

To
Ministry of Economic Development

For
Investment Law Team

From
Westland Cooperative Dairy Company
Limited

By
Email: investment@med.govt.nz

Date
5 September 2011

Dear Sir/Madam

Financial Markets Conduct Bill

1. Introduction

1.1 Westland Cooperative Dairy Company Limited ("**Westland**") is one of New Zealand's leading cooperatives. As a cooperative, we are significantly impacted by the Ministry of Economic Development's ("**the Ministry**") Financial Markets Conduct Bill (the "**Bill**"). We are therefore pleased to be able to make a submission on the Bill.

1.2 We have reviewed the Bill, and wish to comment on the following matters:

- (a) disclosure by cooperatives;
- (b) corrective disclosure;
- (c) unsolicited offers of financial products; and
- (d) advertising.

1.3 Westland is not directly affected by the remainder of the Bill and therefore we do not consider we can usefully comment on other matters.

2. Disclosure by cooperatives

2.1 Westland is a cooperative dairy company. Westland collects raw milk from its farmer members, processes the milk, and markets and sells processed milk products to customers.

2.2 The constitution of Westland requires farmer members to hold a certain number of membership shares in proportion to the quantity of milksolids the farmer member supplies to Westland each year. Currently this is fixed at one share for each kilogram of milksolids supplied. Member shares are fixed at a nominal value of \$1.50.

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- 2.3 Westland pays returns to farmer members by way of the milk price, the price paid to farmer members for each kilogram of milksolids. For example, in 2010 Westland paid its farmer members a Net Average Payout of \$6.15 for each kilogram of milksolids supplier. Westland does not pay dividends, or rebates. Further, as Westland's share price is fixed at a nominal value of \$1.50, farmer members do not realise any capital gains. It is possible for Westland to pay a dividend or make a bonus share issue, however there is no policy for it to do so.
- 2.4 Under the provisions of the Securities Act (Cooperative Companies) Exemption Notices 2002 and 2011, Westland has prepared and filed a short-form evergreen prospectus, and distributes an investment statement as part of its membership pack.
- 2.5 This tailored disclosure regime is designed to acknowledge the special status of cooperative companies. In particular, the decision to become a member of a cooperative is not driven by the possible investment returns from holding member shares, but rather the benefits (or requirements) of membership. In Westland's case, farmers choose to supply raw milk to Westland due to its processing and marketing capabilities, not because of the investment returns. The "decision" to acquire member shares is simply a necessary condition of membership.
- 2.6 We note that the Bill's explanatory note (and previous Ministry papers on this issue) provides that different disclosure requirements may be prescribed for different types of financial products. We **support** this proposal, and **submit** that tailored disclosure requirements be implemented that address the special status of cooperative companies and the unique factors that will inform decision making by prospective members. We further **submit** that the Ministry engage with the cooperative sector at the earliest possible opportunity to ensure that the disclosure regime for cooperative member shares is appropriate.

3. **Corrective disclosure**

- 3.1 We **support** the proposed corrective disclosure regime set out at clauses 61 and 62 of the Bill. The traditional approach to address such issues is to repay the subscription, provide a new investment statement and ask that the member re-subscribe. This is a ridiculous situation that does not advantage anyone. We believe that the proposed corrective disclosure regime, combined with a one month "reconsideration" period provides an appropriate balance between the interests of investors and issuers.

4. **Unsolicited offers**

- 4.1 We **oppose** the proposed unsolicited offers regime in its current format. Clauses 69 and 70 of the Bill appear to prohibit offers of any financial products made in the course of an unsolicited meeting, telephone call or electronic communication. We consider that this unsolicited offers prohibition would cause significant business issues for Westland and most other cooperatives.

- 4.2 Westland sales representatives approach farmers that are potential Westland suppliers, either at the farm or at various rural functions. This is a very common practice by other businesses, cooperative and non-cooperative alike. If the unsolicited offers regime were implemented, then Westland sales representatives would not be able to discuss farmers supplying milk to Westland. Any discussion of milk supply would necessarily involve discussing Westland membership, which is a financial product. This would cause significant disruption to our business.
- 4.3 This situation would further create a significant competitive disadvantage for cooperatives. Dairy companies that are not structured as cooperatives simply purchase milk from farmers without issuing member shares. As this does not involve a financial product, our competitors would be free to make unsolicited approaches to farmers. However we would be prohibited from doing so.
- 4.4 There is no reason to impose this restriction on Westland, or other similar cooperatives. The mischief the clause may be addressing simply does not arise in the context of a cooperative such as Westland discussing the membership, and shareholding, with potential members who are all significant farm businesses in their own right.
- 4.5 We therefore **submit** that offers of "business" or "non-consumer" financial products should be excluded from the unsolicited offers regime. We believe this would reflect both the status quo under section 35 of the Securities Act, and the proposed "uninvited direct sales" regime of the current Consumer Law Reform Bill.

5. Advertising

- 5.1 Westland updates members regularly on latest industry developments through our web portal as well as district meetings, newsletters and e-mail. Westland farmer members are invited to regular farm monitor days which provide networking opportunities in an environment where knowledge and experience can be shared.
- 5.2 The current Securities Act advertising regime causes Westland some difficulties. Because Westland has a continuous offer of securities (new members may join at any time), there is a risk that virtually any communication that refers to Westland may be considered an "inducement" to subscribe for Westland member shares. This contrasts to other non-financial businesses; a company conducting an IPO or bond offer merely has to consider its statements and advertisements under the Securities Act advertising regime for the period of the offer. Cooperatives on the other hand must consider every statement. Because there is a permanent offer of securities, the rules have a permanent impact.
- 5.3 Part of the rationale for the tailored disclosure requirements of the Securities Act (Cooperative Companies) Exemption Notices 2002 and 2011 is that returns to members are due to trading with the cooperative (e.g. the milk price paid for milksolids supplied) rather than investment, and therefore reduced disclosure is appropriate.

However because shares are required to trade, the possibility arises that any comment about the cooperative or returns from trading (e.g. the milk price for 2011 is X) could be considered an inducement to buy shares. In many cases, the possibility will be remote. However, requirement to even consider this issue is somewhat perverse. Statements about trading are subject to the advertising regime of the Securities Act, while at the same time the fact that members purchase shares in cooperatives for trading returns, but not investment returns, is the reason why reduced disclosure requirements for cooperatives have been put in place.

5.4 We therefore **strongly support** the proposal at clause 72(a) of the Bill that "business as usual" statements are not intended to be treated as "inducements" to subscribe for Westland member shares. However, the drafting of clause 72 only provides that this is a matter that "must be taken into account". We are therefore still uncertain as to the intended scope of advertisement regulation. We **suggest** that this is something that could usefully be clarified by including some examples.

5.5 As a related point that has recently caused Westland some issues, we **suggest** that you should give further consideration to the treatment of websites under the advertising regime. Currently, section 2A(6) of the Securities Act provides that where one statement (not a securities advertisement) appears "in association" with another statement (that is a securities advertisement), then both must be treated as a single advertisement and therefore are subject to the Securities Act advertising rules. We support the intent of this anti-avoidance provision in offline publications. However for websites, the plain meaning of this requirement is that every page of a website must be vetted against the Securities Act advertising rules. The majority of Westland's website relates to Westland's processed milk products. While the individual requirements of the Securities Act advertising rules are not particularly onerous, the process of reviewing every page of Westland's website for compliance on an ongoing basis is a very large undertaking. We therefore **submit** that a single reasonably prominent statement on a website that includes the matters referred to in clause 75 should be deemed to comply with the Bill's proposed advertising regime. In other words, a website should be treated as a single publication rather than a series of related publications.

6. Financial products definitions

6.1 We **support** the proposal to exclude cooperative company member shares from the definition of debt security. We believe the reasons in support of this have been well-canvassed elsewhere.

7. Concluding remarks

7.1 In summary, we submit that:

- (a) you should provide certainty as to the disclosure regime applicable to cooperatives at the earliest possible opportunity;

- (b) the corrective disclosure regime should be adopted in New Zealand.
- (c) the unsolicited disclosure regime should **not** apply in the case of "business" or "non-consumer" financial products;
- (d) the advertising regime seems broadly appropriate, however further clarification may be useful in relation to "business as usual" publications and the treatment of websites; and
- (e) cooperative company member shares should be excluded from the definition of debt security.

7.2 We would be happy to discuss any matters of our submission or the impact of the Bill on cooperatives with you if that would be helpful. If you would like to discuss, in the first instance please contact:

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7.3 We confirm that we have no objection to the Ministry publishing this submission on the Ministry's website.

Yours sincerely

For and on behalf of Westland



Catherine Walker