

# ISSUING SHARES IN YOUR COMPANY

**Disclaimer:** This resource is intended for information purposes only and does not constitute formal legal advice. It is strongly recommended that you obtain specialist legal advice before offering shares to any investor.

## OUTLINE

Issuing shares is a useful way for a company to raise capital without bank financing. A business owner may have friends or family who are keen to help out (in return for a share in the company), or may be looking for an angel investor, to give the company a capital injection.

There are a number of commercial and legal considerations for a small business when it is looking at taking on a new shareholder. A key issue, which is often overlooked, is the matter of compliance with securities legislation. Securities laws generally exist to protect investors, and require companies to take certain steps before issuing shares to investors. This resource is intended to be a brief overview of those securities laws.

## NEW LAWS IN FORCE

The Financial Markets Conduct Act 2013 (the Act) recently came into force, overhauling New Zealand's capital markets and financial services laws. Under the Act, every share issue requires full disclosure by the company to the investor, unless one of the Act's specified exclusions applies.

Critically, this rule applies even where a company is only issuing shares to one investor.

Full disclosure involves preparing extensive documentation, in strict compliance with the disclosure requirements set out in the Act and related regulations. The time and cost involved in preparing full disclosure is disproportionate for small to medium sized companies seeking to raise comparatively small amounts of capital.

As a result, every time that a SME issues shares (even to one person), then to avoid either full disclosure or breaching the Act, the company's directors must ensure that an exclusion is available for that particular share issue.

**EXCLUSIONS** All of the exclusions are set out as bright-line tests under the Act. The exclusions generally relate to either the nature of the proposed investor, or the nature of the offer of shares.

The exclusion categories which may be relevant for SMEs seeking to raise capital are as follows:

- where the investor is:
  - o a close business associate;

- o a relative; or
- o a wholesale investor, which comprises a number of different subcategories, including the concept of an eligible investor; or
- where the offer is a small offer.

Each exclusion category is further defined in the Act. Specialist legal advice will be required to confirm the availability of an exclusion in the circumstances of the particular investor and the particular offer of shares.

If an offer falls into an exclusion category, it will be excluded from the Act's disclosure regime, either in full, or with fairly straightforward limited disclosure and compliance requirements. So, after determining which exclusion(s) may be available for the offer and issue of shares, it is important to identify the steps required for that exclusion. For example, some exclusions require warning statements to be included in the offer documents, and/or require a notification to the Financial Markets Authority.

The compliance requirements for the exclusions are significantly less onerous than the compliance requirements for full disclosure, but should be checked off to ensure that the exclusion is effective.

## PENALTIES

Although a number of the exclusions relate to the investor's circumstances (e.g. whether they are an eligible investor), it is the company which is under the obligation to satisfy itself that an exclusion applies. The consequences for non-compliance are potentially very serious for the company and its directors.

There are significant penalties for a company and its directors for issuing shares without either complying with full disclosure, or ensuring that an exclusion is available. Knowingly or recklessly failing to comply with the requirement for full disclosure (in lieu of an exclusion) can even lead to imprisonment. Civil liability with monetary penalties may also apply, subject to defences.

A common situation is where the business unfortunately goes on to fail, and the investor loses some or all of their money. If the company had issued the investor their shares in breach of the Act, this will be another string to the disgruntled investor's bow of claims.

**SEEKING LEGAL ADVICE** We recommend seeking specialist legal advice, not only to avoid falling foul of the requirements of the Act, but also to assist with the Companies Act 1993 requirements, company resolutions, and in preparing the share issue and any shareholders' agreement documentation.

This resource has been kindly provided by



If you have any questions, please call 0800 CHAMBER (0800 242 623).

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