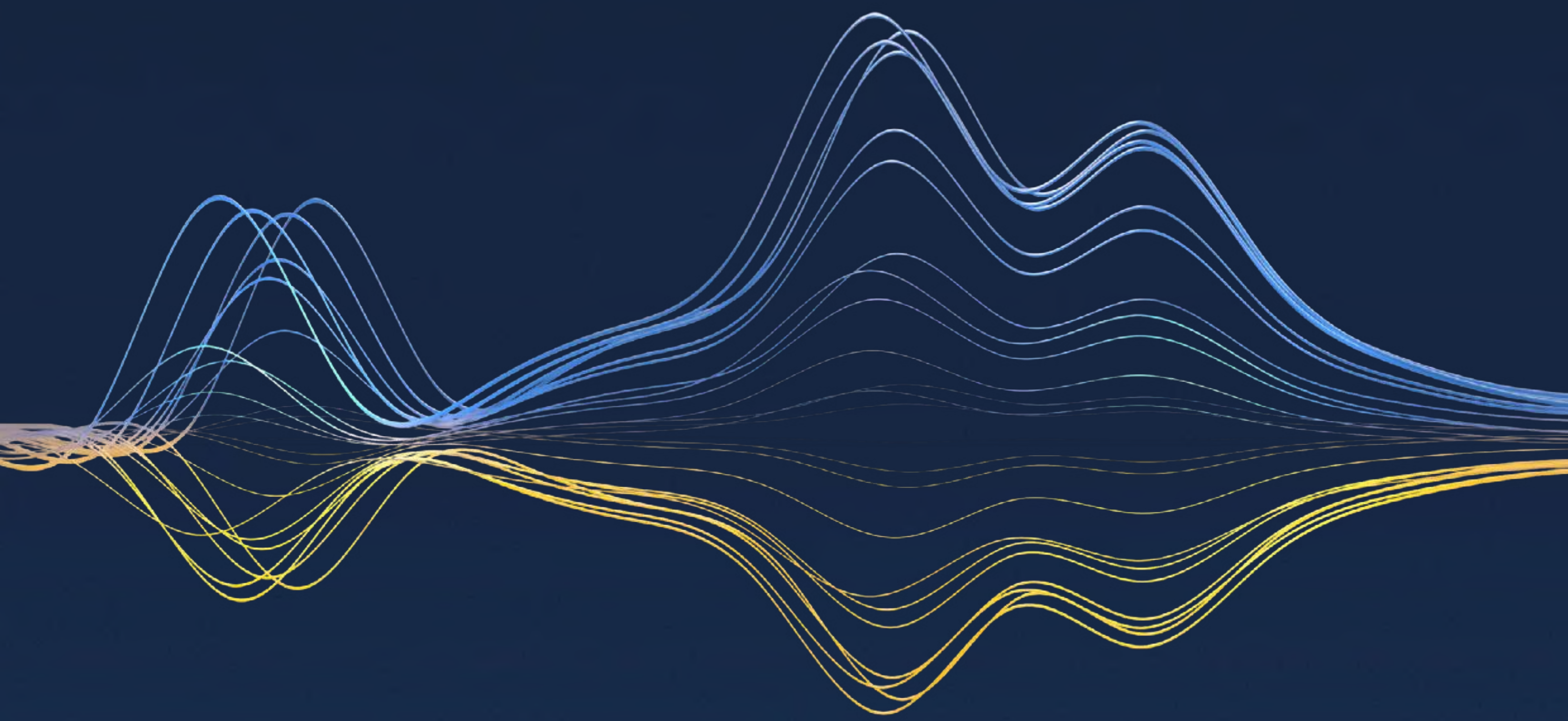
DLA PIPER - NEW ZEALAND START-UP PACK

Raising Equity Finance



A guide to the New Zealand Regulatory Framework

DLA PIPER

Raising Equity Finance

A key source of financing for start-up companies is by way of equity financing. This often takes the form of personal investment or investment by third parties (including friends and family, professional investors and/or alternative sources such as crowdfunding).

When an investor acquires shares in a start-up company, there is a risk that the investor may lose his or her entire investment if the company is not successful. Shares in companies (and particularly start-up companies) are illiquid assets and difficult to value. It is for this reason that the New Zealand legislative regime seeks to offer some protection to investors by regulating companies that offer their shares for investment.

This note provides an overview of the relevant New Zealand legislation to be considered by start-ups (though it should not be viewed as legal advice). It is not possible to provide comprehensive advice on the matters that may apply in the particular circumstances of your business in this note. This checklist is also by no means exhaustive. If you have any queries or concerns in relation to the New Zealand regulatory framework, we recommend that you talk to one of our experts before taking any further action.

This information is intended as a general overview and discussion of the subjects dealt with. The information provided here is accurate as of December 2017. However, the law may have changed since that date.

The information provided is not intended to constitute advice to any person. This information is not intended to be, and should not be used as, a substitute for taking legal, financial or tax advice in any specific situation.

DLA Piper is not responsible for any actions taken or not taken on the basis of this information.

Offers of Financial Products to the public

Overview

The Financial Markets Conduct Act 2013 (**FMCA**) governs the offer of financial products for sale and issue. The term 'financial products' is very broad and covers debt securities, equity securities, managed investment products and derivatives. Ordinary (or other) shares in a company are equity securities and are therefore regulated by the FMCA as a financial product.

An offer of financial products to one or more investors will be a 'regulated offer' for the purposes of the FMCA unless all of those investors fall within a category of investor that does not require disclosure (see below).

To make a regulated offer of financial products, the issuer must prepare a product disclosure statement (**PDS**), and lodge certain information on an online offer register (the **Disclose Register**).

Requirement to prepare a PDS and Disclose Requirement to prepare a PDS and Disclose Register entry

Generally, issuers of financial products are required to provide prospective investors with a PDS to allow them to make an informed decision about the investment, unless a relevant exclusion applies to the offer (see below).

The content, format and length of a PDS for a regulated offer are prescribed by the FMCA and the Financial Markets Conduct Regulations 2014 (**FMC Regs**), and are tailored to the particular type of financial products being offered. For a regulated offer of shares, the PDS cannot be longer than either 30,000 words or 60 A4 pages.

Material information relating to the offer that is not required to be in the PDS, and other prescribed information in the FMC Regs, must be lodged on the Disclose Register together with the PDS.

Exclusions to the disclosure requirement

An offer of shares will not be a regulated offer if the only investors that can acquire the financial product do not require disclosure under the FMCA. The Financial Markets Authority (**FMA**) may also grant general or specific relief for certain offers.

Some of the disclosure exclusions provided by the FMCA include:

- offers to wholesale investors, which include:
  - a person whose principal business is an investment business;
  - a person who meets certain investment activity criteria relating to their portfolio holding or trading history;

- a person who is 'large', being someone who has net assets exceeding NZ$5 million or total consolidated turnover exceeding NZ$5 million in the two most recently completed financial years;
- 'eligible investors', being a person that has obtained a certification that they have a certain amount of previous experience in trading financial products;
- persons who invest a minimum of NZ$750,000 in the offer;

- offers to close business associates or relatives;
- small offers of equity securities to no more than 20 investors in a 12-month period, raising less than NZ$2 million;
- offers to employees under some share employee purchase schemes; and
- offers to existing shareholders under a dividend reinvestment plan.

However, even where one of these exclusions applies, the issuer will still have obligations under the FMCA fair dealings provisions which it must comply with. These largely regulate misleading and deceptive conduct in relation to financial products.

Equity crowdfunding

New Zealand has introduced a crowdfunding regime under which equity securities can be offered to retail and/or wholesale investors through a licensed crowdfunding platform without the need to produce a PDS.

In order to take advantage of the crowdfunding regime:

a) the offer will need to be made through a crowdfunding platform that is provided by a person licensed by the FMA;

b) the offer must include a prescribed short warning statement;

c) you will need to comply with the fair dealings provisions in the FMCA (which relate to misleading and deceptive conduct); and

d) you will need to prepare the following transaction information for the platform provider to make available to investors:

   i. the names of the parties (unless the parties are anonymous under the service);

   ii. a product description;

   iii. the price per product;

   iv. the quantity of products;

   v. the total amount of the transaction;

   vi. the date of the transaction; and

   vii. in the case of a loan, any security given.

Issuers are limited to raising $2 million in any 12 month period from retail investors using a crowdfunding platform (and this cap applies to an issuer using a combination of peer to peer lending, crowdfunding and the small offers exemption in the FMCA).

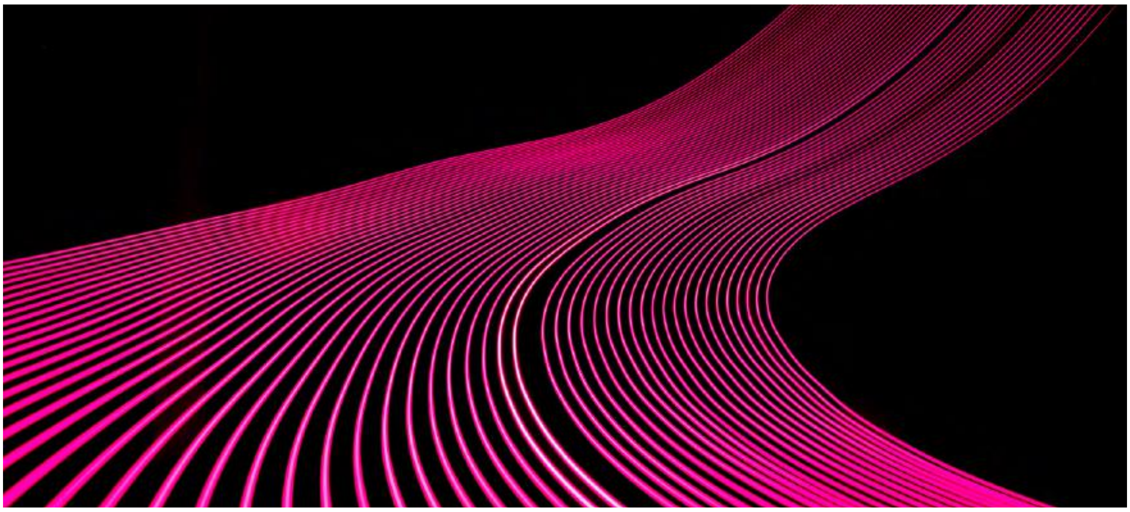
Penalties

Depending on the nature of the breach, the FMCA prescribes both criminal and civil consequences for breaching the disclosure obligations. The penalties for getting FMCA disclosure wrong can be severe (for example, in some circumstances up to ten years' imprisonment). Therefore, you will need to obtain comprehensive legal advice before making a regulated offer or seeking to rely on one of the disclosure exclusions under FMCA. See more on potential liability below.

General Guidance

Before any offer is made by a start-up company, the scope and extent of the offering should be assessed to ensure that these restrictions are not triggered. Ideally, any offer should be targeted at specific individuals (whether it be professional investors or friends and family) only, or utilise less burdensome regulatory frameworks such as the small offers or crowdfunding frameworks to avoid triggering the requirement to produce a PDS.

Advertising



Overview

The general position for advertising regulated offers is set out in section 89 of the FMCA. If financial products have been, or are intended to be, offered under a regulated offer, any advertisement authorised by or on behalf of an issuer or offeror in relation to that offer or intended offer will need to comply with the FMCA advertisement provisions.

The FMCA advertisement regime regulates advertisements differently depending on whether the advertising is made before or after a PDS and other disclosure information has been lodged on the Disclose Register.

The Financial Markets Authority has issued useful guidance on advertising.

Advertisements prior to lodgement of PDS and other Disclose Register information

Section 91 of the FMCA provides that advertisements before a PDS is lodged will not breach section 89 if the advertisement is accompanied by a reasonably prominent statement that:

a) no money is currently being sought;

b) financial products cannot currently be applied for or acquired under the offer or intended offer;

c) if the offer is made, the offer will be made in accordance with the FMCA; and

d) if the offeror wishes, specifies that the offeror is seeking preliminary indications of interest and, in that case, also specifies:

   i. how indications of interest may be made; and

   ii. that no indication of interest will involve an obligation or a commitment to acquire the financial products.

Advertisements after lodgement of PDS and other Disclose Register information

Section 92 of the FMCA provides that advertisements after a PDS is lodged will not breach section 89 if the advertisement is accompanied by a reasonably prominent statement that:

a) identifies the issuer of the financial products and (if applicable) the offeror of the financial products; and

b) indicates that the PDS for the offer is available and where and how it can be obtained.

The advertisement must not contain any information, sound, image, or other matter that is materially inconsistent with the PDS, or register entry, for the offer to which it relates.

Unsolicited offers of financial products

Section 34 of the FMCA contains a prohibition on the offer of financial products to a person in the course of an unsolicited meeting with that person, unless that person is acting 'in trade'. A meeting can include a telephone call or any other electronic communication which allows people to simultaneously communicate.

Where financial products are purchased by a person in breach of section 34, that person will have a right to a refund for one month after the issue/transfer date.

Other considerations

Fair Dealing provisions

While the FMCA is mostly concerned with requirements relating to regulated offers, the Part 2 Fair Dealing provisions apply more broadly to any person that, in trade, is dealing in financial products or supplying, promoting or intending to supply financial services (with financial services defined very widely).

The Part 2 Fair Dealing provisions regulate the following in connection with financial products or financial services:

a) misleading and deceptive conduct; and

b) false, misleading or unsubstantiated representations.

Unsolicited offers of financial products are also regulated under Part 2 (see above).

Financial service provider registration

Any issuer or offeror of a FMCA regulated offer will be required to:

a) register as a financial service provider; and

b) become a member of an approved dispute resolution scheme,

in accordance with the Financial Service Providers (Registration and Dispute Resolution) Act 2008.

Potential Liability

Liability under the FMCA

The FMCA provides for a range of civil and criminal liability for both corporate entities and individuals.

Civil liability can be very significant, with potential pecuniary penalties for a range of different breaches of the FMCA of up to the greatest of:

a) the consideration for the transaction that constituted the contravention;

b) three times the gain made or loss avoided by the person in contravention; and

c) $1 million for an individual or $5 million for a corporate entity.

Criminal liability under the FMCA requires proof of knowledge or recklessness by the perpetrator in most cases. For example, criminal liability under section 510 of the FMCA for a false or misleading statement in a PDS will only apply if the person has knowledge of, or is reckless as to, the statement. Section 510 is the most severe criminal liability provision in the FMCA, with a fine of up to $1 million and/or imprisonment up to 10 years for an individual, or a fine of up to $5 million for a corporate entity.

Common law liability

If an investor can demonstrate that he or she bought shares in reliance on a false or misleading pre-contractual representation, or a misstatement of fact, for which the company is responsible, he or she may be able to bring a claim in contract law or tort against the company.

Get in touch

Please get in touch if you would like to discuss any of the information provided, or how we can assist in meeting your business goals.

NZstartup@nz.dlapiper.com