

Feedback form

Consultation paper: Class exemptions for small co-operatives and irrigation companies

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Date: 18/04/2022 Number of pages:
Name of submitter:
Company or entity: Irrigation NZ
Organisation type:
Contact name (if different): Vanessa Winning
Contact email and phone: vwinning@irrigationnz.co.nz 0272741291

Question number	Response
Question 1	<p><i>Do you Support Renewal of the Class Exemption For Co-operatives?</i></p> <p>Yes. The submitters strongly support the renewal of this notice and further submit that consideration should be given to a complete exemption from issuing a PDS or established irrigation schemes where all voting shares are held by the shareholders who also take the water from the scheme.</p> <p>This is a submission on behalf of irrigation companies, some of which operate as co-operative companies and others as companies or under other legislation.</p> <p>Support is given to providing an exemption to irrigation companies with an emphasis on those who have been in operation for a period of years and who provide IFRS compliant financial statements.</p> <p>It is submitted that where there is an irrigation company where all voting securities are held by farmers/users, who have also agreed to take a volume of water in proportion to the shareholding held, then extensive exemptions should be available to those issuers.</p> <p>A distinction must be made between issuers who:</p> <ul style="list-style-type: none">(a) are operating an irrigation scheme where shares are issued to investors who expect a return; and(b) have raised share capital (and sometimes loans) from farmers who are also taking the water and where those schemes operate on a break-even basis. These entities are service providers and not profit making schemes. <p>Yes. The submitters strongly support the renewal of this notice and further submit that consideration should be given to a complete exemption from issuing a PDS or established irrigation schemes where all voting shares are held by the shareholders who also take the water from the scheme.</p>
Question 2	<p><i>Do you Support Renewal of the Class Exemption for Irrigation Companies</i></p> <p>Yes. The submitters strongly support the renewal of this notice and further submit that consideration should be given to a complete exemption from issuing a PDS for established irrigation schemes where all voting shares are held by the shareholders who also take the water from the scheme. Instead of a PDS a disclosure statement should be provided (tailored for irrigation companies) where the issuer operates on co-operative principles.</p> <p>A majority of the irrigation schemes operating in New Zealand are operated by companies (or other entities) where the company has been formed to enable the substantial costs of establishing and keeping up to date an irrigation scheme to be met by raising equity capital from farmers and bank debt.</p>

	<p>The purpose of the capital raising is not to pay dividends or rebates but to permit all farmers who require irrigation water to pay their contribution to meet capital costs, and ongoing annual charges to meet operating costs to obtain water for their properties. The issuer does not make profits, operates on a cashflow break even basis, and ensures the shareholders can maximise their own farm profits by only having to meet costs of the scheme without a contribution to a “profit”. The farmers do not view the equity securities as a financial instrument that provides a return on investment in the traditional sense, rather a mechanism to meet their contribution to capital costs. It is a conduit to gain water to improve on farm income through irrigation.</p> <p>When raising capital the farmers are fully aware of the risks and rewards in making an equity investment in the issuer.</p> <p>It is submitted that an exemption similar to the small co-operative Exemption Notice would be more appropriate for owner/operated irrigation companies, particularly those who have been in operation for 3 to 5 years and have an established scheme with audited financial statements. It is submitted that any issuer who:</p> <ul style="list-style-type: none"> (a) has completed an irrigation scheme which has operated for 3 years; and (b) issues audited financial statements; and (c) where all voting shares are held by the same entity that has signed a water supply agreement to take irrigation water; and (d) where the issuer does not distribute profits as dividends or rebate and operates on a cost recovery model; <p>should have a wide ranking exemption. That exemption should be subject to a number of further conditions (in addition to those set out above) which would include:</p> <ul style="list-style-type: none"> (a) A requirement for a certificate from a solicitor or chartered accountant that the applicant is fully aware of the rights and obligations attached to the shares for which application is being made. (b) That the applicant has been provided with the water supply agreement and any other documents required to be signed. (c) The issuer has provided to the applicant audited financial statements no older than 16 months and a statement of the risks attached to the investment. (d) A statement on the annual charges which the applicant will be expected to pay for the supply of water. (e) That no dividends will be paid on the shares. (f) The volume of water available, its reliability and the consequences of the stated volume not being available. (g) The environmental requirement of the scheme and ongoing compliance with these requirements. <p>This can be discussed in more detail with the FMA if this submission is taken further.</p> <p>The existing exemption should be continued recognising that very few irrigation companies have taken advantage of it. Most irrigation companies issuing securities have either restructured to avoid issuing a PDS or have utilised the Schedule 1 exemptions by only issuing securities to Eligible Investors.</p>
<p>Question 3</p>	<p><i>Use of Current Exemptions</i></p> <p>3.1 Most irrigation companies cannot use either of the exemptions which are available under the Exemption Notices.</p> <p>3.2 Because of the significant capital cost in implementing an irrigation scheme applicants for shares are required to pay significantly more than \$5,000 in taking up shares in an irrigation company. Even smaller schemes do not meet the \$5,000 limit because banks will normally fund 50-60% of the total cost of the irrigation scheme but the balance of the moneys has to be found from equity investment. An example of a small scheme which has delivered stock water to farmers (and not irrigation water) had an initial capital cost of \$2 million with the investment from farmers ranging from \$15,000 to \$200,000 to raise equity of \$1 million. A larger scheme has an even greater outlay and share price, even though these are shares for the purposes of allocating water not trading. For example the \$5,000 limit buys two (2) MGI shares at \$2,400 each, so a better exemption could be that the exemption is for shares of \$5,000 each rather than total value.</p>

	<p>3.3 In addition the Irrigation Schemes Exemption Notice requires a PDS to be filed, even though there are a number of matters that are not required to be covered in that PDS. This involves significant costs for the issuing company which can range from \$50,000 to \$100,000. Farmers raising the money are reluctant to meet the cost of a full PDS in raising capital as they prefer those moneys to be used within the scheme rather than in paying professional advisers for the preparation and issuance of a PDS. For this reason, and because most farmers taking up shares in an irrigation or water scheme have significant on farm assets, and have a high degree of knowledge about irrigation and water supply schemes, the issuers prefer to use the exemptions available under Schedule 1 to the Financial Markets Act, and ensure that the parties taking up shares meet the requirements under that Schedule, rather than meet the cost of issuing a PDS.</p> <p>3.4 For the above reasons each of the Exemption Notices are either impractical to use or are not being used when irrigation companies are raising capital.</p> <p>3.5 It is submitted that if an Exemption Notice was drafted which gave the opportunity for irrigation and water supply companies to raise capital by issuing a disclosure statement rather than a PDS this would create a far improved regulatory framework for these issuers. It is accepted that these different standards should not apply to issuers who are raising equity capital to provide a return to the investors but only where the moneys are being raised by a 'farmer owned entity' and where that entity is being operated as a service company to farmers by owning and operating the scheme, but providing no dividends or other returns for the investing farmers.</p>
Question 4	<p><i>Companies who do not use current exemptions</i></p> <p>4.1 As stated above, many companies use the exemptions under Schedule 1 to the Act rather than utilise the Exemption Notices. In doing so they provide to the prospective investor:</p> <ul style="list-style-type: none"> (a) a full information memorandum which sets out all relevant matters relating to the investment; (b) audited financial accounts; (c) the water supply agreement which is required to be signed; (d) a list of environmental matters that need to be satisfied before water will be supplied. <p>4.2 Some very small co-operatives determined that the cost of developing and providing a PDS and audited financial information was far too onerous based on the value of the outcome. Some companies arrange for the transfer of existing shares to a new owner, or issue shares to eligible investors, or bring in farmers under a supply agreement. There are also options under which they may issue shares for no consideration and reflect the cost of providing equity as an additional water charge which is paid by the farmer on a monthly basis so as to build up equity within the company. That excess water charge is used to service or reduce bank debt to provide equity within the entity. It is submitted that a number of companies take steps to structure the introduction of new shareholders so as to avoid the requirements of issuing a PDS because those requirements are so onerous.</p> <p>4.4 Where there is an initial irrigation scheme which has no track record, and needs to raise share capital, those irrigation schemes do issue a PDS because they need to raise a minimum amount of capital before they can proceed to implement the scheme. Examples of this are Central Plains Irrigation and Amuri Irrigation.</p>
Question 5	<p><i>Entities Excluded from Accessing Class Exemption</i></p> <p>None known.</p>
Question 6	<p><i>Any Entities relying on other FMC Exclusions or Exemptions</i></p> <p>Some of the larger irrigation schemes utilise the Small Offer, Eligible Investor and Large Person (Safe Harbour) exclusions when needed</p>
Question 7	<p><i>Comments on Tailored Disclosure Rules for Irrigation Companies</i></p> <p>7.1 The tailored provisions for irrigation companies contained in the current Exemption Notice only relate to companies that meet the requirements of clause 5 of that Exemption Notice. Effectively</p>

	<p>the company has to be operating under co-operative principles to qualify for issuing securities under this Exemption Notice. This raises an issue for some companies who need to obtain the support of local authorities or other entities to contribute a base level of capital and then raise the balance of capital from farmers. The example of this is the North Otago Irrigation Scheme where the local council gave initial support to the company by way of substantial seed capital and the balance of the moneys was raised from farmers who meet the co-operative principles. The Exemption Notice could not be used by such a company because of the structure that needed to be adopted.</p> <p>7.2 In addition the Exemption Notice for irrigation companies does not exempt them from issuing a PDS but requires the PDS to contain the information set out in Schedule 1 to the notice. It is submitted that by extending the matters that are contained in Schedule 1 the Exemption Notice for irrigation companies could be redeveloped into a disclosure statement on the same lines as the small co-operatives which would provide all relevant and meaningful information to prospective investors. This would be of real benefit to irrigation companies.</p> <p>7.3 It is also submitted that the tailored rules should not apply to irrigation companies or water supply companies where the purpose of the issue is to raise moneys on which a return will be paid as against other issuers who operate their companies on co-operative principles.</p>
<p>Question 8</p>	<p><i>Changing the Maximum Investment Threshold</i></p> <p>8.1 This is more applicable to the current Exemption Notice with the existing \$5,000 limit. Because most irrigation companies who are raising capital require an investment well above the \$5,000 limit this Exemption Notice cannot be utilised by irrigation companies.</p> <p>8.2 By way of example, recent capital raisings by irrigation companies have required capital contributions as set out below:</p> <p>(a) For 15 litres per second of water available under a water supply agreement an investment of \$105,000 (the 15 litres per second being the minimum amount of water that can be taken).</p> <p>(b) For another irrigation company 15 litres per second of water for a cost of \$123,000.</p> <p>There are other examples of where the cost of obtaining water, and paying for a share in infrastructure, is substantial, so that when the farmer is applying for shares there is a high degree of awareness of the cost of that investment, the volume of water being obtained, and the further costs that must be incurred by that farmer to provide infrastructure to distribute that water on the property of the farmer.</p> <p>8.3 For the above reasons the maximum investment threshold for irrigation companies, if this was the proposal from the FMA, would need to be at a very high level to allow irrigation companies to operate efficiently under an Exemption Notice. For this reason, it is preferable there will still be two Exemption Notices, one for smaller co-operatives who can utilise the monetary exemption and another for irrigation companies who meet the criteria already set out in this submission.</p>
<p>Question 9</p>	<p><i>Should the \$2 million revenue threshold be changed</i></p> <p>Yes. As the \$5,000 limit and the \$2 million revenue threshold is not a practical solution for irrigation companies. It is pointed out that because irrigation companies need to generate sufficient revenue to meet annual charges and servicing bank debt, most medium sized irrigation schemes have a revenue well above the \$2 million threshold. If there is no profit making element to the scheme a level of revenue appears moot.</p>
<p>Question 10</p>	<p><i>Estimate of Cost Savings for an Entity that relies on the Exemption</i></p> <p>10.1 It has already been stated above that the usual compliance costs in issuing a PDS, and obtaining IFRS compliant audited financial statements range between \$50,000 - \$100,000 for each PDS.</p> <p>10.2 Accordingly if a short form information memorandum or disclosure statement could be implemented it is estimated the cost of issuing this would be in the range of \$5,000 - \$10,000 so there would be significant savings for all irrigation companies using such an exemption.</p>

<p>Question 11</p>	<p><i>Benefits or Risks to Investors that are Materially Changed</i></p> <p>11.1 Over the last 10 years many irrigation schemes have been issuing equity securities to raise money relating to those schemes. Most farmers are well aware of the benefits and costs in joining an irrigation scheme and are very well informed of those benefits and costs prior to taking up securities in an irrigation scheme. Because of the significant capital cost involved in applying for shares, and the further major costs that are always incurred on-farm in implementing the distribution of water on a farmers property, most farmers undertake a comprehensive economic analysis of the costs and benefits prior to taking up shares in an irrigation or water supply company. Farmers would almost always be working with their bank, accountant, farm consultant and other relevant professional advisers when making decisions around irrigation investment and undertaking this economic analysis.</p> <p>11.2 All of the costs and benefits are now far better understood by farmers and they also understand the risks, particularly with complying with environment standards that are now being imposed by most regional councils and environmental bodies. The level of knowledge of farmers on all of these matters has increased significantly since national proposals on quality of water were issued and implemented, most of which require farmers to also address issues such as nitrates, water discharges, and other matters that affect water and soil quality.</p> <p>11.3 In most cases where equity securities are issued to farmers they are a far more sophisticated investor than the general public, and have a depth of knowledge on the risks and benefits that they will be taking and obtaining in investing in equity securities in an irrigation scheme.</p>
<p>Question 12</p>	<p><i>Changes Needed to the Contents of the Prescribed Disclosure Documents</i></p> <p>Under Question 2 above details have been provided of the type of information which irrigation companies consider needs to be disclosed before an applicant for shares becomes a member of or extends their shareholding in, an irrigation company. In particular it is submitted that except where there is a new irrigation scheme, and that scheme requires to raise a minimum amount of capital before it can proceed, or schemes raised capital to provide a dividend return, that other irrigation schemes which have been in existence for some time, have a track record, and can produce audited financial statements should have a tailored Exemption Notice which enables them to reduce the cost of issuing shares to farmers.</p>
<p>Question 13</p>	<p><i>Aligning the Drafting of Two Exemption Notices</i></p> <p>It is submitted that a special Exemption Notice should apply to all irrigation companies as the \$5,000 Exemption Notice would be inapplicable to irrigation companies because of the amount of capital that would need to be raised.</p>
<p>Question 14</p>	<p><i>Should the Warning Statement be Changed</i></p> <p>No. It is submitted that the Warning Statement should remain in place and be a prominent part of any issue document. What should also be addressed is the information that should be provided to all potential investors to enable them to be fully informed and to understand that they are not only taking up an investment in an irrigation company but are also taking up a long-term commitment to meet charges that will be levied against them for the supply of water and which are needed to meet the costs of the irrigation scheme.</p>
<p>Question 15</p>	<p><i>Issues of any Technical or Interpretative Aspects of Exemption Notice</i></p> <p>Clause 5 of the current exemption notice is confusing for readers of the notice. This states that an irrigation company means a company “other than a co-operative company”.</p> <p>This means the exemption applies only to companies which are not co-operative companies but which follow the co-operative principles.</p> <p>Irrigation companies that are co-operatives consider they need to be included under a general exemption if the proposals in this submission are accepted.</p>
<p>Question 16</p>	<p><i>Other Comments</i></p> <p>The submission from the Co-operatives Association is fully supported.</p>

Feedback summary – if you wish to highlight anything in particular	
<p>Please note: Feedback received is subject to the Official Information Act 1982. We may make submissions available on our website, compile a summary of submissions, or draw attention to individual submissions in internal or external reports. If you want us to withhold any commercially sensitive or proprietary information in your submission, please clearly state this and note the specific section. We will consider your request in line with our obligations under the Official Information Act.</p> <p>The information we gather from this consultation will be utilised primarily for the purpose of considering whether the exemption noted should be granted for a further period and it may be used for other regulatory purposes as noted in the Transparency Statement on our website www.fma.govt.nz.</p> <p>Personal information gathered in this consultation will be handled in accordance with our Privacy Statement on our website www.fma.govt.nz.</p>	
Thank you for your feedback – we appreciate your time and input.	