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FURTHER REPORT OF THE SECURITIES COMMISSION

ON

SOVEREIGN GOLD MINES LIMITED

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ON

SOVEREIGN GOLD MINES LIMITED

In its report on Sovereign Gold Mines Limited dated 20 December 1984 the Securities Commission said that it saw a need to consider changes to the practices of solicitors, sharebrokers, valuers and accountants in various respects. The Commission wrote to the New Zealand Law Society, the New Zealand Stock Exchange, the New Zealand Institute of Valuers and the New Zealand Society of Accountants asking them to consider the report, and to give particular attention to matters itemised in it. In addition the Commission referred the report to the Australasian Institute of Mining and Metallurgy.

Each of the above organisations has replied to the Commission's request for comment. Their views are set out in this report, together with additional comment from the Commission where appropriate.

1. The New Zealand Law Society

1.1 Acting for more than one party. The Commission quoted from the Society's Code of Ethics the rule that applies to a solicitor who acts for more than one party as follows:

> "1.1.3 Acting for more than one party
>
> (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."

The Commission thought that further guidance was 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, that is, gives advice to, the company, the promoters, the directors, the organising brokers and the underwriters or any two or more of them.

The Law Society replied:-

"There are many situations in which a practitioner may be confronted with a potential conflict of interest. You will appreciate the problems and dangers involved in attempting to qualify a general rule to provide for particular circumstances. The terms of Rule 1.1.3 were agreed after careful consideration relatively recently.

The Society is not persuaded that any amendment to Rule 1.1.3 is appropriate. It is a clear statement of the ethical obligation of a practitioner in a conflict of interest situation and it is for the practitioner to apply the rule in the particular circumstances.

The rule would seem to be broadly consistent with the obligation of practitioners to their clients as laid down under the general law. In this connection we would refer you to the recent decision of the Court of Appeal in Farrington v O'Sullivan and Ors. (CA 39/84 Judgement 21 March 1985)

While this Society has the power to make ethical rules for members of the legal profession it should

> be noted that the duty of determining whether there have been breaches of ethical rules (whether specific rules laid down by this Society or broader ethical obligations) is in the last resort that of the disciplinary tribunals established under the Law Practitioners Act 1982."

The Commission considers that when a solicitor or other professional expert or consultant is mentioned in the prospectus as acting in any capacity, the prospectus should contain a statement of every other interest he may have in the proposal. For example, a solicitor who acts for the issuer and a promoter should ensure that both facts are disclosed in the prospectus. The Commission will keep the matter under observation.

1.2 Solicitors' Fees. The Commission referred to the terms agreed for the solicitor's fee. The Commission asked the Society to consider the limitations on contracts for legal fees and referred to recent Canadian research on aspects of the subject.

The Law Society has commented:

> "The position in New Zealand changed substantially with the enactment of the Law Practitioners Act 1982, which came into force on 1 April 1983. Under section 56 of the 1955 Act agreements for costs could be made which were not subject to taxation. This section is not repeated in the 1982 Act. Section 142 provides that all bills of costs are subject to revision in accordance with the provisions of the Act notwithstanding any agreement made between the practitioner and the client. In these circumstances it is not clear to the Society precisely what aspect of the law relating to costs is of concern to the Commission. In the view of the Society, the 1982 Act affords adequate protection to clients against any suggestion of overcharging."

The Commission agrees that the new Act appears to have made a substantive change which meets the point.

2. New Zealand Stock Exchange

2.1 Pre-prospectus Commitments. The Commission saw the Sovereign matter as a good example of the problems that can arise when, before the registration of a prospectus, commitments are entered into to take up securities. The Commission noted that the Exchange had reviewed this matter and, with the approval of the Commission, had recommended new practices to members of the Exchange. These are described in a circular issued by the Exchange to its members on 14 December 1984 entitled "Pre-prospectus Publicity".

The Commission expects members of the Exchange to conform with this practice. The prompt attention given by the Exchange to this difficult matter is commendable.

2.2 The Broker's Role. The Commission asked the Exchange to consider generally the broker's role in and responsibility for the preparation of a prospectus.

The Exchange described this role in the following terms:

> "A broker is normally approached by a company or by a company and its underwriter and asked whether a proposed issue can be placed on the market. The broker will usually advise on the terms required by the market for a successful issue and provided the directors and the company's professional advisers consider the company can meet the market criteria, the issue will then proceed.
>
> The criteria will include:
>
> directorate
>
> management
>
> business of the company

professional advisers

size

issue price

projected earnings

projected dividends

major shareholders

underwriters

These matters are interrelated and the degree a broker undertakes checking procedures relating to them will depend on his knowledge of the directorate, the proposed management, the professional advisers involved, the business or proposed business and the underwriters if any. On occasions there will be a conflict between the requirements of market conditions and the ability of the company to meet them and this results in either the cancellation of the issue or a compromise as to size, price or some other criteria.

The preparation of the prospectus then proceeds, based either on a earlier draft prepared by any one of the participants or from the ground up with all of the participants playing a checking role in line with the established criteria and their particular role in the preparation of the documentation. These roles vary from issue to issue and there is no established procedure other than the clear necessity to meet the requirements of the Securities Act, the Stock Exchange, the Companies Act and the professional standards of the various advisors.

The Exchange is not privy to the procedures followed in the preparation of the Sovereign prospectus but acknowledges that subsequent events may indicate that not all aspects of the flotation were given adequate attention. The Sovereign prospectus was one of the last prepared before the Securities Regulations took effect and the Exchange considers that with the new regulations now requiring an independently assessed income projection, the inadequacies disclosed in the Sovereign flotation would not be as likely to reoccur."

The Commission accepts the views of the Exchange, and will keep the practice under review.

2.3 Broker also Acting as Underwriter. The Commission enquired whether it was proper for a broker to act both as

organising broker and as underwriter?

The Exchange replied:

> "The Exchange can see no difference between the situation in New Zealand where a member acts both as organising broker and underwriter and one where as often happens overseas, the organising broker virtually becomes the underwriter by taking the whole issue firm and then retailing it to members of the public.
>
> In either situation the same potential conflict could arise and in our submission no useful purpose would be served by requiring an organising broker to obtain completely independent underwriting. Indeed such a requirement could even prejudice the successful flotation of a speculative issue."

The Commission considers that any conflict of interest should be disclosed in the prospectus by including a statement of all capacities in which the broker is interested.

2.4 Brokers' Conflicts of Interest. The Commission said that a broker involved in a public flotation sometimes gives 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?

The Exchange's comments are:

> "The Exchange sees no need for specific regulations to control the situation of a broker being required to give advice to more than one party involved in a public flotation. Members are required to conduct their affairs at all times according to ethical standards and it is considered that this criterion is quite sufficient to allow the proper advice to be given to all parties concerned.
>
> One useful option might be to require a prospectus to contain a statement highlighting any financial interest

> an organising broker who is also underwriting might have in the issue, but otherwise, the Exchange does not agree that acting in a dual capacity can produce an undesirable conflict.
>
> The growing internationalisation of securities markets and the advent of deregulation have made it increasingly important that our members become and remain competitive, both in New Zealand and overseas, and to subject them to constraints which are not imposed elsewhere would be neither fair nor reasonable."

The Commission agrees that a prospectus should disclose the nature of any financial or other interest of an organising broker. Whether any further legislation will be proposed depends upon the conduct of brokers.

2.5 Reporting Results of Public Offer. The Commission said that a company, when reporting the results of a public offer, should state the number of shares subscribed for by the public separately from the number of shares subscribed for by underwriters and subunderwriters.

The Exchange agreed and issued an amended Listing Requirement to give effect to this change.

2.6 Reporting by Mining Companies. The Commission said that the requirements of the Listing Agreement regarding periodic reporting by mining companies should be strengthened.

The Exchange agreed and issued amended Listing Requirements for mining company flotations and subsequent reporting.

2.7 Suspension of Trading. The Commission said that 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 the company shares is not possible.

The Exchange replied:

> "The Executive is concerned at the Commission's suggestion that the Exchange has not exercised the power of suspension where facts available were so confused that an informed market in a company's shares was not possible.
>
> It has been our philosophy to maintain a market in a company's securities for as long as possible, even where the company may be in receivership, so long as the Exchange considers that the market has all possible information.
>
> In the case of Sovereign Gold Mines any confusion regarding the company's affairs was not apparent until after the receivership had been announced and the directors did not appear to be able to decide how many shares they had actually allotted. At that stage the Exchange acted promptly to suspend quotations."

The Commission accepts the view of the Exchange in this instance.

2.8 Broker acting as Principal. The Commission said that 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 the Commission.

The Exchange comments:

> "An underwriter has always been seen as having prime responsibility for ensuring an orderly market in a company's shares especially in the early stages of a new company's listing. Where the underwriter and organising broker are the same, obviously it will be the organising broker who takes on such a support role subject always to the necessary declaration that he is acting as a principal."

The Commission desires to emphasise the need for the broker to disclose to his client the fact that the broker is acting as principal. The Commission will keep the matter under observation.

3. New Zealand Institute of Valuers

Valuation of assets. The Commission enquired whether, where assets are valued in situ, the valuer should report upon the tenure of the site, and include in the report a valuation on a removal basis?

The Institute of Valuers, in reply, drew attention to their recently issued Asset Valuation Standards containing Guidance Notes to which all "Registered Valuers" will be required to adhere. Under the Asset Valuation Standards a registered valuer is required to include in a valuation report for this type of asset a report on the tenure of the site and a valuation of the asset on a removal basis (see also the comments on this matter in section 5, Australasian Institute of Mining and Metallurgy).

4. New Zealand Society of Accountants

Purchase of a Business. The Commission considered the distinction between purchasing assets and purchasing a business was presenting difficulties. Could clause 11 of the First Schedule to the Securities Regulations 1983 be improved?

The Society of Accountants believe it is possible to prepare an acceptable definition of the "purchase of a business" for the purposes of the Securities Regulations 1983. They made certain suggestions on the essential elements of such a definition and the Commission is considering these.

5. Australasian Institute of Mining and Metallurgy

The Commission invited comments from the Australasian Institute of Mining and Metallurgy on (a) the usefulness to potential investors in minerals exploration and mining ventures of expert opinions in a prospectus, (b) the desirable qualifications of an expert and, (c) the extent to which an obligation should be imposed on promoters to include expert opinions.

Institute comments of particular interest are:

5.1 Valuation of Plant.

> "Valuation of mining equipment and plant must principally be concerned with its appropriateness and ability to perform the mining and mineral recovery task for the particular deposit in question".

> "Paragraphs 34 to 36 [of the Commission's report] clearly demonstrate the necessity for a mining engineer's report on the proposals (possibly for inclusion in the prospectus) and in some circumstances a metallurgist's report may also be required."

5.2 Status of Mining Privileges

> "Where large sums of money or vendor's shares are to change hands over a mining privilege, it is clearly the obligation of the company to ascertain precisely what the status of the license(s) are, and to spell this out absolutely clearly in a prospectus".

5.3 Valuation of mining privileges.

> "..it is clearly a matter on which [the consultant geologist] or a similarly experienced person should be required to comment on".

5.4 Qualifications of an Expert

The Institute proposed that to be eligible as a mineral industry expert a person should be a member of the

Institute or of the Mineral Industry Consultants Association.

The Commission is pleased that the comments of the Institute were taken into account by the New Zealand Stock Exchange in formulating the revised Listing Requirements for Mining Companies.

6. Acknowledgement

The Securities Commission is grateful to the five organisations for their comments on the questions raised in the Commission's Report of 20 December 1984. The revised procedures, if observed in practice, should improve the quality of information available to the public relating to new issues of equity securities. At this stage, the Commission does not propose further legislation on any of the matters raised.

For Securities Commission

Chairman.