr Boustridge's shares, all occurred before the period we are considering. Between 5 April and 10 April Mr Butterfield bought 79,900 shares at a price of 18 cents. Between 13 June and 26 June he sold 21,000 shares at a price of 17 and 95,000 options at a price of 7. During the first week of July 1984 a syndicate in which Mr Butterfield has a one quarter interest purchased approximately 600,000 shares at prices between 3 and 8 cents. Mr Hyde-Harris and Mr Hunt announced publicly an on-market purchase of shares, but did not succeed in obtaining a significant number before the quotation was suspended. Mr Butterfield did not consider that he was in possession of any information not generally available to the public, and indicated that his action in forming the syndicate was a reaction to the on-market offer made by Messrs Hyde-Harris and Hunt.

100. We take a serious view of the state of the register of directors' shareholdings. Section 195 of the Act places the onus on the company to keep this register. We have already referred to the further provisions that supplement the company's obligations. We will ask the Registrar of

Companies to bring appropriate prosecutions under these provisions.

101. FAS at all material times had a holding of just under 900,000 shares resulting from their underwriting liability and their support activities during the first month of trading. We have examined the records of these transactions and find no evidence of impropriety in them. Different views can be held of the action of purchasing. On the one hand, purchases by brokers can be regarded as a form of market manipulation sustaining the price above the true market level. On the other hand, by purchasing, FAS gave to those who had honoured their commitments the opportunity to quit their holdings without loss. In the circumstances of the case, we think it was proper for FAS to make the market for a period after the allotment. This is a matter we will discuss with the Stock Exchange with a view to settling a rule of practice.

Conclusion

102. In reviewing the evidence, we see a need to consider changing the practices of solicitors, sharebrokers, valuers and accountants in various respects. We conclude by summarising them. We will ask the New Zealand Law Society, the New Zealand Stock Exchange, the New Zealand Institute of Valuers and the New Zealand Society of Accountants to consider this report, and to give particular attention to the following matters.

103. The New Zealand Law Society

(a) In paragraph 12 we quoted from the Society's Code of Ethics the rule that applies to a solicitor who acts for more than one party. We think that further guidance is needed where a solicitor acts in the preparation of a prospectus for an issue of equity securities by a newly incorporated company where the solicitor is acting for, i.e. gives advice to, the company, the promoters, the directors, the organising brokers, and the underwriters, or any 2 or more of them. We commented on this situation in paragraphs 65 and 66.

(b) In paragraph 11 we referred to the terms agreed about the solicitor's fee in this matter. We would like the Society to consider the limitations on contracts for legal fees, and we referred, in paragraph 67, to some recent Canadian research on aspects of the subject.

104. The New Zealand Stock Exchange

(1) This is a good example of the problems that can arise when, before the registration of a prospectus, commitments are entered into to take up the securities, (paras. 19, 20 and 70). The Exchange has reviewed this matter with us, and has agreed to new procedures described in a circular to members entitled "Pre-prospectus Publicity".

(2) We will ask the Exchange to consider the broker's role in and responsibility for the preparation of a prospectus, (paras. 54 to 64, 68 and 69).

(3) Is it proper for a broker to act both as organising broker and underwriter? (Para. 68).

(4) A broker involved in a public flotation may give advice to the issuer, the promoters, the directors, the underwriters, other brokers, and the public. Are there conflicts of interest to such an extent as to require any particular rules for the regulation of the broker's conduct? (Para. 68).

(5) In reporting the results of a public offer, the number of shares subscribed for by the public should be stated separately from the number of shares subscribed for by underwriters and sub-underwriters, (para. 74).

(6) The requirements of the Listing Agreement regarding periodic reporting by mining companies should be strengthened, (para. 80).

(7) The Exchange should make more use of its power to suspend trading where the facts are so confused that maintenance of an informed market in a company's shares is not possible, (para. 86).

(8) The Exchange should review the practice when a broker enters the market as principal, whether as buyer or

seller, and adopt rules on the matter in consultation with this Commission, (para. 101).

105. <u>The New Zealand Institute of Valuers</u>

Where assets are valued in situ, should the valuer report upon the tenure of the site, and include in the report a valuation on a removal basis? (Para. 73).

106. <u>The New Zealand Society of Accountants</u>

The distinction between purchasing assets and purchasing a business is presenting difficulties, (paras. 26, 27 and 28). Can clause 11 of the First Schedule to the Securities Regulations 1983 be improved?

For SECURITIES COMMISSION

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