

## **The Rise and Rise of Regulatory Litigation**

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### **Introduction**

During the past decade, the New Zealand legislature has reversed the trend towards “light-handed” regulation evident in the 1980s and 1990s and reverted to an increasingly heavy-handed model of regulatory enforcement. The implications for market participants have involved:

- The criminalisation of conduct formerly addressed under the civil law;
- Closer scrutiny by commercial regulators with significant statutory powers and enlarged litigation budgets;
- Heightened deal execution risk associated with regulatory intervention; and
- Record penalties for breaches of the regulatory regimes.

This trend has continued apace in 2006. In this context, it is especially important to be alert to the regulatory dimensions of corporate activity.

### **The criminalisation of breaches of securities laws**

One of the most significant regulatory developments in New Zealand during 2006 was the introduction of criminal liability for insider trading and misleading conduct in relation to securities. These reforms, which are expected to come into force in early 2007, represent a fundamental conceptual shift in the law’s treatment of insider trading. Under the former regime, insider trading was treated as a civil wrong against the public issuer and any counter-parties to the trade. Under the new regime, it is treated as an offence against market efficiency and fairness warranting up to five years’ imprisonment.

Likewise, amendments to the takeovers legislation in 2006 have created a criminal offence of knowingly making a materially false statement in relation to a transaction governed by the Code if it is likely to induce a person to trade or hold their securities, or to vote for or against a transaction. As with insider trading, the maximum penalty is up to five years’ imprisonment.

The criminalisation of these matters substantially increases the reputational impact and personal risk associated with such proceedings.

### **The heightened profile of commercial regulators**

In recent years, Parliament has enhanced the information-gathering and enforcement powers of the key commercial regulators. In 2001, for instance, Parliament conferred on the Commerce Commission the power to issue “cease and desist” orders, which was exercised for the first time this year. The cease and desist provisions empower designated Commissioners to issue administrative orders restraining alleged breaches of the restrictive trade practices provisions of the Commerce Act if satisfied that a prima facie case has been made out and that it is necessary to act urgently in the interests of the public or a particular class of consumers. By enabling the Commission to restrain alleged contraventions without applying to the Court for an interim injunction, the jurisdiction to issue cease and desist orders materially expands the Commission’s options for emergency relief.

The broader powers have facilitated more energetic enforcement activity by the regulators. In the past several years, there has been a substantial and increasing number of criminal prosecutions by the Commerce Commission under the Fair Trading Act 1986. In particular, there have been a series of high profile criminal prosecutions alleging misleading conduct in relation to goods or services. These have resulted in a number of very substantial fines and settlements.

## **Record penalties**

Sanctions for regulatory infringements have also risen appreciably. In a recent case involving a cartel in the timber treatment industry, the High Court imposed a record penalty of \$3.6 million. This penalty was especially significant because it represented a 50% discount on the starting point adopted by the Court.

## **Heightened deal execution risk associated with regulatory intervention**

The increasingly active involvement of regulators in lobbying to expand their powers and seeking “test cases” with respect to their statutory functions has raised the deal execution risk associated with regulatory intervention. For example, in mid-2006 the Takeovers Panel formed the view that the Court approved amalgamations and schemes of arrangement were being used as structures to avoid the provisions of the Takeovers Code. The Panel indicated that, pending legislative consideration of its recommendations to incorporate the “principles of the Takeovers Code” into the Companies Act 1993, it would seek to be heard by the High Court in all cases of proposed schemes of arrangement involving code companies.

The first case that was subject to the Panel's new approach was a standard amalgamation of three property investment companies. Although all shareholders would participate in the post-transaction vehicle and there was no acquisition of voting rights, so as to engage the Code, the Panel intervened in the High Court where it succeeded in varying the initial Court orders to require the promoters to meet certain quorum requirements said to reflect the “principles of the Takeovers Code.” This decision was subsequently reversed by the Court of Appeal which substantially restored the original orders allowing the amalgamation to proceed based on ordinary voting thresholds. Although the applicant companies ultimately prevailed in the Court of Appeal, and the amalgamation was subsequently approved by the High Court, the Panel's intervention in the amalgamation process illustrates the risk of company reconstruction processes being derailed by unexpected regulatory involvement.

## **Conclusion**

As a result of the developments canvassed above, a significant number of the largest litigation matters in the market now involve commercial regulators. This trend which looks set to continue as New Zealand's regulators proceed to test their new powers.