Commercial Quarterly

Bell Gully

AUTUMN 2006

Welcome to the Autumn 2006 issue of *Commercial Quarterly,* Bell Gully's digest of current commercial law issues that may impact on your business and trading operations.

Each quarter, we will summarise recent issues and preview upcoming developments under the following headings:

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A companion publication, *Regulator Report,* covers developments in the corporate and regulatory sector (New Zealand and Australian exchanges, securities commissions, and takeovers and competition regulators) and is published every three weeks or so. *Regulator Report* is available online at *www.bellgully.com/publications*.

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In the courts

Supreme Court saves mobile phone company from refunding millions of dollars to customers
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High Court awards record penalties for cartel behaviour and price fixing
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The days of sleeping directors are long gone: a wake-up call
Two recent cases involving insolvency matters highlight the fact that directors can not escape liability for inaction. In a High Court case, the court indicated that if a person is listed as a director of a company they will be deemed to be managing the company whether or not in practice they are carrying out this role. In another case, the Court of Appeal notes that "directors must take reasonable steps to put themselves in a position not only to guide but to monitor the management of a company."

When is a scheme of arrangement not caught by the takeover provisions?
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A reminder that acquisition of a business does not mean all the business' contracts go with it
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The Court of Appeal indicates that exemplary damages will not be available for breach of contracts and one-year notice of termination would constitute reasonable notice in appropriate circumstances
A contractual dispute in the wastepaper field has raised some interesting legal issues for the Court of Appeal.

First conviction under overseas investment regime
A United States businessman has become the first overseas investor to be convicted under New Zealand's overseas investment regime. The conviction results from closer monitoring by the Overseas Investment Office of foreign investors' compliance with the Overseas Investment Act – and more convictions could follow.

***The Da Vinci Code* strikes again**
The judgement clearing the author, Dan Brown, from copyright infringement in his successful novel, *The Da Vinci Code*, has been published with an odd series of italicisations and marked letters. It would seem that weeks of immersion in the thriller's plot has led to the judge coming up with a code of his own.

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The limits of the Door to Door Sales Act 1967 (the **Act**) were determined in a recent decision[1] of the Supreme Court where it held Telecom was not liable to repay customers an estimated $17 million in reparation.

Background

The decision signals the end of a long-running courtroom drama brought by the Commerce Commission against Telecom following a marketing campaign for mobile phones undertaken by Telecom in 2001 and 2002.

Telecom called customers during the campaign, marketing mobile phones on the Telecom network. Credit checks were undertaken if the customer was interested in receiving a phone and if these were satisfactory, the customer was sent a phone along with a copy of Telecom's standard terms.

The customer was informed that by breaking the seal on the box containing the phone they were accepting the phone and a contract for the supply of telecommunications services for a 24-month period.

This arrangement was found to be subject to the Act because acceptance by the customer of the contract was made at a place other than "appropriate trade premises", i.e. where they broke the seal on the box, which was usually at their home. Telecom was held to have misled its customers concerning their rights of cancellation under the Act.

Telecom accepted this decision but appealed an order made by the Court of Appeal to undertake a corrective advertising exercise to inform its customers that they may be entitled to refunds.

Supreme Court's decision

The Supreme Court considered the corrective advertising orders were only appropriate if the arrangement was covered by the "catch-all" provision in the Act - section 12(2).

This provision provides for a separate remedy to apply where a seller has deliberately set up an arrangement to evade the effects of the Act. In this event, the contract will be unenforceable and all money paid by the customer is recoverable.

However, in the court's view Telecom's arrangement could not possibly be regarded as having the effect of "defeating" the operation of the Act. To the extent that Telecom had purported to deny customers their cancellation rights under the Act, section 12(1) (the general contracting out prohibition) operated to make those provisions ineffective.

Section 12(2) was interpreted by the Court as being intended to apply to agreements structured in a way to take them outside the Act and to prevent the Act from operating when it would otherwise do so.

The Supreme Court felt that to require Telecom to repay this money when they had not deliberately attempted to avoid the Act would be unfair and inappropriate. They were satisfied that the Act itself had protected customers adequately by giving customers the right of cancellation.

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[1] *Telecom Mobile Ltd v Commerce Commission* [2006] NZSC 17

This means however that a customer unaware of the unenforceability of its contract due to the contract's failure to comply with the Act and therefore unaware of its right to cancel the contract could continue to make payments.

The Supreme Court considered that "*the legislative scheme … is arguably imperfect*" but that section 12(2) was a "*very blunt instrument*" to use as a means of filling a perceived gap.

The Supreme Court held the order for corrective advertising envisaging a statement that moneys paid by consumers were recoverable under section 12(2) should not have been made.

For a commentary on this case and the effectiveness of the Door to Door Sales Act as part of the consumer protection regime, see the article by Alexandra Sims, entitled "The death of the Door to Door Sales Act", in *The New Zealand Law Journal*, May 2006.

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In the courts

High Court awards record penalties for cartel behaviour and price fixing

The High Court has awarded record penalties after companies admitted participating in a cartel in the wood preservative chemicals industry between 1998 and 2002. The $3.6 million dollar penalty is more than double the previous highest penalty for cartel behaviour in New Zealand.

The judgment[2] concerned an application brought by the Commerce Commission for approval of agreed penalties for what the parties defined as "price-fixing conduct" and for "exclusionary conduct".

This is the first case to come before the courts since penalties for cartel behaviour were significantly increased in 2001. Under the new penalty regime in the Commerce Act 1986, companies can face a penalty for as much as $10 million or three times the value of any commercial gain, actual or expected, resulting from the breach or, if the commercial gain is known, 10 per cent of the turnover of the business.

The penalties for individuals are up to $500,000 and guilty parties can be excluded from management of a business.

The penalties awarded against Koppers Arch Wood Protection (NZ) Limited and its Australian parent company (together referred to as **Koppers**) were the result of a successful investigation by the Commerce Commission following a complaint by Timtech Chemicals Ltd (**Timtech**) that Koppers and two other major suppliers were operating a cartel, undertaking market sharing, price fixing and bid rigging.

The claim involved the markets for the supply of wood preservative chemicals from mid-1998 to mid-2002. On the facts, it was agreed that:

- Koppers and some of its senior executives were party to an "overarching understanding" with certain suppliers to maintain market share, avoid unrestrained competition and keep copper chrome arsenic (**CCA**) pricing above the level applicable in a fully competitive market;
- the parties shared price information on CCA so that all altered prices at much the same time and to much the same degree;
- they did not compete on prices in the relevant markets by ensuring their bids to prospective purchasers were at existing market price based on shared information;
- on occasions they adjusted tender prices for CCA supply so as not to compete with each other for existing customers;
- they all took steps to prevent or hinder TimTech's entry into the market.

For a discussion on this case visit the Commerce Commission's website at *www.comcom.govt.nz.* A speech given by Paula Rebstock, Commission Chair (27 February 2006) on the Commerce Commission's approach to cartels and collusion is also available on its website. Some behind-the-scene details of the Commission's investigation into this cartel are included in the speech. You can view this speech at *www.comcom.govt.nz/MediaCentre/Speeches/competitionlawandregulationreview2.aspx.*

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[2] *Commerce Commission v Koppers Arch Wood Protection (NZ) Limited and Ors* (Unreported, High Court , Auckland, 6 April 2006, CIV2005-404-2080)

In the courts

The days of sleeping directors are long gone: a wake-up call

Two recent cases involving insolvency matters highlight the fact that directors can not escape liability for inaction. In a High Court case, the court indicated that if a person is listed as a director of a company they will be deemed to be managing the company whether or not in practice they are carrying out this role. In another case, the Court of Appeal notes that "directors must take reasonable steps to put themselves in a position not only to guide but to monitor the management of a company."

Are you deemed to manage a company simply by being named a director?

The High Court recently had to consider: "*Whether a director, solely by virtue of that appointment and designation, "manages a company" within the means of s.62 (1) (b) of the Insolvency Act*"[3]

Facts

The director in question was the son of an undischarged bankrupt, Mr Carroll. Mr Carroll had been a director of the same company prior to his bankruptcy and his son had been appointed to the position of director after his resignation. Mr Carroll remained as an employee of the company in the role of purchasing officer.

The Insolvency Act does not prohibit a bankrupt from being employed in a business but, where the business is operated by a company which is managed or controlled by a relative of the bankrupt, the employment of the bankrupt must be consented to by the Official Assignee.

As noted in the case, this is to prevent "window-dressing" where the business is effectively operated by the bankrupt and to ensure that the bankrupt is not in a position to exert influence over the relative who occupies a management role.

In this case, Mr Carroll had not sought the consent of the Official Assignee to remain as an employee and argued that he did not need to do so because his son's directorship did not, of itself, show that he managed the company. The District Court judge found in favour of Mr Carroll.

The Official Assignee appealed, arguing that the decision of the District Court judge was wrong because it failed to recognise that under the Companies Act 1993 it is the duty of directors individually to manage a company.

The court's decision

The High Court judge agreed with the Official Assignee noting that it was clear from the Companies Act and the company's constitution that the company could not operate except through the decisions of the board. The company's constitution provided a quorum of two directors for a meeting. Whether the son was actively participating in management or not, the company was still being managed.

Therefore, in the court's opinion, there was no need to determine the extent of the son's involvement in the company to determine whether as a director the son was "managing the company" for the purposes of s.62 of the Insolvency Act.

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[3] *Official Assignee v Carroll* (Unreported, 16 December 2005, High Court, Auckland, CRN 400-450-2376)

In reaching this decision, the court noted the following on the roles of directors:

- it is settled that the management function of directors cannot be delegated;
- management does not necessarily mean total control;
- decisions taken and policy formulated by the board only occur as a result of the decision of each individual director;
- a director cannot, as a matter of law, assert that he or she is a "sleeping" director.

Does being unsophisticated and naïve assist a director to escape from the full force of the law?

In the second case[4], the Court of Appeal had to determine whether two directors were in breach of their obligations not to allow a company to trade recklessly (s.135 of the Companies Act 1993) and to keep proper books of account (s.300 Companies Act 1993).

Facts

Mr and Mrs Lewis were directors of a company set up to run a print brokering business in November 1999. The business was the brainchild of a Mr Grant whom Mr Lewis had met in a business context. Mr Grant had persuaded the Lewises to invest in the company.

Mr Grant's official role in the company was as manager. He had told the Lewises that he could not be a director due to an unresolved legal dispute. Instead, his wife, Mrs Grant, was appointed as a director.

When the business began, three additional directors (who were also investors) were involved in the company but they resigned in April 2000 and sold their shares to Mrs Grant. At the time proceedings were brought, Mrs Grant owned 80% of the shares and the Lewises owned the remaining 20%.

The company lost its main client in February 2000 and was in serious financial trouble from the end of March 2000. However, it wasn't placed into voluntary liquidation until February 2002. Mr Grant, the manager, was charged and convicted on five charges of fraud for creating false invoices made out by the company to third parties.

The liquidator had commenced proceedings on the basis that the Lewises had allowed the business of the company to be carried on in a manner likely to create substantial risk of serious loss to the company's creditors since the company's insolvency dated back to at least 31 March 2000.

The Lewises, who were never actively involved in the day-to-day management of the business, contended that they had done their best to ascertain the state of the company as:

- no directors' meetings were called other than at the commencement of the company;
- all their enquiries to both the manager, Mr Grant, and an accountant (employed to do the company's books and some specific calculations from time to time) were met with assurances that everything was under control and that the company's business was increasing; and
- they had taken action immediately they became aware that Mr Grant's assurances could no longer be believed (in December 2001).

On the evidence presented, the trial judge had concluded that the Lewises had "*acted honestly and in good faith throughout the life of the company, and that they had acted as reasonable directors in the circumstances in which they found themselves*".

He was also of the view that *"so far as [the Lewises] were concerned a competent reliable person ....was responsible for seeing that appropriate accounting records were kept."*

The court's decision

(1) A paradigm case of reckless trading

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[4] *Mason & Anor v Lewis* (Unreported, 30 March 2006, Court of Appeal, Hammond, Chambers and Robertson JJ, CA 267/04)

On appeal, the liquidator argued that the judge's *"obvious sympathies"* for the Lewises had caused him to take the wrong approach by *"focusing on their subjective belief and experience"*. The Court of Appeal agreed. Taking into consideration academic and judicial authorities on s.135, the court concluded the following:

- *the duty which is imposed by s.135 is one owed by directors to the company (rather than to any particular creditors);*
- *the test is an objective one;*
- *it focuses not on a director's belief but rather on the manner in which a company's business is carried on, and whether that modus operandi creates a substantial risk of serious loss;*
- *what is required when the company enters troubled financial waters is ....a "sober assessment" by the directors,...of an ongoing character, as to the company's likely future income and prospects.*

On the facts of this case, the court was of the view that any reasonable and prudent director would have known that the cessation of trading had to be contemplated at least 15 months before steps were actually taken by the Lewises. This was in the courts view *"a paradigm case of reckless trading".*

The court went on to note:

> *"Directors must take reasonable steps to put themselves in a position not only to guide but to monitor the management of a company. The days of sleeping directors with merely an investment interest are long gone: the limitation of liability given by incorporation is conditional on proper compliance with a statute."*

(2) Failure to keep proper accounts

The court also held that the Lewises were in breach of s.300 of the Companies Act for failing to keep proper accounts. On s.300 the court noted:

> *"A director cannot be heard to say 'I did not realise we were in such a pickle, because we did not have any, or adequate, books of account'. It is fundamental that such books must be kept, and directors must see to it that they are kept."*

The reliance the Lewises had placed on both Mr Grant and the accountant did not, in the court's view, amount to a defence under s 300(2) of the Act. The court acknowledged that the Lewises had been taken in by Mr Grant who in their opinion was a *"thoroughly devious and dishonest man"*. But there was enough evidence to show the Lewises actually knew that there was no adequate system in place, especially given they were not themselves getting any accounts.

What does this mean for the Lewises?

The court's finding that the Lewises were in breach of both s.135 and s.300 of the Companies Act means that the court, in its discretion, can grant an order requiring the Lewises to contribute towards the assets of the company and, for breach of s. 300, require them to repay all or any part of the debts and other liabilities of the company.

In determining the total amount of the Lewises' liability, there are three factors which are relevant to the exercise of the court's discretion:

- causation (in so far as there is a clear link between the Lewises allowing the company to continue to trade beyond August 2000 and the indebtedness to creditors that subsequently arose);
- the duration of the trading; and
- the extent of the Lewises' culpability.

On the facts of this case the court considers that the 'culpability' factor will be key in determining how much the Lewises have to contribute to the liabilities over the relevant period. In its opinion, this is likely to be significant as it considered the neglect of their duties to be "reckless" on the facts.

However, the final amount payable by the Lewises is still to be determined by a further round of litigation. The court was not able to determine this quantum matter because it considered that additional evidence

was required to resolve the relevance and status of some of the debts listed in the liquidator's statement of claim.

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In the courts

When is a scheme of arrangement not caught by the takeover provisions?

The New Zealand Takeovers Panel's recent indication that it is going to take a more active role in schemes of arrangement before the High Court makes the facts of this Australian case particularly relevant. Here, the Federal Court approved both a demerger scheme and a transfer scheme involving Foodlands operations in Australia and New Zealand. The Court was satisfied that the complexity of the arrangement removed any suggestion that the arrangement had been proposed to avoid the takeover provisions.

This case[5] involved an application by Foodland Associated Ltd (**Foodland**), for court approval of a proposed arrangement between the company and its shareholders under Part 5.1 of the Australian Corporations Act 2001 (the **Act**) which is similar to the provisions relating to New Zealand schemes of arrangement under Part XV of the Companies Act 1993.

A scheme of arrangement, in short, is a statutory mechanism which allows the court to order that an arrangement or amalgamation or compromise binds the company's shareholders and creditors.

The significance of the scheme provisions is that they allow a company to make an application to the court without first having to put the matter to shareholders or creditors.

However, the court can make an order directing that a meeting or meetings be held to consider and, if thought appropriate, approve any proposed arrangement, amalgamation or compromise.

In Australia, the Act also contains an express exception to the takeovers regime for compromises or arrangements approved by the court under Part 5.1. Section 411 (17) provides that a court will only approve of a scheme of arrangement where either:

- it is satisfied that the scheme has not been proposed to avoid the operation of the takeovers legislation; or
- a statement is received from the Australian Securities and Investment Commission indicating that it has no objection to the arrangement.

There is no equivalent provision in the New Zealand legislation.

Background to the decision

A previous order had been made by the court under the Act, ordering that meetings of Foodland shareholders be convened to consider the proposed arrangement and that an explanatory statement proposed to be sent to the shareholders be approved.

The proposed arrangement to be put to Foodland's shareholders was complex and required shareholders to consider a number of possible transactions for the acquisition of their shares.

Each possible transaction would have different financial consequences according to the form of consideration opted for and the country in which the shareholder resided.

The proposed arrangement

The arrangement that was put to members was in two parts:

- The first part was a proposal to demerge Foodland's operations in New Zealand and Australia by transferring the NZ operation to Progressive Enterprises Holdings Ltd (**PEH**). Foodland shareholders would then be entitled to one share in PEH for each Foodland share they held. Any amounts that were

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[5] Re Foodland Associated Ltd *56 ACSR 352*

otherwise distributable to Foodland's shareholders, from a reduction in the capital of Foodland and from a special dividend, were to be applied to the acquisition of PEH shares on behalf of shareholders.

- The second part of the arrangement involved the transfer of the foregoing entitlements of Foodland shareholders, to shares in PEH to Woolworths Ltd, the acquisition by Woolworths from Foodland of certain supermarket stores operated by Foodland in Australia, and the transfer of the shares in Foodland to Metcash Ltd.

The decision

The court approved the proposed arrangement noting that:

- the explanatory statement provided sufficient information to Foodland shareholders to allow them to exercise their commercial judgment on whether the arrangement proposal should be accepted or rejected;
- the meetings had been duly convened and that the resolutions had been passed with the correct majorities; and
- the complexity of the proposed arrangement supported the view that the arrangement had not been proposed in order to avoid the Act's takeover provisions.

This case should be read with the article on *Schemes of Arrangement under the Companies Act 1993* by Sacha Oudyn reviewed in this issue of the *Commercial Quarterly*. Also, see the commentary on the New Zealand Takeovers Panel's discussion paper on this topic in the Recent Development section of this issue of *Commercial Quarterly*.

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In the courts

A reminder that acquisition of a business does not mean all its contracts go with it

An Australian Federal Court case illustrates the difficulties associated with assigning rights of existing business contracts to the new owners. Here we are reminded that some terms of contracts are incapable of assignment because they are "personal" to the original contracting party.

The issue

In *Pacific Brands Sports & Leisure Pty Ltd v Underworks*[6], Pacific Brands appealed a decision preventing it from terminating a sub-licence that granted Underworks the exclusive right to use two clothing trademarks in Australia.

The main question was whether the critical provisions of the sub-licence agreement, including the right to terminate, were assignable to Pacific Brands without Underworks' consent.

The facts

Pacific Brands had become the assignee of the sub-licence through a complicated series of transactions. The trademarks had originally been held by a US company (Saramar) which had granted a licence to use the trademarks to a related company in Australia, Sara Lee Apparel (Australasia) Pty Ltd (Sara Lee).

Sara Lee, in turn, had granted an exclusive sub-licence to Underworks for a five-year period with an option for a further five years in November 2000. Under the terms of this licence, Sara Lee had a right to terminate the sub-licence if Underworks failed to submit appropriate marketing plans, reports and audits to Sara Lee.

In February 2001, Sara Lee sold its Australian apparel business operations and certain assets to Pacific Dunlop. As part of this sale, it was agreed that the sub-licence agreement would be assigned by Saramar to Pacific Dunlop. This was effected in March 2001, subject to the rights of Underworks as sub-licensee.

A few months later, Pacific Dunlop sold several of the assets it acquired from Sara Lee (including the licence to Underworks) to Pacific Brands, a competitor of Underworks.

Both Pacific Brands and Sara Lee attempted to have the sub-licence novated but Underworks refused to consent to the novation on the terms offered.

After a period of time, a dispute arose between Pacific Brands and Underworks. Pacific Brands alleged that Underworks was in breach of the terms of the sub-licence (in particular to submit marketing plans to Pacific Brands) and that as the assignee of Sara Lee's rights under the sub-licence they were entitled to cancel the sub-licence.

The outcome of the trial

In a controversial decision, the Federal Court (in 2005) held that Pacific Brands was not entitled to cancel the licence with Underworks because:

- the alleged breaches of the contract involved rights of Sara Lee that were incapable of assignment because they were "personal' to Sara Lee and could not be enforced by another party; and further
- a sub-licensor could not validly assign the right to terminate a sub-licence without the consent of the sub-licensee since the right or power to terminate a contract also had an element of personal confidence about it and was not capable of assignment.

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[6] Pacific Brands Sport & Leisure Pty Ltd v Underworks Pty Ltd [2006] FCAFC 40

The Full Court decision

On appeal, the Australian Full Federal Court upheld the trial judge's decision that the sub-licence obligations alleged to have been breached by Underworks had not been successfully assigned to Pacific Brands.

However, the Full Court rejected the trial judge's approach to differentiating between various rights and powers of a party, and of giving to some the character of assignable property while denying that character to others especially in relation to the court's treatment of a sub-licensor's right to terminate.

In the view of the Full Court, the proper approach was to:

- start with the premise that all of the party's contractual rights are assignable: and then

- determine whether in a given case there is a reason why they or some of them are unassignable. Such reasons include statutory or contractual prohibition of assignment, or where the identity of the original contracting party is material to the contractual relationship.

This final point was significant in the outcome of the case. The court put considerable weight on the fact that the sub-licence required significant co-operation between the Underworks and Sara Lee.

Underworks had agreed to such an arrangement with Sara Lee who was not a competitor. The assignment of the sub-licence to a competitor would significantly alter the deal for Underworks.

While the sub-licence contained no express prohibition on assignment of rights by Sara Lee, the Court noted that Sara Lee was defined as the sub-licensor rather than "Sara Lee and its assigns".

This would have signified a contractual intent that Sara Lee's rights under the contract could be assigned. As it was, the court deemed that there were sufficient indications in the contract that the sub-licensor could not be changed without Underworks' consent.

On the facts, the court was not prepared to find that Underworks had consented to the assignment even though the parties had been operating under the terms of the licence for over two years.

Practical implications

This case serves as a reminder of the varied issues that can arise in the sale of a business. Sometimes it is impossible to achieve the desired outcome of the contracting parties especially where a third party does not want to engage in business with the acquirer.

Also it is unwise to assume that a contract that is silent as to assignability can always be assigned.

The court commented that much of the confusion in this case would have been avoided if the sub-licence had been drafted more clearly to start with. An express provision dealing with assignment and whether consent is or is not required will generally be decisive.

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In the courts

The Court of Appeal indicates that exemplary damages will not be available for breach of contracts and one-year notice of termination would constitute reasonable notice in appropriate circumstances

A contractual dispute in the wastepaper field has raised some interesting legal issues for the Court of Appeal.

The facts

This case[7] was an appeal from a series of High Court judgments of Judge Nicholson, delivered in 2004. It involved two parties – Paper Reclaim Limited (**Paper Reclaim**) and Aotearoa International Limited (**Aotearoa**) who were involved in the collecting, recycling, selling and exporting of wastepaper.

The relationship between the two parties began sometime in the mid-1980s when Aotearoa contended that it had sold its paper baler in order to become the sole exporter of Paper Reclaim's wastepaper and to source and provide paper for Paper Reclaim on a 50/50 commission basis. The exact nature of this relationship was not recorded in writing and was a matter of dispute in the courts.

The relationship lasted for nearly two decades until, in early 2001, in the words of Judge Chambers, *"their relationship completely fell apart".* At this point, Aotearoa tried to hold Paper Reclaim to its obligations under the parties' alleged joint venture relationship by applying for an interlocutory injunction.

When this failed, Aotearoa accepted that the relationship was at an end but instigated legal proceedings against Paper Reclaim for breach of contract and for its breach of fiduciary duty to act reasonably and in good faith in the implementation of the joint undertaking.

After considering lengthy evidence on the nature of the arrangement, the High Court found in favour of Aotearoa.

Judge Nicholson found that the parties had entered into a joint venture agreement and that Paper Reclaim had breached the agreement in several respects, including a finding that the agreement could only be terminated on giving reasonable notice. On the facts, the judge considered an eight-year notice period to be reasonable.

Court of Appeal's decision

Paper Reclaim appealed to the Court of Appeal on a number of issues including:

- that on the evidence presented, the High Court should not have found that the joint venture agreement existed;
- if it did exist, the court should not have found an implied term that it was terminable by either party giving reasonable notice (it contended that at best the agreement was terminable at will);
- the court should not have found that Paper Reclaim was liable as a fiduciary and had breached its fiduciary obligation; and
- Aotearoa should not have been able to amend its statement of claim (for the purposes of the quantum hearing) to include a claim for exemplary damages for breach of contract and breach of fiduciary duty.

It is the length of the reasonable notice period and the exemplary damage issue which are of most note.

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[7] *Paper Reclaim Ltd v Aotearoa International Ltd* (Unreported, Court of Appeal, Anderson P, Chambers and O'Regan JJ, CA 70/04, 14/3/2006)

Reasonable notice period

After reviewing the evidence, the court held that the High Court had been correct in its finding that the agreement existed and that there was an implied term that the contract could be terminated by either party giving reasonable notice.

However, the Court of Appeal did not agree that the contract had been terminated by notice. On the facts, the court was of the view that the contract had been terminated by an election by Aotearoa to cancel the contract in response to Paper Reclaim's repudiation of its obligations. The exact timing of both these events is unclear on the facts.

As a result, Aotearoa was entitled to a claim for damages for breach of contract. The only reason for working out what constituted a reasonable notice period was, therefore, to assist in the calculation of damages in so far as it could be used to determine a cut off point.

Although this was a matter to be sent back to the High Court (as part of the quantum hearing), the Court of Appeal expressed its *"preliminary views"* as to the significance of what a reasonable notice period would have been.

According to the court, the key factors (each of which should be considered from the date of cancellation rather than from the date at which the contract was formed) to consider when determining a reasonable notice period are:

- judicial authority on the point because a reasonable business person would normally consult a lawyer (who had access to such information);
- other relevant matters including:
    - carrying out existing commitments;
    - giving notice of the termination of supply to existing customers;
    - bringing current negotiations to a conclusion; and
    - obtaining the benefits from any extraordinary expenditure or effort carried out as part of the contract.

On the facts of the case, the court concluded that the High Court judge had erred in fixing an eight-year notice period, mainly because he appeared to have set aside judicial authority as being relevant to decide this point. Judicial authority suggests that in comparable circumstances the appropriate notice period would be one year.

The High Court judge had also put great weight on the need to allow time for Aotearoa to replicate the role of Paper Reclaim in order to establish itself as a significant competitor in the wastepaper industry.

The Court of Appeal rejected this requirement. It noted that on the facts it would be unlikely that Aotearoa would ever be able to compete with Paper Reclaim given the enormous investment Paper Reclaim had made in its business.

Furthermore, and perhaps more importantly, the court expressed the view that it is not necessary for the recipient of a termination notice to do as well in its first few years of a new business. This is a risk which should be expected when entering into an agreement terminable at any time.

Availability of exemplary damages

The second important issue arising in the case was whether or not exemplary damages should be allowed where a breach of contract was proved.

These damages are strictly punitive, and are therefore controversial as damages for breach of contract are traditionally only designed to compensate the wronged party for the loss suffered.

The High Court had allowed Aotearoa to amend its statement of claim to include a claim for exemplary damages and Paper Reclaim appealed this decision. The Court of Appeal noted that the law on this topic in New Zealand was not clear and there was at least a possibility that exemplary damages could be claimed. However, this possibility has now been firmly closed.

The court noted that exemplary damages have never been explicitly allowed in New Zealand – on the facts of a case, or even in principle. There has only been some inconclusive discussion in New Zealand cases. The court also reviewed the position in relevant overseas jurisdictions and noted there was a clear trend against granting exemplary damages.

Furthermore, the Court warned about the consequences of a judgment which allowed exemplary damages in "very rare cases" or "in exceptional circumstances". This would allow many cases which had little chance of success to be brought on the basis that they claimed such extraordinary circumstances. This could lead to unmerited and expensive litigation, and unworthy settlements.

The judgment did expressly leave open the possibility that exemplary damages may be granted where a breach of contract also constitutes a tort; or where there is a breach of fiduciary duty.

It should be noted that this may not be the last we hear on this case. Aotearoa filed an application for leave to appeal to the Supreme Court on 11 April 2006 and although the exemplary damages point is not being pursued, Aotearoa is asking the court to consider whether the Court of Appeal erred in its determination of an appropriate notice-of-termination period.

For further commentary on the court's rejection of exemplary damages as a remedy for breach of contract, please see the article by Elizabeth Tobeck, entitled "Exemplary damages in contract", in The New Zealand Law Journal, May 2006.

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In the courts

First conviction under overseas investment regime

A United States businessman has become the first overseas investor to be convicted under New Zealand's overseas investment regime. The conviction results from closer monitoring by the Overseas Investment Office of foreign investors' compliance with the Overseas Investment Act – and more convictions could follow.

The sentencing notes[8] of the first conviction under the Overseas Investment Act 1973 (the **1973 Act**) (the predecessor to the Overseas Investment Act 2005 (the **2005 Act**)) have recently been released by the Overseas Investment Office (**OIO**).

The facts

Lance Connell Wellor, a United States businessman, was fined NZ$17,000 and ordered to pay NZ$5,000 in court costs in November 2005 for failing to comply with a condition of an Overseas Investment Commission (the **Commission**) consent. The Commission was the predecessor to the OIO.

In January 2001, Mr Wellor purchased 43 hectares of land in Queenstown. One of the conditions of the Commission's consent to the purchase was that Mr Wellor would, over a period of time, develop a 20 hectare chestnut orchard and a five hectare Douglas Fir plantation on the property. The orchard and plantation were expected to create three full-time jobs.

However, when Mr Wellor sold the property in August 2004, the only developments made to the land were roading and foundation works for Mr Wellor's planned $5 million holiday home and guest lodge. No work had commenced on either the orchard or the plantation.

The decision

District Court Judge Stephen Erber, in sentencing Mr Wellor, stated that it was unacceptable for foreign investors to ignore conditions that the Commission imposed when granting consent. Judge Erber stated *"it must be perfectly clear to people who buy land here that conditions are to be complied with".*

One of the changes to the overseas investment regime under the 2005 Act is that the penalties for breaches are significantly higher than under the 1973 Act.

Indeed Judge Erber stated that had Mr Wellor been subject to the 2005 Act he may have had to forfeit the profit he made from the resale of the property, which was estimated to be over NZ$700,000. Under the 2005 Act, foreign investors can now be fined up to NZ$300,000 or face up to 12 months' imprisonment. The High Court also has the power to force a foreign investor to dispose of his/her property.

Further convictions expected

Following the conviction of Mr Wellor, Overseas Investment OIO Manager Annelies McClure said that the conviction was a direct result of the OIO's renewed focus on monitoring overseas investors.

The OIO made public in November 2005 that it was investigating 30 further cases involving overseas investors in the Auckland and Southern Lakes regions.

To date, no further convictions have been made under either the 1973 or the 2005 Acts. However, a warrant was issued in the Wellington District Court in February 2006 for the arrest of Earl Richard Schomburg for alleged breaches of the 1973 Act.

Mr Schomburg, a construction company owner from Illinois in the United States, bought a $1.35 million share of Benmore Station in Canterbury in February 2003.

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[8] *New Zealand Overseas Investment Commission v Lance Connell Wellor*, (Unreported, 14 November 2005, District Court, Queenstown CRN4059500073).

It is alleged that Mr Schomburg misled the Commission by failing to disclose a previous conviction from 2000 for illegally buying and selling antelope in the United States for which he was fined US$15,000 and banned from hunting in the United States for a year.

If found guilty under the 1973 Act, Mr Schomburg faces a fine of up to NZ$30,000 or 12 months' imprisonment.

For further information on the 2005 Act, please refer to the Bell Gully Overseas Investment Act 2005 Guide dated January 2006 located at www.bellgully.com. A copy of the sentencing notes can be downloaded at *www.oio.linz.govt.nz/pdf/oio-sentencing-notes.pdf.*

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In the courts

The Da Vinci Code strikes again

The judgement clearing author Dan Brown from copyright infringement in his successful novel, The Da Vinci Code, *has been published with an odd series of italicisations and marked letters. It would seem that weeks of immersion in the thriller's plot has led to the judge coming up with a code of his own.*

The case

In a recent High Court ruling[9] in the United Kingdom, Dan Brown's bestseller, *The Da Vinci Code,* has been found not to be in breach of copyright laws as claimed by the writers of *Holy Blood, Holy Grail*, Richard Leigh and a New Zealand-born claimant, Michael Baigent.

The authors of the *Holy Blood, Holy Grail*, written in 1982, claimed non-textual infringement in a literary work. This meant that their case was not based on a claim that a substantial part of their book had been copied; rather they said that Brown copied *"a substantial part of the work to produce an altered copy or a colourable imitation"*.

They argued that their book made a sequence of connections that no one had made before. Among these was that Jesus was married to Mary Magdalene, that she bore his child, and that the Holy Grail was a metaphor for Mary Magdalene.

Brown admitted he had looked at *Holy Blood, Holy Grail* before completing *The Da Vinci Code* and Justice Smith felt Brown had "*genuinely and clearly acknowledged Holy Blood, Holy Grail in The Da Vinci Code*".

To succeed in their claim of non-textual copying, the claimants had to show there was copying of a substantial part of their work to make an altered copy. It was not their facts, themes and ideas that were protected by the law but how those facts, themes and ideas are put together.

This meant the claimants had to show that the structure of the book had been copied. They did this by claiming *The Da Vinci Code* had taken too much of the central theme of *Holy Blood, Holy Grail*.

Justice Peter Smith felt however that the claimants failed to make out their central theme. He held that, even if there had been a central theme to *Holy Blood, Holy Grail*, it was merely an expression of facts and ideas at a very general level and did not warrant protection.

Judge's additional inserts

In the spirit of *The Da Vinci Code,* Justice Smith put his very own code into his 51-page judgement. The mystery was revealed when lawyers pondering the judgment realised that italics had been placed in strange spots throughout the 51-page document. The judgment has a mixture of bold and italicized font scrambled amongst his findings.

The message embedded in the ruling reads 'Smithy Code Jackie Fisher who are you Dreadnought' and is a reference to an event from about 100 years ago. The encryption scheme was based on the Fibonacci number sequence, the same one used in the Dan Smith novel.

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[9] *Michael Baigent and Richard Leigh v The Random House Group Limited* [2006] EWHC 719 (Ch)

In the journals

Void transactions under the Securities Act 1978
This article focuses on the protection offered to investors under the Securities Act for failure to disclose relevant information in an offer of securities to the public. In particular, the author addresses whether "void" in section 37 of the Act means that the allotment is invalid and of no effect or something much less in practice.

Corporate governance post-Enron
In this paper, Jane Diplock, who has recently been reappointed for a second term as the Chair of the New Zealand Securities Commission, provides an overview of the Commission's view on corporate governance in New Zealand.

The unfitness of directors, insolvency and the consequences – some comparisons
The authors examine what level of director's unfitness justifies intervention and the imposition of personal liability particularly in the area where the company is approaching insolvency. The article compares New Zealand's current provisions with the Australian and United Kingdom regimes and concludes that currently New Zealand's law is confused and unsatisfactory and suggests reform along the lines of the Australian model.

What directors need to consider before calling in an administrator – and it's not just insolvency...
This article discusses how, in Australia, directors who wrongly put a company into voluntary administration may face personal liability actions from aggrieved stakeholders and outlines steps directors can take to protect themselves against such actions.

Schemes of arrangement under the Companies Act 1993
A topical article, given the Takeovers Panel's release of its discussion document on the use of schemes of arrangement. In this article, Sacha Oudyn focuses on the relationship between the schemes of arrangement provisions in the Companies Act and the more specific codes that regulate takeovers, amalgamations and compromises. The article concludes that it may be desirable to reform the schemes of arrangement provisions in the Companies Act to minimise the risk of circumventing the Takeovers Code.

Retention of title and the trans-Tasman supply of goods
This article considers the effect of the different security regimes in New Zealand and Australia on supplies of goods on retention of title terms.

A comparative study between Australia, New Zealand and USA concerning directors' duties when issuing shares as a takeover defence strategy
This article provides an overview of both statutory and common law duties which must be considered by directors in a hostile takeover. The author draws on the US experience in this area to contrast and compare the current situation in Australia and New Zealand but does not discuss provisions specific to listed companies.

Illusion or reality – reporting under AIFRS
The first companies to use the Australian equivalent of the International Financial Reporting Standards (IFRS) reported their first half-year results in December 2005. Ann Durie assesses the impact of the new requirements, particularly on investors' perceptions of corporate performance in relation to the new standards. This article is of particular relevance given New Zealand's full adoption of New Zealand's equivalent IFRS for reporting entities from 2007.

Directors' fiduciary duties
With recent New Zealand courts highlighting directors' statutory duties, this Australian article also serves as a reminder that these are not the only duties imposed on directors. Here the author provides an overview of the nature of a director's duties and discusses in detail a director's fiduciary obligations and potential remedies available for breach of a fiduciary duty.

Directors' liability and leaky buildings
Samuel Carpenter examines whether directors may find themselves to be personally liable in the growing number of leaky building cases hitting our court system. He finds that, as yet, there is no definitive answer.

Contemporary challenges in takeovers: Avoiding conflicts, preserving confidences and taming the commercial imperative
Through the medium of a hypothetical fact scenario, Andrew Tuch of the University of Sydney discusses legal, commercial, ethical and other issues that can arise in corporate takeover transactions. Although set in the Australian market, the issues raised are just as relevant for New Zealand directors and legal advisers.

In the journals

Void transactions under the Securities Act 1978

Stephen Potter 13 [2005] *Waikato University Law Review*

This article focuses on the protection offered to investors under the Securities Act for failure to disclose relevant information in an offer of securities to the public. In particular, the author addresses whether "void" in section 37 of the Act means that the allotment is invalid and of no effect or something much less in practice.

Under section 37 of the Securities Act 1978 (the **Act**), an issuer who offers securities to the public must meet the minimum disclosure thresholds stated in the Act.

Section 37(4) states that any allotment made in contravention of the provisions of this section shall be invalid and of no effect. As observed by Master Venning in *Cowles v Syndicated Investigations Limited*,[10] no steps need to be taken by a subscriber, or the issuer, under section 27 to avoid an allotment in contravention of section 37, as such an allotment is void *ab initio* as opposed to voidable.

Accordingly, relief should be available under the Illegal Contracts Act 1970 (the **Illegal Contracts Act**).

However, an issuer who contravenes section 37 does not, in practice, find its allotment invalid and of no effect. Often the Securities Commission approaches an issuer in breach of the Act and the parties come to an "enforceable undertaking" that will remedy or resolve the breach.[11]

This often takes the appearance of validating and making effective an allotment which is invalid and of no effect under section 37(4); that is, making the allotment voidable, rather than void.

This undertaking, made under section 69J of the Act, appears to make voidable an allotment that is deemed void by section 37(4).

Superimposed on this apparent inconsistency are the relief provisions under the Act. The 2004 amendments to the Act excluded relief under the Illegal Contracts Act (by section 4(5)), and introduced mandatory relief orders under section 37AC and discretionary relief orders under section 37AH instead.

The article discusses the scope of the application of these sections. Both sections are applicable regardless of when the contravention occurred. Additionally, both sections appear to capture a larger range of matters than void irregular allotments alone.

The article suggests that an applicant seeking relief under one of these provisions would be wise to seek it under a discretionary relief order. The machinery of the provision endows the court with an extremely wide ambit to do justice between the parties, particularly where a subscriber has suffered losses following an allotment that contravenes section 37.

In light of the overriding concern being one of equity and justice to innocent third parties, the author concludes that "void", in terms of the Act, has never strictly meant void; that it has always meant something else. That something else is now manifested in sections 37AC and 37AH of the Act.

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[10] (1998) 8 NZCLC 261 581 (HC).

[11] For example, *South Pacific Energy Limited and Calgary Petroleum Limited: Enforceable Undertaking with the Securities Commission*, 21 February 2005.

In the journals

Corporate governance post-Enron

Jane Diplock AO13 [2005] *Waikato University Law Review*

In this paper, Jane Diplock, who has recently been reappointed for a second term as the Chair of the New Zealand Securities Commission, provides an overview of the Commission's view on corporate governance in New Zealand.

Jane Diplock reviews the Commission's framework on corporate governance issued in 2004 and discusses regulatory and enforcement options available. The paper also notes the importance of New Zealand's commitment to membership of international information exchange and enforcement cooperation among securities regulators.

The paper is a revised version of a presentation given by Ms Diplock at a conference of the Australian Law Teachers' Association held at the University of Waikato in July 2005.

Regulatory options

The author notes how the Commission has contributed a robust principles-based framework for good corporate governance across a full spectrum of economic entities in New Zealand. This is set out in the Commission's 'Corporate Governance in New Zealand: Principles and Guidelines' published in February 2004 (the **Principles**).

She believes that it has been received so well because it reflects a distinctly New Zealand approach. She notes:

"The last thing we want in this country is a 'tick the box' compliance mentality on corporate governance."

Two key aspects of the Principles are that they acknowledge that the standards of governance in any particular entity will depend on:

- the knowledge, experience and integrity of its directors and managers; and
- the disciplines of the market, and the ability of interested parties to hold accountable directors and management.

The Commission views this framework as a baseline for the behaviour of boards and executives.

To ensure this principle-based approach to corporate governance works, the Commission regards reporting and disclosure critical. In this regard, the Commission has been monitoring company annual reports. Jane Diplock notes that, for the most part, the Commission has been pleased with the increased level of awareness of corporate governance issues, especially amongst large corporates. However, the Commission would like to see annual reports containing:

- more details on their directors or substantiating their independence case by case;
- pro-active disclosure of the composition and charter of all board committees;
- more emphasis on fostering constructive relationships with shareholders; and
- information on the companies' interaction with other stakeholders.

Commission enforcement

The paper also addresses the Commission's other main focus for corporate governance through securities law enforcement. In its view, lapses in corporate governance often result in non-compliance with securities law. This is particularly apparent in the context of:

- investment offerings to the public;
- insider trading; and

- other deceptive or manipulative behaviour involving securities.

The author states that the Commission will use *"all our powers to call individuals to account before the civil or criminal justice systems".*

IOSO initiatives

The final section of the paper discusses the Commission's focus on building a network for international information exchange and enforcement cooperation among securities regulators.

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In the journals

The unfitness of directors, insolvency and the consequences – some comparisons

John Farrar and Doug Tennent, *Canterbury Law Review*, Volume 11, 2005

The authors examine what level of director's unfitness justifies intervention and the imposition of personal liability particularly in the area where the company is approaching insolvency.

The article compares New Zealand's current provisions with the Australian and United Kingdom regime and concludes that currently New Zealand's law is confused and unsatisfactory and suggests reform along the Australian model.

The article notes that:

- the New Zealand cases and commentary reveal the interpretation of the reckless trading provisions in the Companies Act 1993 are not well settled but are likely to be interpreted objectively and conservatively;
- directors must balance risk and return when making decisions – however, the sections do not reflect this;
- risk and return are not easily balanced when the company has little or no equity and this can expose directors, even of small companies, to substantial personal risk, even if they have not breached their fiduciary duty or committed fraud under these provisions;
- unlike the Australian and United Kingdom provisions, sections 135 and 136 have no specific defences available for directors;
- in all three jurisdictions, the objectivity test means courts are less reluctant than traditionally to second guess the business judgment rule;
- the equivalent Australian provisions are more extensive, operate more efficiently and are enforced more effectively; therefore New Zealand should look to Australia when considering reform.

It is worth reading this article with Nuncio D'Angelo's article *"What directors need to consider before calling in an administrator – and its not just solvency"* which is also reviewed in this issue of the *Commercial Quarterly.*

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In the journals

What directors need to consider before calling in an administrator – and it's not just solvency

Nuncio D'Angelo, *Company and Securities Law Journal*, Volume 24, 2006

This article discusses how, in Australia, directors who wrongly put a company into voluntary administration may face personal liability actions from aggrieved stakeholders and outlines steps directors can take to protect themselves against such actions.

The author concludes:

- directors have a statutory right but not an obligation to put a company into voluntary administration. They are, however, under a statutory duty to prevent insolvent trading;
- directors face a potential conflict of interest and duty where they try to avoid personal liability for insolvent trading by putting the company into voluntary administration. The duty to act in the best interests of the company and to consider the position of stakeholders is paramount. Avoiding the risk of personal liability cannot be the primary or substantial purpose for putting the company into voluntary administration;
- stakeholders can seek redress against directors personally if they are materially adversely affected by the directors' decision to put the company into voluntary administration;
- directors are under a positive obligation, not a legal obligation, to consider the position of creditors when the company is nearing insolvency or potentially face personal liability in relation to any loss or damage suffered by the creditor as a result of the directors' actions;
- directors ignore their statutory and common law duties during this process at their peril.

This article should be read in conjunction with Farrar and Tennent's article also reviewed in this issue of the *Commercial Quarterly* which argues that New Zealand should reform its reckless trading legislation along Australian lines.

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In the journals

Schemes of Arrangement under the Companies Act 1993

Sacha Oudyn, *New Zealand Business Law Quarterly,* Volume 12, March 2006

A topical article, given the Takeovers Panel's release of its discussion document on the use of schemes of arrangement. This article focuses on the relationship between the schemes of arrangement provisions in the Companies Act and the more specific codes that regulate takeover, amalgamations and compromises. The article concludes that it may be desirable to reform the schemes of arrangement provisions in the Companies Act to minimise the risk of circumventing the Takeovers Code.

The author examines the schemes of arrangement provisions in Part XV of the Companies Act 1993 (the Act). The discussion focuses on the relationship between Part XV and the more specific codes that regulate takeovers, amalgamations and compromises, and highlights the potential for abuse of the schemes of arrangement provisions.

The author's main concern is that Part XV could be used to circumvent specific codes, for example, the Takeovers Code or specific provisions in the Act such as Parts XIII and XIV, which provide rules for the protection of shareholder and creditor interests.

What is a scheme of arrangement?

A scheme of arrangement under Part XV of the Act is a statutory mechanism which allows the court, notwithstanding other provisions of the Act or a company's constitution, to order that an arrangement, amalgamation, or compromise binds the company's shareholders and creditors.

Following application to the court, the court can make an order directing that a meeting or meetings be held to consider and, if thought appropriate, approve, any proposed arrangement, amalgamation, or compromise. The court may determine the extent to which meetings are required, the majorities required at those meetings, and the consequence of a negative vote.

The author, before proceeding to a discussion of the problems associated with Part XV, considers what the Law Commission was trying to achieve when drafting the schemes of arrangement provisions in the Act.

What are the problems with Part XV?

The author identifies two concerns with Part XV:

- the provisions of Part XV are drafted with a high level of generality and give the court a wide discretion and little legislative guidance to determine what meeting, voting and disclosure procedures a company should follow for a proposed scheme; and

- the correct legal position is unclear on the relationship between Part XV of the Act, the Takeovers Code and the Takeovers Panel's policy on schemes of arrangement which, in the Panel's view, amount to a takeover.

The role of the Takeovers Panel in schemes of arrangement

Under the Takeovers Code, the Takeovers Panel considers that any transaction entered into by a company which has the result of a shareholder obtaining control of 20% or more of the voting rights in a "Code company" will be caught.

This means that a scheme of arrangement cannot be used in these circumstances without an exemption from the Panel. The Panel, when deciding whether or not to grant an exemption to a scheme that is for intents and purposes a takeover, will consider whether compliance with the Code is possible and whether compliance would create an inappropriate, unreasonable or unintended result.

The author argues that, as the courts have in the past suggested that a takeover may constitute an "arrangement" under Part XV, then they must necessarily retain the power to sanction an arrangement under the Act irrespective of any decision of the Takeovers Panel.

Schemes of arrangement in other jurisdictions

The author considers the application of scheme provisions in Canada, the United Kingdom and in Australia. Particular attention is paid to Australia, where the court can only approve a scheme of arrangement where either:

- it is satisfied that the scheme has not been proposed to avoid the operation of takeovers legislation; or

- a statement is received from the Australian Securities and Investment Commission indicating that it has no objection to the compromise or arrangement.

Conclusions

The author comes to a number of conclusions regarding Part XV:

- it may be desirable for the courts to have wide powers when deciding whether or not to approve schemes of arrangement. This allows for the flexibility needed to cope with complex transactions for which the specific provisions within the Act may not be suitable. However, the flexibility provided by the general wording in s.236 should not be a licence for the courts to necessarily apply lower approval thresholds than those set out in Parts XIII and XIV in cases where those Parts would otherwise be appropriate;

- it may be desirable to redraft Part XV to clarify the relationship between the scheme provisions and the Takeovers Code. This would be achieved by imposing a limitation on the court's power to approve a scheme of arrangement that amounts to a takeover along the same lines as the Australian approach outlined above; and

- an amendment could be made to include various mandatory disclosure requirements.

These amendments would, in the author's view, ensure that due regard is paid to the protection of shareholder and creditor interests.

It is worth considering this article with the Takeovers Panel's *consultation paper on schemes of arrangement* also summarised in this issue of the *Commercial Quarterly*.

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In the journals

Retention of title and the trans-Tasman supply of goods

Juliet Taylor, *New Zealand Business Quarterly*, volume 12, March 2006

This article considers the effect of the different security regimes in New Zealand and Australia on supplies of goods on retention of title terms.

Sales on retention of title terms are a commercial law development allowing the seller/supplier of goods to employ "quasi-security" devices to secure repayment and allow them to take back goods that have not been paid for if the buyer becomes insolvent. Generally, the supplier will have priority over other creditors in respect of those goods.

The Australian High Court has directly applied the principles of *Romalpa*[12], the case that gave retention of title suppliers the rights described above.

In New Zealand, the enactment of the Personal Property Securities Act (**PPSA**) has resulted in an entirely distinct regime for retention of title clauses.

The author of this article identifies a number of implications arising from this divergence in regimes.

Australia

In essence, Australia's sale of goods legislation provides for property to pass when the contracting parties intend for the property to pass. The focus is on the intention of the parties in determining the conditions and at what point property is to pass between the buyer and the seller.

Therefore it is only when the goods have been paid for that there is a clear intention for ownership of the property to pass to the buyer.

New Zealand

The PPSA refocuses attention on the *substance* of the security interest taken in the personal property and not the *form* of the agreement that created the security interest. In addition, priority of a security interest now depends on the registration of a financing statement.

Conflicts rules in the PPSA

The PPSA sets out a regime for determining conflict of law issues. Section 26 contains the residual rule:

> "(1) *Validity, perfection and the effect of perfection or non-perfection of a security interest in goods...is governed by the law of New Zealand if, -*
>
> (a) *at the time the security interest attached to the collateral, the collateral is situated in New Zealand; or*
>
> (b) *at the time the security interest attached to the collateral, the collateral is situated outside New Zealand but the Secured Party has knowledge that it is intended to move the collateral to New Zealand..."*

Application of conflict rules

As a general rule, proprietary concerns are almost always referable to *lex situs* (the country in which the goods are located for the time being) and, therefore, contractual propriety aspects are considered by the law of the same jurisdiction.

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[12] *Aluminium Industrie Vassan B.V. v Romalpa Aluminium Ltd* [1976] All ER 552

Goods sold to a New Zealand buyer but then remain in Australia

The law of *lex situs* is likely to govern whether the reservation of title by the seller is valid and whether the title has passed to the buyer in any particular case. Once it is ascertained where title lies pursuant to *lex situs*, the question becomes whether removal to another jurisdiction, pursuant to the law of the subsequent jurisdiction, would override the prior reservation of title in the original *lex situs*.

The provisions of the PPSA generally respect these established principles. Thus, New Zealand courts would have to recognise that title to goods remained with the Australian seller.

This rule must continue to be recognised despite an intention on the part of the buyer prior to its insolvency that the goods be moved to New Zealand (as referred to in section 26(1)(b)).

Goods delivered directly to the buyer in NZ

In this case, the foreign seller who retains title must register its security interest in its goods at the Personal Property Securities Register (**PPSR**).

Goods delivered to the buyer and subsequently moved to NZ

The traditional position has changed with implementation of the PPSA. Section 27(1) requires registration of the seller's interest at the PPSR if the seller's retention of title is to be effective against other secured party claiming an interest in the goods.

If the seller does not register its interest within the specified timeframes, the seller's unperfected interest becomes subordinate to a perfected interest.

Conclusions

The author concludes that the PPSA has enhanced commercial certainty for sellers that retention of title clauses will be upheld in the New Zealand courts.

However, this certainty comes at a price - sellers must enter into an enforceable security agreement and they must also register their interest at the PPSR. In all but a few cases, Australian suppliers of goods to New Zealand buyers will have to register their retention of title arrangements.

It remains to be seen, however, how the New Zealand courts will interpret the rules set out in the PPSA to afford foreign secured parties the presumed protection under the PPSA.

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In the journals

A comparative study between Australia, New Zealand and USA concerning directors' duties when issuing shares as a takeover defence strategy

Nico Just, *The New Zealand Postgraduate Law E-Journal*, Issue 3, 2006

This article provides an overview of both statutory and common law duties which must be considered by directors in a hostile takeover. The author draws on the US experience in this area to contrast and compare the current situation in Australia and New Zealand but does not discuss provisions specific to listed companies.

The author considers the position of directors in hostile takeovers where, on the one hand, they are required to act for the benefit of the company and, on the other, they are faced with providing impartial advice when the takeover could result in the loss of their position.

In particular, the author reviews the employment of defensive measures, such as issuing company shares to a friendly party, in order to avoid the takeover and how, in these circumstances, a director will be in breach or deemed to be in breach of his or her duties.

In doing so the author provides a comparative study of the position in the jurisdictions of Australia, New Zealand and the United States. The ability of courts to second guess business decisions is also considered.

Key points

The differences between the US and Commonwealth approach are analysed in relation to four principles that influence directors' duties and behaviour in a takeover situation. These include the:

- valid business purpose underlying the transaction;
- burden of proof;
- duty to auction the company; and
- the review of business decisions by the courts.

The author notes that the jurisdictions of Australia and New Zealand are very similar. The overriding duty of a director is to act for a 'proper purpose'.

In general, the director is acting for a proper purpose if the action is motivated by a desire to promote the company's interests. The burden of proof lies on those challenging the director's decision to establish that they did not act for a proper purpose.

In the US, the 'business judgement rule' traditionally provided that the defensive measure would not be held voidable unless the primary purpose of the director was to retain his or her own position within the company.

This has now been modified by the adoption of the 'Unocol' test, which comprises a reasonableness element (directors must show they had reasonable grounds for believing a danger to corporate policy existed) and a proportionality element (the defensive measure must be reasonable in relation to the threat posed).

The intrinsic fairness test, which requires a fair dealing and a fair price, and the duty to auction the company and sell for the highest price, also play a role in the US jurisdiction.

Conclusion

The author concludes that the American approach is preferable to that of New Zealand and Australia.

He criticises the commonwealth law as too restrictive, giving the example that directors' actions are voidable when they were motivated by the sole purpose to stay in office, even if the results were economically advantageous to the company. He also states that our law could promote target company passivity.

The article is available online at *www.nzpostgraduatelawjournal.auckland.ac.nz.*

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In the journals

Illusion or reality – reporting under AIFRS

Ann Durie, *Australian Corporate News*, Issue 6, 10 April 2006

The first companies to use the Australian equivalent of the International Financial Reporting Standards (IFRS) reported their first half-year results in December 2005. Ann Durie assesses the impact of the new requirements, particularly on investors' perceptions of corporate performance in relation to the new standards. This article is of particular relevance given New Zealand's full adoption of New Zealand's equivalent IFRS for reporting entities from 2007.

The Australian IFRS were introduced and due to be adopted for all financial reporting periods beginning on or after 1 January 2005. Australia was one of the forerunners in the adoption of the international reporting standards, along with the EU and South Africa.

In this article, the author begins by providing a background to the adoption of IFRS as the new standard for financial statements in Australia and other parts of the globe.

The focus of the article is to highlight that the transition to IRFS is not necessarily going to be smooth. She notes that the adoption of the new accounting standards has proved to be a challenging time for investors and the market generally, as well as for companies and auditors.

The author's sources are largely based on a November 2005 survey conducted by CPA Australia as well as a research paper released by Tyndall Investment Management (**Tyndall**) in summer 2006, entitled *Apples and oranges – investors coping with the Accounting Standards*. These are reviewed in detail in the article.

The author discusses the more significant alterations to the accounting measures as identified by Tyndall:

- financial instruments
- restatement of balance sheets
- goodwill
- impairment of assets
- share-based payments
- pension benefits; and
- investment property.

In her conclusion, the author notes that there is going to be a certain period of upheaval and market fluctuation with the introduction of Australia's IFRS.

In her view, investor communication will be a key tool to prevent inappropriate investor responses to the release of financial reports based on the new standards.

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In the journals

Directors' fiduciary duties

Julian Svehla, (2006) 27 *Australian Bar Review* 192

With recent New Zealand courts highlighting directors' statutory duties, this Australian article also serves as a reminder that these are not the only duties imposed on directors. Here the author provides an overview of the nature of a director's duties and discusses in detail a director's fiduciary obligations and potential remedies available for breach of a fiduciary duty.

In this article, Julian Svehla summarises:

- a director's fiduciary duties;
- the remedies for breach of such duties; and
- what distinguishes those duties from the non-fiduciary duties of a director.

Svehla provides a useful overview of some well-recognised fiduciary duties of directors', including:

- a duty to act in good faith;
- a duty to act for a proper purpose;
- a duty to avoid conflicts of interest;
- a duty not to take profits or advantages from the company's property or funds for himself or herself or some other person.

Svehla then discusses whether a "proscriptive/prescriptive" test should be the yardstick for distinguishing between the fiduciary and non-fiduciary duties of directors.

Under this test, a fiduciary obligation would be a proscriptive obligation (an obligation to refrain from doing an act). A non-fiduciary obligation would be a prescriptive obligation (a obligation requiring the doing of an act).

Syehla concludes that such a formalistic test is inconsistent with how the law of equity determines whether a fiduciary duty exists. Equity asks:

- whether the particular circumstances give rise to an obligation whereby a person has to have regard to and to protect the interests of another; and
- then ascertains the extent of that obligation in the circumstances.

Svehla's comments on the common law, equitable and contractual duties of directors represent a useful overview for directors seeking to exercise their duties in New Zealand.

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In the journals

Directors' liability and leaky buildings

Samuel Carpenter, *The New Zealand Law Journal*, April 2006

Samuel Carpenter takes a look at whether directors may find themselves to be personally liable in the growing number of leaky building cases hitting our court system. He finds that, as yet, there is no definitive answer.

This article analyses a company director's duty of care and potential liability in leaky building cases. In particular, it considers the implications of recent leaky building cases for directors in the building industry.

Carpenter explains that this issue is critical, as building owners are often dealing with building or certification companies that no longer exist.

He identifies two principal issues for holding directors in the building industry liable:

- What is the proper legal basis for that liability, if it exists at all?
- What sorts of fact scenarios are clear indicators of liability?

The key points Carpenter makes on these issues are:

- He assesses the two main legal theories underpinning leaky building cases decided to date: the "assumption of responsibility approach" and the "actual control" approach.
- He suggests that recent leaky building cases show a fairly clear line of legal reasoning. The Court seems to ask *"has the director actually done or said anything that has caused loss?"* and then imposes the conclusion that the director has "*assumed responsibility".*
- This test, in effect, excludes the director who hasn't actually been on site or carried out works from personal liability, but imposes on small-scale directors the whole responsibility simply because they personally carried out the works.

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Contemporary challenges in takeovers: Avoiding conflicts, preserving confidences and taming the commercial imperative

Andrew Tuch, *Company and Securities Law Journal*, April 2006

Through the medium of a hypothetical fact scenario, Andrew Tuch of the University of Sydney discusses legal, commercial, ethical and other issues that can arise in corporate takeover transactions. Although set in the Australian market, the issues raised are just as relevant for New Zealand directors and legal advisers.

This article is based on a hypothetical case study of a corporate takeover. It centres on the proposed acquisition by a large Australian oil and gas exploration and production company listed on the Australian Stock Exchange which intends to make a cash takeover bid for the shares of its smaller competitor.

The study formed the basis of a panel discussion in the Faculty of Law at the University of Sydney in 2004 that resulted in the publication of this article.

The deal advisers consist of law firms for both the bidder and target companies, investment banks for both companies, and a professional services firm.

The author provides some useful discussion on these conflict situations in the context of a corporate takeover and how deal advisers could overcome such conflicts.

There are numerous potential conflicts that arise in the deal. These include:

- legal adviser conflicts relating to:
  - opposing a former client;
  - attendance at a 'beauty parade'; and
  - protection of information disclosed by a potential client;

- investment bank conflicts relating to:
  - opposing former clients;
  - research analyst independence;
  - conflict at a professional services firm regarding the independence of an expert's report; and

- company director conflicts relating to:
  - multiple directorships; and
  - having a legal adviser as a director of a client.

Conflicts involving legal advisers

One issue discussed within the legal adviser conflict of opposing former clients is the duty to protect confidential information. In regards to the discharge of an evidential burden by the firm the author looks at the use of Chinese walls.

Tuch notes that despite expressed judicial scepticism towards such procedures, Australian courts have recently become more accepting of their effectiveness for preventing what would otherwise be a breach of the duty of confidence.

In 2002, the Federal Court of Australia held that information barriers were effective even though they were established on an ad hoc basis after the conflict was drawn to the firm's attention.

In the author's view, the target law firm should have these procedures integrated into their day-to-day structure.

Another legal adviser conflict considered is the attendance at a 'beauty parade' for potential advisers.

Here the potential conflict arises where a firm who has received potentially confidential information at the 'beauty parade' to represent a party to a transaction and after failing to secure that role is then engaged to represent the other party to the proposed transaction.

One aspect discussed is the related policy matter of whether a company could make strategic use of a beauty parade as a way of disqualifying the strongest law firms from representing the other side of the transaction.

Although there is no direct judicial authority on the issue, the author canvases a range of arguments, concluding that courts would be unlikely to condone such practice from companies.

Conflicts involving the investment bank

Where an investment bank opposes a former client, the author referred to circumstances in which he would recommend that a challenge should be made to an investment bank's decision to act.

Tuch notes that the most important considerations should be the legal principles for the protection of confidential information and an assessment of the information barriers in place.

Reference is also made to the risks associated with seeking to restrain an investment bank for tactical or strategic reasons.

On that point, there is judicial authority cited that courts would be highly critical of any application made to restrain another party that is not done so in good faith or where there is no evidence to support a claim that confidential information had in fact been obtained.

Conflicts involving directors

The case study also includes a commentary on the situation where a director sits on the boards of both the target and bidder companies.

Although the article notes that there is no general rule of law prohibiting multiple directorship (even of competitor companies), here the director is in a position where the duty owed to each company conflicts.

The author looks at whether the director can avoid breaching this fiduciary obligation on the assumption that informed consent of the companies is unlikely to be offered.

Tuch notes that in reality the director would have disclosed their competing role and so when the issue arose the director would be prevented from participating in a decision. This would be one way to avoid conflict.

However, once the bid was announced, the conflict would appear to be unavoidable and it was recommended that the sensible approach would be for the director to resign from both boards.

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Legislation/In Parliament

Securities Legislation Bill and Regulations
It is expected that the Securities Legislation Bill will go through its final legislative changes in the next couple of months. This omnibus bill will make wide-reaching reforms to the Securities Act, the Securities Market Act, the Takeovers Act and the Takeovers Code. A discussion document seeking public comment on the consequential regulatory requirements for the new legislation was released in March 2006.

Insolvency Law Reform Bill
The Insolvency Law Reform Bill passed its first reading in Parliament in February 2006 and was referred to the Commerce Select Committee for consideration. The Committee began hearing evidence on the Bill on 18 May 2006.

KiwiSaver – the Government's new work-based savings scheme
The KiwiSaver Bill had its first reading in Parliament on 28 February 2006 and is expected to receive its final assent later this year with implementation of the scheme by 1 April 2007.

New legislation to target excessive salary sacrifice for superannuation contributions
The Government has announced it will introduce legislation to minimise the use of excessive "salary sacrifice" through the use of employer superannuation contributions as a means of paying less tax. The changes are included in the taxation bill introduced into Parliament on 17 May 2006.

Trans-Tasman MOU on Coordination of Business law
A revised Memorandum of Understanding on Coordination of Business Law between Australia and New Zealand was signed on 22 February 2006. The revised MOU reaffirms both countries' commitment to coordination of trans-Tasman business law (from the earlier MOU signed in 2000) and commits both countries to working together to reduce impediments to trans-Tasman commerce.

Legislation/In Parliament

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The amendments proposed by the Securities Legislation Bill will make wide-reaching amendments to the Securities Act 1978, the Securities Markets Act 1988, the Takeovers Act 1993 and the Takeovers Code. These reforms include:

- fundamental changes to the insider trading laws;
- new market manipulation laws;
- revisions to the substantial security holder disclosure requirements;
- new rules for the regulation of investment advisers and brokers;
- changes to the Takeovers Code; and
- significant criminal sanctions for non-compliance with the new rules.

As a package of reforms, the new amendments will:

- redefine both the policy basis for prohibiting insider trading and the conceptual framework of the insider trading regime;
- significantly expand the role of the Securities Commission;
- increase the regulatory burden on market participants; and
- introduce criminal liability for breaches of the securities laws.

The statutory reforms will be complemented by regulations that are currently being developed. These will relate to:

- Investment advisers' and brokers' disclosure;
- Substantial security holders' disclosure;
- Insider trading exemptions; and
- Market manipulation exemptions.

The most important of the new regulations will involve exemptions for efficient market conduct that might otherwise be caught by the new regime. It is anticipated policy proposals for the regulations will be sent to Cabinet in June 2006, and draft regulations to Cabinet in September 2006.

For further details on the Securities Legislation Bill and regulations visit the Ministry of Economic Development's website at *www.med.govt.nz.*

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Legislation/In Parliament

Insolvency Law Reform Bill

The Insolvency Law Reform Bill passed its first reading in Parliament in February 2006 and was referred to the Commerce Select Committee for consideration. The Committee began hearing evidence on the Bill on 18 May 2006.

The Bill was introduced into Parliament at the end of 2005, following a Government-initiated insolvency law review that began in 1999 and the release for consultation of a draft bill in 2004.

The main aspects of the draft bill are:

- introduction of a voluntary administration regime for companies, similar to that which exists in Australia;
- changes to the voidable transaction and preferential payments provisions of the Companies Act 1993;
- introduction of new phoenix company provisions to deal with companies that carry on business using a similar name to that of a failed company;
- adoption of the United Nations Commission on International Trade Law (UNCITRAL) Model Law on cross-border insolvency; and
- introduction of a "no asset procedure" as a one-off reprieve from bankruptcy for the small-time individual debtor out of his or her financial depth.

Commerce Minister Lianne Dalziel has stated that, while she expects widespread support for the new "phoenix company" provisions and the tightening of the voidable transaction provisions, she expects that the two areas of reform that will attract the most debate are:

- the streamlining of the bankruptcy administration process and the introduction of a new "no asset procedure" as an alternative to personal insolvency; and
- the introduction of a voluntary administration procedure for companies with potential for rehabilitation.

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Legislation/In Parliament

KiwiSaver – the Government's new work-based savings scheme

The KiwiSaver Bill had its first reading in Parliament on 28 February 2006 and is expected to receive its final assent later this year with implementation of the scheme by 1 April 2007.

KiwiSaver is a Government-sponsored work-based savings scheme. On retirement, KiwiSaver rewards an employee with the savings contributed over the years, together with any return on the investment made.

This type of scheme differs from pension-based schemes that are (or were previously) operative in New Zealand such as the Government Superannuation Fund.

As a savings-based scheme, KiwiSaver will complement the pensions currently paid under NZ Super, so KiwiSaver participants could enjoy a higher standard of living during their twilight years than they would on the NZ Super pension alone.

KiwiSaver is a voluntary scheme. Employers are required to offer the scheme to employees - but workers can "opt out". For those employees that do opt in, the employer is not obliged to make any contributions to savings.

For further information on the KiwiSaver, please read the following articles on Bell Gully's website:

KiwiSaver: You know it makes sense by Andrew Scott-Howman, Partner and Ainsley Benefield, Solicitor,
KiwiSaver a Super Tool by Mark Todd, Partner

For more details on the KiwiSaver scheme and a copy of the Bill, please visit the Treasury's website at *www.treasury.govt.nz.*

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New legislation to target excessive salary sacrifice for superannuation contributions

The government has announced it will introduce legislation to minimise the use of excessive "salary sacrifice" through the use of employer superannuation contributions as a means of paying less tax. The changes are included in the taxation bill introduced into Parliament on 17 May 2006.

On 19 April 2006, the Government confirmed that it would introduce legislative changes in a taxation bill to counter employees sacrificing salary in return for increased superannuation contributions.

The announcement followed an issues paper ("Countering extreme salary sacrifice") released by the Inland Revenue Department in February describing the operation of the Specified Superannuation Contribution Withholding Tax (SSCWT) rules and suggesting ways of countering extreme salary sacrifice.

The Government considers the changes to be necessary in order to stop the misuse of the tax rules and a potential revenue loss of between $90 million and $120 million a year if the present regime is retained[13].

Under the current progressive regime introduced in April 2004, SSCWT is calculated at rates of either 15%, 21% or 33%, applied to all contributions made on behalf of a particular employee with the applicable rate being determined by the employee's salary or wages in the previous year. This has effectively allowed high-income employees to sacrifice greater amounts of their income to bring themselves within either the 33%, 21% or the 15% SSCWT rate bracket.

The changes announced by the Government will mean that high-income earners will no longer be able to access the lower SSCWT rates by swapping salary in return for employer superannuation contributions.

Under the new regime, SSCWT rates will be based on the total of an employee's salary or wages and employer superannuation contributions. The SSCWT thresholds for tax on employer contributions will be 15% higher than personal income tax thresholds to reduce the possibility of over-taxation.

To view the changes, see the issues paper, "Countering extreme salary sacrifice" on the Inland Revenue Department's website at *www.taxpolicy.ird.govt.nz.*

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13 Source: Government press release – 19 April 2006 – www.taxpolicy.ird.govt.nz/index.php?view=438

Legislation/In Parliament

Trans-Tasman MOU on Coordination of Business law

A revised Memorandum of Understanding on Coordination of Business Law between Australia and New Zealand was signed on 22 February 2006. The revised MOU reaffirms both countries' commitment to coordination of trans-Tasman business law (from the earlier MOU signed in 2000) and commits both countries to working together to minimise impediments to trans-Tasman commerce.

The revised MOU also sets new priority areas for trans-Tasman business law coordination including:

- managing cross-border insolvency;
- consideration of mutual recognition and/or further co-ordination of the regulation of financial intermediaries;
- co-ordination of disclosure regimes in securities law;
- insurance regulation;
- information sharing amongst regulators;
- continued alignment of financial reporting standards;
- managing cross-border recognition of companies;
- exploring the adoption of a mechanism allowing for disqualification of persons from managing corporations in both jurisdictions;
- coordinating anti-money laundering supervisory frameworks;
- developing a regime for the granting of patents and registration of trademarks;
- coordinating competition law (e.g. the cross appointment of regulators and developing a single track procedure for business acquisition applications).

The MOU acknowledges several important developments in the trans-Tasman environment, such as:

- the objective of a trans-Tasman single economic market;
- the benefits of coordination in efforts to influence evolving international regulatory standard and regimes;
- the importance of maintaining existing business law coordination;
- the adoption by both countries of IFRS; and
- the importance of cooperation between regulators.

A report on a review of the previous MOU (signed in August 2000) has also been released. This shows that there is wide support for the central aims of the MOU.

Significant progress has been made in relation to the work programme outlined in the 2000 MOU, including the completion of legislation governing electronic transactions and an agreement on mutual recognition of securities offerings (which was signed on the same day as this MOU).

In addition, significant work has been progressed on:

- Information-sharing and cooperation between regulators; and
- coordination of accounting standards through the Trans-Tasman Accounting Standards Advisory Group which led to a regional policy forum on International Financial Reporting Standards with representatives from Japan, the Hong Kong SAR, Singapore, China, Korea, Malaysia, Thailand, Indonesia and the Philippines.

Further information on the review and final report of the review of the 2000 MOU can be found on the Ministry of Economic Development's website at *www.med.govt.nz*.

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Recent Developments

Corporate

Takeovers Panel takes steps to mitigate use of schemes of arrangement for the protection of shareholders
The Takeovers Panel has revoked its class exemption for initial public offers which has been relied upon in some schemes of arrangement involving code companies. This follows the Panel's release of a consultation paper on 4 April 2006 which asked for public responses to a series of questions on the refining of takeover laws to prevent companies avoiding Takeovers Code scrutiny by merging through schemes of arrangement under the Companies Act.

Securities Commission reviews financial reports
The Securities Commission is carrying out an ongoing financial reporting surveillance programme to review the reporting practices of issuers, with the aim of encouraging New Zealand issuers to improve the quality of their financial reporting.

Financial Reporting Act review
Reform of the Financial Reporting Act is scheduled to take place in December.

Registrar of Companies issues further convictions under the Financial Reporting Act
The Registrar of Companies continues to monitor closely companies with obligations to file financial statements under the Financial Reporting Act 1993 and has followed up its findings with a number of recent convictions against directors who have failed to file financial statements on time.

MOU between NZ Companies Office and ASIC
In February 2006 a Memorandum of Understanding was signed by the New Zealand Companies Office and the Australian Securities and Investment Commission (ASIC) to allow for the continued aligning of regulatory functions including the alignment of corporate registration processes, compliance and disclosure activities between both bodies.

Getting on with Business: government takes a fresh look at regulatory frameworks
Commerce Minister Lianne Dalziel announced on 22 May 2006 that the government would be undertaking a broad review of the regulatory frameworks governing business in New Zealand.

Capital Markets

New NZX Listing Rules implemented in May 2006
NZX has completed its 2005 review of the NZSX/NZDX Listing Rules. The 2006 amendments came into effect on 10 May 2006, with the exception of specific provisions relating to preliminary announcements and half-yearly reports which come into effect on 1 July 2006.

Securities Commission Oversight Review of NZX
Under the co-regulatory regime created by the Securities Markets Act, the Securities Commission has announced that it will conduct an oversight review of NZX.

Competition and Consumer Protection

Final report released on regulation of mobile termination rates
The Communications Minister has released the Commerce Commission's final recommendations on the regulation of mobile termination rates.

Local loop unbundling: the Government releases its Telecommunications Stocktake Review Paper
The New Zealand Government announced on 3 May 2006 that it would unbundle Telecom's local loop. The Minister of Communications, David Cunliffe, said that legislation will be introduced shortly and expects it to be implemented by the beginning of 2007.

A discussion paper released on New Zealand's consumer protection legislation
The Ministry of Consumer Affairs released an international comparison discussion paper in May 2006 on the Review of the Redress and Enforcement Provisions of Consumer Protection Law. The two key pieces of legislation under discussion are the Fair Trading Act and the Consumer Guarantees Act.

Government to review Parts 4 and 5 of Commerce Act
Commerce Minister Lianne Dalziel, announced on 22 May 2006 that the Ministry of Economic Development is to review Parts 4 and 5 of the Commerce Act.

Resources and Energy

Discussion Paper released on investment in electricity generation
The Ministry of Economic Development has released a discussion paper examining options to encourage electricity lines companies to make increased investment in generation. Options discussed in the paper include allowing lines companies to trade in electricity hedges, relaxing some arms-length separation rules for lines companies involved in generation, and clarifying parts of the Electricity Industry Reform Act 1998 to help reduce uncertainties about how the legislation is applied in practice.

Electricity Commission rejects Transpower's proposed Auckland 400kV grid investment proposal
On 27 April 2006, the Electricity Commission issued its draft decision on Transpower's grid upgrade proposal to construct a 400kV line linking Whakamaru and Otahuhu by 2010. In response, Transpower has indicated that it will submit a new modified proposal.

Intellectual Property

Copyright changes proposed in discussion paper
In March 2006, the Ministry of Economic Development released a discussion paper called "The Commissioning Rule, Contracts and Copyright Act 1994" as a starting point for submissions and possible legislation changes involving the application of the "commissioning rule" to copyright-protected works such as photographs, art pieces and computer programs.

Trade mark compliance costs under discussion
The Government issued a discussion paper in March 2006 on International Trade Mark Treaties addressing the issue of whether New Zealand should join a number of international trade mark treaties administered by the World Intellectual Property Organization.

Panel to resolve domain name disputes
In March 2006, the New Zealand Domain Name Commissioner announced that an expert panel had been appointed to resolve disputes over .nz domain name registrations. The new system will be available from the date of implementation on 1 June 2006.

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Corporate

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The Panel is reviewing its policy regarding the use of its exemption powers to facilitate changes of control of code companies resulting from schemes of arrangement under Part XV of the Companies Act 1993. The two areas which it considers should be revised are:

- the threshold that must be satisfied in order for an exemption to be granted; and
- the conditions for shareholder approval which the Panel will be likely to impose, particularly those designed to protect minority shareholders.

The Panel's existing policy on exemptions for schemes of arrangements was published in July 2003.

The consultation paper also addresses the legislative framework regarding changes of control of companies and the relationship between the Takeovers Code and the Companies Act.

Bell Gully has made submissions on the matters raised in the consultation paper and these can be viewed on Bell Gully's website (see below).

In its media release on 15 May 2006, the Panel notes that it is likely to recommend amending legislation to the Government on the relationship between the Takeovers Code and the Companies Act. Pending this review, the Panel has announced that it:

- will exercise its power to be heard by the High Court when the Court considers proposed schemes of arrangement involving code companies; and
- has revoked the class exemption for initial public offers contained in clause 7 of the Takeovers Code (Class Exemptions) Notice (No.2) 2001. Future applications for exemptions for new company floats will be considered on a case-by-case basis.

For further details, visit the Takeover Panel's website at *www.takeovers.govt.nz*.

To download the consultation paper, visit the Takeover Panel's website at *www.takeovers.govt.nz/publications/policy/.* To view Bell Gully's submissions on the consultation paper see *www.bellgully.com.*

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Corporate

Securities Commission reviews financial reports

The Securities Commission is carrying out an ongoing financial reporting surveillance programme to review the reporting practices of issuers, with the aim of encouraging New Zealand issuers to improve the quality of their financial reporting.

Two cycles of this surveillance have now been completed. The report setting out the findings for cycle 2 was published in February.

The findings are similar to those of cycle 1 in that few serious problems were identified, but a number of issuers need to raise the standard of their financial reporting. The report on cycle 1 was not available prior to the financial statements reviewed in cycle 2 being prepared.

The reports of 46 issuers were reviewed against NZ GAAP. 19 issuers had matters that needed to be addressed, with the following significant matters arising several times:

- the format of the "Statement of Movements in Equity" was incorrect;
- failure to date and/or sign the financial statements; and
- inadequate actual versus prospective financial information comparisons.

All issuers will have to switch to the International Financial Reporting Standards (**IFRS**) from 2007. At present, issuers can choose between the current system and IFRS.

The Commission is reviewing the financial statements of a selection of issuers who have chosen to comply with IFRS already, aiming to provide feedback to the Commission so that it can better educate parties in respect of the IFRS and better enforce the IFRS.

For more information, visit the Securities Commission website at *www.sec-com.govt.nz.*

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Corporate

Financial Reporting Act review

Reform of the Financial Reporting Act is scheduled to take place in December.

At the end of 2005, a cabinet paper was released on the review of the Financial Reporting Act 1993 (FRA), which follows on from the proposed adoption of New Zealand equivalent International Financial Reporting Standards (NZIFRS).

The paper indicates that a small number of amendments will be required to the FRA and the Companies Act 1993 before the NZIFRS comes into force on 1 January 2007.

A Bill is to be introduced in the next few months, with a view to enactment of the legislation by the end of the year.

This will reduce business compliance costs, especially for small and overseas companies.

For more information, read the Ministry of Economic Development's newsletter at *news.business.govt.nz/new/business/general/article/3096.*

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Corporate

Registrar of Companies issues further convictions under the Financial Reporting Act

The Registrar of Companies continues to closely monitor companies having obligations to file financial statements under the Financial Reporting Act 1993 and the Companies Office has followed up its findings with a number of recent convictions against directors who have failed to file financial statements on time.

The average penalty imposed by the courts on directors for not filing financial statements on time has been $6,000. However, this reflects cases at the bottom end of the sentencing spectrum, where there is no evidence of anyone being misled and little, if any, potential for anyone to be misled by the non-compliance.

In a recent case, the High Court[14] has confirmed that a starting point of $8,000 for lower-end offending is appropriate given that the maximum penalty ($100,000) which can be imposed under the Financial Reporting Act indicates the legislature views this type of offending as serious.

It should also be remembered the penalties imposed by the courts are applied to each director of a company as every director carries personal responsibility for compliance by the company with the requirements of the Act.

For more information, see *news.business.govt.nz.*

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or call her on 64 9 916 8825.

[14] *Hale v Registrar of Companies* (CRI 2005-404-000237, High Court Auckland, 28 September 2005)

Recent Developments

Corporate

MOU between NZ Companies Office and ASIC

In February 2006, a Memorandum of Understanding was signed by the New Zealand Companies Office and the Australian Securities and Investment Commission (ASIC). The MOU allows for the continued aligning of regulatory functions including the alignment of corporate registration processes, compliance and disclosure activities between both bodies.

The MOU is designed to make it easier to do business in both countries by simplifying the corporate regulatory obligations for companies operating in both markets. It also allows for cooperation and the exchange of information to assist each regulator, particularly on operational and enforcement matters.

For more details of the MOU, visit the Companies Office website at *www.companies.govt.nz.*

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or call her on 64 9 916 8825.

Recent Developments

Corporate

Getting on with Business: government takes a fresh look at regulatory frameworks

Commerce Minister Lianne Dalziel announced on 22 May 2006 that the government would be undertaking a broad review of the regulatory frameworks governing business in New Zealand.

The Regulatory Frameworks Review is part of the government's economic transformation agenda outlined by the Prime Minister earlier in the year. Lianne Dalziel stated that the Review will:

- introduce fast-track mechanisms for change;
- make life easier for business where multiple regulatory frameworks intersect;
- improve government's own processes for monitoring the impact of the regulations; and
- conduct sector studies.

The first sectors to be reviewed are food and beverage, wine, retail and the hospitality industry.

The review will be led by the newly established, Ministerial Group for Quality Regulation. This Group will oversee an inter-departmental Quality Regulation Taskforce led by Peter Mumford from the Ministry of Economic Development.

The Group will report to Cabinet at the end of October this year and at the end of March 2007. A final report on the review is expected by 31 July 2007.

For further details of the review visit the Ministry of Economic Development's website at *www.med.govt.nz* and the Commerce Minister's press release on the government's website at *www.beehive.govt.nz.*

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or call her on 64 9 916 8825.

Capital Markets

New NZX Listing Rules implemented in May 2006

NZX has completed its 2005 review of the NZSX/NZDX Listing Rules. The 2006 amendments came into effect on 10 May 2006, with the exception of specific provisions relating to preliminary announcements and half-yearly reports which come into effect on 1 July 2006.

For the most part, the rule changes reflect clarifications of the existing Listing Rules and do not place any additional obligations on listed issuers.

The more significant amendments relate to the rules governing related parties and to the disclosure and information rules. In practice, NZX has stated that this latest round of rule changes should see a reduction in waiver applications to NZX, as well as reduce the overall compliance costs associated with disclosing material information.

Summary of key changes

Related party provisions

The related party and material transaction provisions in Section 9 of the Listing Rules have undergone a number of changes to further clarify the scope of the provisions and reduce the types of transactions falling under the regime. Some of the more significant changes are:

Clarification of the application of the de minimus exception for material transactions involving service contracts

Redrafting of the related party transaction rules now makes it clear that a service contract (regardless of its length and overall value) will be subject to the NZ$250,000 de minimus exception in each financial year of the contract;

Executive employment contracts no longer require NZX approval

Employment contracts entered into on an arm's length, commercial basis and approved by independent directors will no longer be considered a related party transaction so long as the appropriate disclosure is made;

Guidance on which "officers" are related parties

NZX has replaced references to "officer" with the term "executive officer" in the related party rules. The change is in response to a request to focus the related party rule on persons that are likely to exercise influence over an issuer such as the CEO or CFO. However to retain flexibility, no further definition has been given. Instead NZX will issue a guidance note on this issue;

New 10% threshold for substantial security holders in related party transactions

A person will no longer be deemed to be a related party solely because that person holds 5% of the voting securities in the issuer. In recognition that a 5% holding is unlikely to influence an issuer, the threshold has been increased to 10%;

All arm's length commercial bank transactions (where the bank is acting as principal) fall under the exception to related party transactions and major transactions

The Listing Rules have always provided an exception for banking transactions where the issuer has recourse to the credit risk of a bank. However, the rules now allow for loan transactions to fall within the general bank exception;

New common director, subsidiaries and joint venture exceptions

The addition of new exceptions for common directors and for transactions with subsidiaries and joint ventures (subject to strict criteria) should also assist in reducing the range of circumstances in which issuers are required to apply for waivers to the related party transactions.

Disclosure and information rules

The other main area affected by the rule changes is the provisions governing the timely disclosure of information, the content requirements of such disclosures and the form of disclosure. In brief, the main changes are:

Amalgamation of the disclosure requirements for acquisitions and dispositions with the continuous disclosure obligations

NZX has made changes to the structure of its disclosure obligations by removing the requirement for separate announcements of material changes. These are now covered by the general continuous disclosure obligations to ensure disclosure of all material information to the market. The footnotes to the continuous disclosure rules have been redrafted to retain the benchmarks which triggered notification under the previous regime and also list the content requirements for such notices.

Offering document required for major change of control or direction

Instead of an information memorandum, NZX (at its discretion) may now require an issuer to prepare a profile for major changes involving the controlling interest in an issuer; sale or purchase of a major part of an issuer's assets; or a change in direction of the business or activities of the issuer;

Changes in content for preliminary announcements, half-yearly reports and annual reports

NZX has removed specific content details from the rules for preliminary announcements and half-yearly reports and included these in Appendix 1. However these changes will not take effect until 1 July 2006. For annual reports, issuers now have the option to disclose details of waivers granted by providing a reference to the issuer's website;

Improvements in timing requirements for director nominations

The time between the closing date of nominations and the date of the annual meeting is now the only relevant period to consider. This is to overcome some of the problems issuers faced in setting the date of their annual meetings when notification of directors' nominations were included in the release of the preliminary full-year announcement.

Other notable changes

The 2006 amendments include a number of other changes including:

The removal of the overall 7% cap for employee equity issues over a five-year period

NZX is now satisfied with the 3% threshold per year for control over employee share schemes;

Minor changes to the rules governing the issues of pro rata offers of securities not exceeding $5,000 for each existing security holder

In particular:

- the rules have been extended to apply to beneficial owners of securities in line with the Securities Act (NZX – Share and Unit Purchase Plans) Exemption Notice 2005;
- a new time limit of three months has been included for the placement of unsubscribed securities after the close of the original offer; and
- it is now up to the issuer (and not NZX as under the previous waiver regime) to decide whether to extend the offer to existing overseas security holders if the legal requirements of the overseas jurisdiction are too onerous for the issuer to extend the plan to that jurisdiction.

Pricing of equity securities

The rules governing the issue price limits for equity securities have been extended to cover the exercise prices of securities (such as options) that convert into voting securities.

Bell Gully's guide to the 2006 amendments to the NZX Listing Rules
If you would like a fuller analysis of the changes, Bell Gully has prepared a guide on the more substantive 2006 Listing Rule amendments. This guide is available online at *www.bellgully.com* or contact us for a printed version.

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or call her on 64 9 916 8825.

Recent Developments

Capital Markets

Securities Commission Oversight Review of NZX

Under the co-regulatory regime created by the Securities Markets Act, the Securities Commission has announced that it will conduct an oversight review of the NZX, following its earlier review of NZX after the collapse of Access Brokerage.

The review covers eight key areas of NZX's regulatory functions as a registered exchange but does not include NZX's general commercial functions. The Commission expects to publish a report on its review by 31 August 2006 and has indicated that this will become a regular review process of NZX.

The key areas of review to be undertaken by the Securities Commission are NZX's:

- supervision of market participants and enforcement of Participant Rules;
- supervision of listed issuers and enforcement of the Listing Rules;
- allocation of human, technological and financial resources as it affects performance of the regulatory functions of NZX;
- internal practices and procedures associated with investigations, price enquiries, complaints-handling and referrals;
- discipline practices, procedures and resources;
- arrangements for market infrastructure development and maintenance;
- Special Division practices, procedures and resources; and
- corporate governance arrangements.

Visit the Securities Commission website at *www.sec-com.govt.nz* for more details and a copy of the Terms of Reference for this review.

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Competition and Consumer Protection

Final report released on regulation of mobile termination rates

The Communications Minister has released the Commerce Commission's final recommendations on the regulation of mobile termination rates.

On 2 May 2006, Communications Minister David Cunliffe released a report prepared by the Commerce Commission recommending the regulation of charges for the cost of calling a mobile phone from a landline.

This is the second report prepared by the Commerce Commission on the regulation of mobile termination rates. Under the Telecommunications Act, the Minister may accept, reject, or require the Commission to reconsider the recommendation.

The Minister has invited written submissions on any new matters raised by the report that were not the subject of previous submissions to the Commission.

Visit the Commerce Commission website at *www.comcom.govt.nz* for a copy of the report.

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or call her on 64 9 916 8825.

Recent Developments

Competition and Consumer Protection

Local loop unbundling: the Government releases its Telecommunications Stocktkate Review Paper

The New Zealand Government announced on 3 May 2006 that it would unbundle Telecom's local loop. The Minister of Communications, David Cunliffe, said that legislation will be introduced shortly and expects it to be implemented by the beginning of 2007.

The Government had not planned to announce the results of its telecommunications "stocktake" review until the Government's Budget on 18 May, but was forced to do so after the paper was leaked to Telecom.

The local loop is widely regarded as a natural monopoly. While other providers do provide networks, these are limited to areas of concentrated demand in some areas of Auckland, Wellington and Christchurch.

Local loop unbundling means that telecommunications providers will be able to obtain access to Telecom's last mile network at forward-looking cost-based prices, relying on the provisions of the Telecommunications Act.

To view the Government's press release and for further details on its decision visit the Government's website at www.beehive.govt.nz**.**

The Securities Commission announced on 12 May that it was conducting an inquiry into whether the conduct and circumstances surrounding the release of the Telecommunications Stocktake Paper affected the transparent and orderly functioning of the securities markets.

To read an article titled "*Local loop unbundling: a further retreat from light handed regulation*" by David Blacktop, a Senior Solicitor at Bell Gully, visit Bell Gully's website at *www.bellgully.com.*

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Competition and Consumer Protection

A discussion paper released on New Zealand's consumer protection legislation

The Ministry of Consumer Affairs released an international comparison discussion paper in May 2006 on the Review of the Redress and Enforcement Provisions of Consumer Protection Law. The two key pieces of legislation under discussion are the Fair Trading Act and the Consumer Guarantees Act.

The Ministry of Consumer Affairs is undertaking a review of the redress and enforcement provisions of key consumer protection laws to assess how effective the enforcement of the Fair Trading Act 1986 (FTA) and the Consumer Guarantees Act 1993 (CGA) are in practice.

The paper compares the New Zealand legislation with consumer protection laws in similar jurisdictions including, Australia, the United Kingdom, Canada and the USA.

The areas that the Ministry considers may merit changes to the New Zealand legislation include:

- providing a prohibition for unfair terms in consumer contracts based on the Australian and United Kingdom practices;
- amending the FTA to allow unsafe products to be removed from sale during an investigation and providing the power to the Ministry to warn the public of the potential danger of those products;
- giving powers to the Commerce Commission to make cease and desist orders in order to prevent a trader continuing with alleged misconduct;
- allowing the Commerce Commission to issue substantiation notices to require a trader to substantiate any claim they make about a product or a service and thereby shift the onus of proof of claims on to the trader instead of the enforcement agency;
- providing for banning orders to prevent serious offenders from continuing to supply goods or services and prevent them from continually misleading or deceiving consumers;
- the introduction of court enforceable undertakings to be used if a trader contravenes the terms of a settlement with the Commerce Commission; and
- strengthening the Commerce Commission's interview powers to enable it to require a person to answer questions and give evidence with appropriate immunity provisions.

Submissions on the discussion paper close on 29 June 2006. To view the discussion paper visit the Ministry of Consumer Affairs' website at *www.consumeraffaiirs.govt.nz.*

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Competition and Consumer Protection

Government to review Parts 4 and 5 of Commerce Act

Commerce Minister Lianne Dalziel, announced on 22 May 2006 that the Ministry of Economic Development (MED) is to review Parts 4 and 5 of the Commerce Act.

The Commerce Act 1986 is designed to promote competition in markets for the long-term benefit of consumers within New Zealand. Where markets fail to deliver competitive outcomes and fail to operate efficiently, Parts 4 and 5 of the Commerce Act contain provisions providing for the control of the prices, revenues and quality standard of goods and services.

The effect of goods or services being controlled is that they have to be supplied in compliance with an authorisation made by (or undertaking accepted by) the Commerce Commission.

Lianne Dalziel has announced that MED will conduct a review of Parts 4 and 5 the Act later this year and interested parties will be provided with an opportunity to comment.

The review has yet to be formally scoped but is likely to include:

- consideration of the appropriateness and effectiveness of the current thresholds for control and decision making processes; and
- whether a "merits review" would add value to the decision making process.

Currently, decisions that relate to control of goods and services under Part 4 can be queried on matters of law only through Judicial Review.

To view the Commerce Minister's Press Release visit the government's website *www.beehive.govt.nz.*

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or call her on 64 9 916 8825.

Resources and Energy

Discussion paper released on investment in electricity generation

The Ministry of Economic Development has released a discussion paper looking at options to encourage electricity lines companies to make increased investment in generation. Options discussed in the paper include allowing lines companies to trade in electricity hedges, relaxing some arm's-length separation rules for lines companies involved in generation, and clarifying parts of the Electricity Industry Reform Act 1998 to help reduce uncertainties about how the legislation is applied in practice.

In March 2005, the Ministry of Economic Development (MED) released a discussion paper entitled *"Facilitating Investment in Generation by Lines Companies: A Discussion Note"* which drew a number of comments from market participants on possible options for minimising the effects of unnecessary barriers to lines companies' investment in generation.

The primary purpose of this discussion paper is to promote further discussion with the industry on the issues of lines and energy separation. The paper:

- sets out the current regulatory settings and the policy rationale underpinning those settings;
- outlines the perceived legislative barriers and options for addressing those;
- presents the MED's analysis and draws some conclusions.

A copy of the discussion paper can be downloaded from the Ministry of Economic Development website at *www.med.govt.nz*.

To read an article on this topic titled *"Issues highlighted in the MED consultation paper on "Investment in Electricity Generation by Lines Companies"* by Bell Gully Partner Garry Downs and Senior Solicitor Louise Hill, visit Bell Gully's website at *www.bellgully.com*.

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or call her on 64 9 916 8825.

Resources and Energy

Electricity Commission rejects Transpower's proposed Auckland 400kV grid investment proposal

On 27 April 2006, the Electricity Commission issued its draft decision on Transpower's grid upgrade proposal to construct a 400kV line linking Whakamaru and Otahuhu by 2010. In response, Transpower has indicated that it will submit a new modified proposal.

Transpower proposed the construction of a new 400kV double circuit line between Whakamaru and Otahuhu. This construction was proposed as the first step in accomplishing Transpower's long-term strategic vision for 400kV to replace 220kV as the core grid transmission voltage.

Transpower's proposal to construct the 400kV line is an "investment proposal", which was part of a grid upgrade plan submitted to the Electricity Commission for approval.

If the Commission approves the investment proposal, this allows Transpower to recover the approved costs of that investment from designated transmission customers in accordance with the transmission pricing methodology set out in section IV of Part F of the Electricity Governance Rules 2003 (Rules).

The Commission invited submissions on the proposal and its draft decision released on 27 April 2006 to turn down the proposal. However, on 1 June the Commission issued a further media release in response to a modified proposal to be put forward by Transpower which would involve building a 400kV line but only operating it at 220kV initially. The Commission has now suspended its official consideration of Transpower's original proposal but is still seeking comment until 23 June 2006 on:

- the four alternatives to Transpower's proposal that are set out in the Commission's draft decision;
- the idea raised in the draft decision on the possibility of Transpower acquiring a corridor through the Waikato to South Auckland in advance of the need for new transmission; and
- the Commission's draft decision on Transpower's proposal, including application of the Grid Investment Test.

The Commission stated that it will consult with Transpower over the timetable for its submission of any new grid proposal and has promised that it will consult the public and the electricity industry before making any decision on Transpower's new proposal.

For a copy of the consultation paper draft decision and more information on the 400kV draft decision visit the Electricity Commission's website *www.electricitycommission.govt.nz.*

To read an article on this topic titled *"Electricity Commission turns down Transpower's proposed 400kV Whakamaru – Otahuhu line to be installed by 2010: A review"* by Bell Gully Partner Garry Downs and Senior Solicitor Louise Hill, visit Bell Gully's website at *www.bellgully.com.*

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Intellectual Property

Copyright changes proposed in discussion paper

In March 2006, the Ministry of Economic Development released a discussion paper called "The Commissioning Rule, Contracts and Copyright Act 1994" as a starting point for submissions and possible legislation changes involving the application of the "commissioning rule" to copyright-protected works such as photographs, art pieces and computer programs.

Lawmakers have in their sights a very real opportunity to back the efforts of New Zealand technology innovators – and they should grab it.

The question over who should own first copyright of a computer program – its original creator or the person who has paid to have the program developed - has long been debated, legislated and litigated.

Commissioning rule and the discussion paper

New Zealand law currently applies what is known as the "commissioning rule" to copyright-protected works such as photographs, art pieces and computer programs. That is, where the works or programs are commissioned, the person commissioning them is the first owner of copyright, as opposed to the creator.

In March 2006, the Ministry of Economic Development released a discussion paper called The Commissioning Rule, Contracts and the Copyright Act 1994, as a starting point for submissions and possible legislation changes.

The paper reaches no firm conclusions but highlights issues that raise doubts over the rationale for the commissioning rule, particularly as it applies to business products such as commissioned software.

The doubts are well-founded. The commissioning rule should be abandoned when it comes to computer programs. But new measures should also be introduced to provide protection to software users who are dependent on third parties for ongoing software support – protection not currently offered under the Copyright Act.

How does the commissioning rule work?

Under the Copyright Act, the author will normally be the first owner of a copyright work unless the work is created in the course of employment, where the first owner will be the employer. There are a number of exceptions to the general rule – including the commissioning rule.

As highlighted earlier, this rule vests first ownership in the person who commissions and agrees to pay for the creation of copyright works. So if you commission a painting or sculpture, you are the first owner of the copyright as the person who commissioned that work, not the painter or the sculptor.

The rationale is that works such as paintings and sculptures are often commissioned for private businesses or homes and it is not right that the creators should be the first owners in these circumstances.

The same rationale cannot be so easily applied when a commercial organisation commissions another to develop a software program. As the discussion paper points out, in other countries the commissioning rule (to the extent it survives) is normally limited to photographs, portraits, sculptures, engravings and sometimes to films and sound recordings.

Added to this, the commissioning rule is not in fact compulsory. It can be reversed or modified by contract. This means that ownership of new computer programs remains a live and contentious issue when it comes to negotiating technology contracts.

The rationale for the commissioning rule

The argument most often used by a commissioning party as to why it should be first owner is "we are paying for it". If the commissioning rule is followed without qualification this means ownership of the copyright work by the customer from the point of its creation.

It also means that the original developer ceases to have any "interest" in the software once it is commissioned even though it is the software developer that is usually best placed to commercialise the product.

Special contractual arrangements can be made such as joint ownership of the new software or appointing the software company as the customer's licensed distributor.

But these arrangements raise a whole set of other issues, among them the sharing of future royalties. Understandably most customers are not keen to take this track.

An alternative to the commissioning rule

The obvious alternative is to abandon the commissioning rule and for the software company to assume copyright ownership of newly developed programs, while the customer holds a software licence.

This is not as bad as it may seem. Most of the benefits of ownership can be conferred by licence in any event – rights to access, to reproduce, to use and even to modify the software product.

The arrangement also gives the customer the opportunity to negotiate a discounted price – in return for giving up its statutory right to be first copyright owner.

But problems can arise over the nature and scope of these licence rights. Most suppliers are content to license access and use rights (for the purposes of the customer's business), but are not happy to allow the software to be reproduced or modified since they see this as a threat to future cash flows – money made from selling further licences or the sale of support services for the software once it has been developed, tested and is in production.

It is at this point that contract negotiations often get stalled – partly because the real issues are not about ownership at all but other things. Most customers don't look at software ownership as inherently valuable by itself but very often instead see it as a control mechanism to help users manage their risks.

Risks could include over-reliance on the original developer to help with later software adaptations (as the customer's IT environment evolves) and to provide ongoing support for the developed software over time.

The commissioning rule and computer programs

The commissioning rule as it applies to computer programs limits opportunities for software to be commercialised – and this is in contrary to the Government's declared aim of minimising regulatory barriers to innovation.

The rule also fails to minimise the wider costs to society of copyright protection. As already noted, the commissioning rule may be overridden by contract. Contract negotiations over software ownership can become more protracted as a result.

Also, the support costs for commissioned software may be higher in a statutory environment that gives little or no protection to the commissioning party or to licensed users where the developer goes out of business or withdraws support from the market.

The position in Australia

These kinds of protections are afforded to owners and licensed users in Australia. Australia's copyright legislation was amended in 1999 with the introduction of a set of "statutory licences" which authorise the reproduction of licensed software to allow for the retention of a back up copy.

There is a New Zealand equivalent statutory provision already - section 80 of the Copyright Act 1994. However this statutory licence can be overridden by contract in contrast to the Australian position.

The Australian amendments also allow adaptations of licensed software to enable it to inter-operate with other computer programs and for the purpose of correcting errors (including the correction of security flaws).

These statutory licences apply notwithstanding any conflicting contractual term. This means that the parties need not waste time in contract negotiations litigating issues concerning ownership or extended licence terms.

For their part, suppliers should not fear being "ripped off" by any misuse of these statutory licences. The rights to modify and reproduce conferred by the statutory provisions are tightly circumscribed by use and purpose limitations.

In addition any adaptation of licensed software without consent has statutory sanction only where the information needed to build the relevant interface or to resolve a security flaw is not readily available from another source.

Conclusion

Introducing these kinds of reforms, together with abandoning the commissioning rule, will go some way to establishing a better balance between the interests of New Zealand's technology sector in its drive to commercialise new software products - and the interests of the software end users whose self-help efforts should not be thwarted by an overly restrictive copyright regime.

The discussion paper is available on the Ministry of Economic Development website at *www.med.govt.nz*.

This commentary is by Bell Gully Partner, Stephen Revill and was first published in The Business, New Zealand Herald, *1 May* 2006. Stephen specialises in information technology and intellectual property law.

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Intellectual Property

Trade mark compliance costs under discussion

The Government issued a discussion paper in March 2006 on International Trade Mark Treaties addressing the issue of whether New Zealand should join a number of international trade mark treaties administered by the World Intellectual Property Organization.

The Treaties considered in the discussion paper are:

- the Nice Agreement Concerning the International Classification of Goods and Services for the Purposes of the Registration of Marks;
- the Trademark Law Treaty; and
- the Madrid Protocol Relating to the Madrid Agreement.

The paper also included a general review of the provisions under sections 83 to 87 of the Trade Marks Act 2002 for registering a person as a licensee of a registered trade mark; and considers the validity of a provision under section 81 that allows for a request to be made to the Commissioner of Trade Marks to certify whether an assignment of a trade mark registration would be likely to deceive or confuse.

The closing date for submissions on the paper was 24 April.

A copy of the discussion paper can be downloaded from the Ministry of Economic Development website at *www.med.govt.nz.*

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Intellectual Property

Panel to resolve domain name disputes

In March 2006, the New Zealand Domain Name Commissioner announced that an expert panel had been appointed to resolve disputes over .nz domain name registrations. The new system will be available from the date of implementation on 1 June 2006

Eight people, including three former High Court judges, have been appointed to the Expert Panel which will, from 1 June, determine disputes over .nz domain name registrations. The panel members are:

- Hon Andrew Brown QC (as Chair)
- Hon Sir Ian Barker QC
- Clive Elliott
- Hon Robert Fisher QC
- Hon Barry Paterson QC
- Warwick Smith
- Terence Stapleton
- Dr Clive Trotman

The current lack of a resolution process means complainants must either negotiate directly with the holder of a disputed domain name or take the dispute to the High Court. Under the new system, the first step will be an informal mediation.

If parties to arguments over a .nz domain name cannot agree, the complainant can apply to an Expert for a determination. After the Expert's decision is released, both parties are offered an opportunity to lodge an appeal to be heard by the Panel chair and two other Experts.

For further details of the new dispute system, visit the Domain Name Commission's website at *http://dnc.org.nz.*

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or call her on 64 9 916 8825.

Bell Gully news

Epidemic Preparedness Law introduced
Parliament has introduced the Law Reform (Epidemic Preparedness) Bill. If passed, it will introduce some sweeping changes to various pieces of New Zealand law - all intended to allow for appropriate steps to be taken in the event of a pandemic (particularly an avian influenza outbreak - but also applicable to other situations caused by things such as cholera, plague or yellow fever).

Bell Gully named New Zealand Law Firm of the Year
Bell Gully has been named *IFLR* New Zealand National Law Firm of the Year for the third consecutive year. It is the fourth time in five years that the firm has received the prestigious award from respected global legal publisher *International Financial Law Review*. The annual *IFLR* awards recognise the leading legal advisers in international corporate and financial transactions over the past year.

Bell Gully named New Zealand's *Who's Who Legal* Firm of the Year
Bell Gully has been named the *Who's Who Legal* Law Firm of the Year for New Zealand in the 2006 Who's Who Legal Awards. Based on nominations received from clients and other practitioners, *Who's Who Legal* has identified pre-eminent firms in 47 countries to receive their country's award. *Who's Who* managing editor Callum Campbell says: " This is the first time we have singled out an individual firm nationally for such an honour, and Bell Gully can truly be said to be New Zealand's leading firm."

To read these articles in full, visit: *www.bellgully.com*.

Useful Web Links

New Zealand government

- Inland Revenue Department [www.ird.govt.nz]
- Ministry of Economic Development [www.med.govt.nz]
- Ministry of Foreign Affairs and Trade [www.mfat.govt.nz]
- Ministry of Labour [www.dol.govt.nz]
- New Zealand Government [www.govt.nz]
- NZ Government E-Commerce Information [www.ecommerce.govt.nz]
- NZ Treasury [www.treasury.govt.nz]
- New Zealand Trade and Enterprise [www.nzte.govt.nz]
- Office of the Clerk of the House of Representatives [www.clerk.parliament.govt.nz]
- Parliamentary Counsel Office [www.pco.parliament.govt.nz]
- Statistics New Zealand [www.stats.govt.nz]

New Zealand regulatory agencies and organisations

- Commerce Commission [www.comcom.govt.nz]
- The Companies Office [www.companies.govt.nz]
- NZ Law Commission [www.lawcom.govt.nz]
- Office of the Ombudsmen [www.ombudsmen.govt.nz]
- Securities Commission [www.sec-com.govt.nz]
- Takeovers Panel [www.takeovers.govt.nz]
- NZ Stock Exchange [www.nzx.com]

New Zealand commercial sites

- CLANZ [www.clanz.org]
- Institute of Chartered Accountants [www.icanz.co.nz]
- Institute of Directors in New Zealand [www.iod.govt.nz]
- NZ Bankers' Association [www.nzba.org.nz]
- NZ Business Roundtable [www.nzbr.org.nz]
- NZ Institute of Economic Research [www.nzier.org.nz]

Australian sites

- Australian Financial Markets Association [www.afma.com.au]
- Australian Securities and Investment Commission [www.asic.gov.au]
- Australian Stock Exchange [www.asx.com.au]

International sites

- NASDAQ [www.nasdaq.com]
- New York Stock Exchange [www.nyse.com]
- United States Securities and Exchange Commission [www.sec.gov]

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