

SPRING 2006

Bell Gully





Welcome to the Spring 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 about every three weeks. *Regulator Report* is available online at <http://www.bellgully.com/resources/index.asp>

**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](mailto:diane.graham@bellgully.com) or call her on 64 9 916 8849.

## In the courts

### **Takeovers Panel seeks leave to be heard in an amalgamation proposal**

In the first case since the Takeovers Panel signalled its change in attitude to schemes of arrangements and amalgamations involving code companies, the Court of Appeal expresses its preliminary views on the Panel's right to be heard.

### **High Court awards penalties for NZ Bus merger**

In September, the High Court issued its first penalty decision for a breach of the business acquisition provisions (section 47) of the Commerce Act. For this reason alone the decision is important, however, it also provides some practical guidance because it is one of the rare occasions under the Commerce Act where the parties have not agreed on a penalty and then simply sought to have that endorsed by the court.

### **A fiduciary relationship can exist between parties without a finally concluded joint venture agreement**

The Supreme Court has upheld a decision determining that an informal commercial relationship between property developers gave rise to fiduciary obligations but differed from the Court of Appeal on how the party should be compensated for breaching those obligations.

### **Commerce Commission continues active pursuit of breaches of the Fair Trading Act**

The Commission has been busy this quarter with a further run of high profile wins and out-of-court settlements from companies found to have breached the required standards of consumer law.

### **In brief**

A brief update on cases reported in recent issues of the *Commercial Quarterly*.

## In the courts

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#### Background

In May this year the Takeovers Panel indicated that pending review of the Companies Act to "*incorporate the principles of the Takeovers Code*", it would seek to be heard by the High Court in cases of proposed schemes of arrangement involving code companies.

This case<sup>1</sup> involved a proposed scheme of amalgamation of three property investment companies (all members of the same group) under Part 15 of the Companies Act 1993 (the Act). Under the proposal, Property Fund Thirty-One Ltd and Dominion Newmarket Properties Ltd are to become amalgamated in Dominion Income Property Fund Ltd (Dominion). Dominion will own all the properties presently owned by the other amalgamating companies and the investors in those companies will become owners of shares and debentures in Dominion.

Initial orders were granted by the High Court on the application of the amalgamating companies setting out the approval steps required for the amalgamation to proceed. These included an order requiring a special resolution (by a postal vote) of the shareholders in each company. A further order stated that there would be no need for a quorum of shareholders for the voting on the special resolutions (Order 6).

On being notified of the proposed amalgamation, the Panel filed an application with the High Court for a variation of the approval mechanisms proposed by the court. In particular the Panel requested that the initial orders be amended to require the special resolutions to be approved by those shareholders entitled to vote representing a majority of the total voting rights of each of the amalgamating companies. The Panel said it was concerned that under the agreed mechanisms the amalgamations could potentially be approved by a very small number of shareholders in each company. It also asked to be notified of the results of the voting so that it could apply for leave to be heard on the application for the final approval.

The High Court granted both orders requested by the Panel but the amalgamating companies challenged these orders on appeal to the Court of Appeal on the basis that:

- the amalgamation is not a takeover for the purposes of the Takeovers Code;
- practice in relation to the amalgamation proposals under the Act has generally been along the lines originally proposed by the High Court including the no quorum requirement;
- the Panel did not have a legitimate interest in the proposed amalgamation to participate in the hearing under section 236(2) of the Act and further that it could not intervene at the initial order phase. In addition it was submitted that the Panel's participation in the hearing was beyond its powers under the Takeovers Act.

#### Court of Appeal decision

The Court of Appeal allowed the appeal and reinstated the initial High Court orders (subject to some necessary amendments to the original dates). However, it retained the additional order granted by the High Court requiring the Panel to be notified of the outcome of the shareholder votes so that it can be heard on the application for final approval (subject to the new requirement that the Panel now only has two working days to give notice that it wishes to be heard).

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<sup>1</sup> *Dominion Income Property Fund Limited and Ors v Takeovers Panel* (Unreported, 26 October 2006, Court of Appeal CA229/06)

### **Was the amalgamation a takeover?**

The Court of Appeal acknowledged that the amalgamation proposal did not come under the Takeovers Code since it did not involve the acquisition by any person or group of associated persons of more than 20% of the voting rights of the code companies involved.

The argument put forward by the Panel that the amalgamation *"would produce an effect which is economically the same (or practically the same)"* as a takeover under the Code was not regarded by the court as a *"controlling consideration"*. The court noted that *"the law generally does not yet equate form and substance"*. It also noted that in practical terms Dominion would be controlled by the same group of shareholders that currently control the other amalgamating companies.

However no definitive ruling was given on whether the amalgamation was a "takeover" for the purposes of the Takeovers Act due to the time pressure under which the decision was given and the fact that they did not see it as critical in the context of the case as a whole. The court did note that it was inclined to agree that the amalgamation was not a takeover.

### **Was the initial approval mechanism appropriate?**

The court considered that the arguments for and against the initial approval mechanism were closely balanced but decided in favour of reinstating the initial orders for the following reasons:

- not requiring a quorum is consistent with powers given to the court under section 236(2)(b) of the Act. This section does not refer to approval by an absolute percentage of shareholders, instead it vests a discretion in those who are present and vote at a meeting (personally and by proxy) or, as in this case, by analogy to those shareholders exercising their right to vote by post;
- the Panel's threshold requirements for each of the amalgamating companies were likely to be difficult to achieve in practice based on evidence provided of shareholder voting figures on similar proposals in the past (including earlier schemes promoted by the Dominion Group). This could mean that the amalgamation could be approved by an overwhelming majority of those who vote but not be passed because of a failure to meet the majority voting threshold requirement. The Panel's suggestion that in such circumstances the amalgamation could still be approved by the court would be contrary to the scheme of section 236;
- there was no basis on the evidence presented for departing from the usual practice, including the usual practice previously adopted for similar amalgamations within the Dominion Group. The court observed that the proposed amalgamation appeared to be a very orthodox amalgamation and not a device to avoid the Takeovers Code.

### **Did the Panel have standing?**

The Court of Appeal made no definitive ruling on the question of whether the Panel had the right to be heard on the amalgamation proposal given that the appeal was allowed on its merits. However the Court did express the view that it was *"at least well arguable that the Panel did have standing"*. It noted that *"given that Part 13 and Part 15 amalgamations... may engage the Takeovers Code and are sometimes used as devices to avoid the Code, we are inclined to think that the proposed amalgamation was legitimately a matter of interest to the Panel under section 8 of the Takeovers Act."*

On the basis of this legitimate interest the court noted that it was also inclined to think that it was open to the High Court to treat the Panel as "interested" for the purposes of section 236(2) of the Act.

### **Was the Panel acting beyond its powers?**

Again, the court declined to express a definitive view on this point but it did note that it *"tentatively"* thought the Panel's participation in the hearing was within its powers.

### **Did the Panel have the right to intervene at the initial order phase?**

On this point, the Court of Appeal considered that there was no procedural objection to the High Court reviewing and supplementing the initial orders. It considers that section 236(2) of the Act contemplates further orders and implies a power to revise orders since it permits an initial order to be made at the instance of "interested parties." There was no need to use the High Court Rules (as in this case) to authorise new or amended orders.

For an update on the Takeovers Panel's proposals to remove schemes and amalgamations from the Takeovers Code and instead include the principles of the Code in Parts 13 and 15 of the Companies Act 1993 see the section on **Recent Developments** in this issue of *Commercial Quarterly*.

Also note that in the Takeovers Panel's press release on this case it notes that "***Any code companies contemplating entering into schemes of arrangement are encouraged to discuss their intentions with the Panel at an early date.***" To view a copy of this release visit the Takeovers Panel's website at <http://www.takeovers.govt.nz/new/releases/2006/071106.htm>.

## In the courts

### High Court awards penalties for NZ Bus merger

*In September, the High Court issued its first penalty decision for a breach of the business acquisition provisions (section 47) of the Commerce Act. For this reason alone the decision is important, however, it also provides some practical guidance because it is one of the rare occasions under the Commerce Act where the parties have not agreed on a penalty and then simply sought to have that endorsed by the court.*

In June the High Court<sup>2</sup> found New Zealand Bus Limited (NZ Bus) guilty of breaching the Commerce Act in acquiring the 75% of Mana Coach Services Limited it did not already own from two private shareholders. The court also found that the vendors were guilty of breaching the Commerce Act. In a further judgment<sup>3</sup> released in October the High Court issued its decision on penalty.

The court:

- fined NZ Bus \$500,000; and
- ordered NZ Bus to pay approximately \$600,000 in costs to the Commission;
- but did not impose a financial penalty on the vendors.

#### Starting point for penalty: commercial gain

The court affirmed that the purpose of a pecuniary penalty is to deter a rational party from engaging in the conduct ex-ante. That is the commercial gain of the action should be cancelled out by the penalty.

The court concluded that NZ Bus's commercial gain from the acquisition would have been about \$2 million. However, the court was not satisfied that the vendors would receive any commercial gain from the sale of their assets over and above a commercial selling price. For that reason, it did not impose a pecuniary penalty on the vendors.

Counsel for the Commission argued because the probability of detection and enforcement action was less than 100%, the starting commercial gain should be inflated. This was because a rational business would weigh up the potential that the acquisition would "fly under the radar". While the court did not rule out this possibility entirely, it did not consider the NZ Bus case warranted such an increase.

#### Other relevant factors

From the \$2 million starting point, the court cited other factors relevant in assessing an appropriate pecuniary penalty under the Commerce Act:

- New Zealand's voluntary merger clearance regime means it is not a mitigating factor if an acquirer proceeded believing reasonably but wrongly that the acquisition would not breach the Act. It follows that favourable legal advice does not amount to a mitigating factor; the court describing it rather as "*absence of an aggravating factor*".
- There is potential for over-deterrence particularly because an active business acquisition market is desirable.
- Because detection and enforcement is difficult and costly, where an acquirer takes a gamble its acquisition would remain undetected or the Commission would lack resources to enforce the law, there might be reason to increase the penalty.

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<sup>2</sup> Commerce Commission v New Zealand Bus Limited and Ors (Unreported, High Court, Wellington, 29 June 2006)

<sup>3</sup> Commerce Commission v New Zealand Bus Limited and Ors (Unreported, High Court, Wellington, 29 September 2006)

## **NZ Bus' penalty**

While the court concluded NZ Bus's expected commercial gain would be about \$2 million, it ordered NZ Bus to pay a fine of only 25% of that amount (\$500,000) because:

- no third party had suffered loss;
- NZ Bus had a previous good record;
- there was some public stigma associated with a finding of breach; and
- the Commission had contributed to NZ Bus' decision to withdraw its clearance application and proceed without clearance, therefore, contributing to the breach.

## **Relationship of pecuniary penalty and costs**

The court held the issues of pecuniary penalty and costs should be treated (and calculated) separately. It noted that a penalty represents the harm done to consumers and is designed to deter a contravention; while an award of costs is designed to compensate for the social costs of enforcing the Act. The court ordered NZ Bus to pay approximately \$600,000 to the Commission in costs – this included full recovery by the Commission of its experts' costs.

## **Implications for acquirers**

While legal advice is not seen by the courts as a mitigating factor when setting a penalty, the approach of the court in using commercial gain as a starting point does highlight the need for acquirers to be fully aware of the competition law issues inherent in any business acquisition proposal. The NZ\$2 million would have represented 10% of the annual turnover of the combined company in the affected market – a substantial number by any standards. In a larger market, the appropriate starting point could be much higher and accordingly, any penalty award much greater.

## **Need more information?**

For more information on this case, please contact one of our competition law team:

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## In the courts

### A fiduciary relationship can exist between parties without a finally concluded joint venture agreement

*The Supreme Court has upheld a decision determining that an informal commercial relationship between property developers gave rise to fiduciary obligations but differed on how the party should be compensated for breaching those obligations.*

#### Background

The case<sup>4</sup> involved two parties (the joint venture parties) agreeing in 1996 to work together as property developers. A development was completed with a third party under the arrangement. An opportunity then arose in 1997 with a Dunedin property. The joint venture parties began to discuss the opportunity in detail and gave extensive consideration to the development late in 1998.

In July 2000, following approaches by one and then both of the joint venture parties, a tenant was secured. In the period between those approaches and the securing of the tenant, one of the joint venture parties had decided to exclude the other in favour of involving other investors in the project. That party confirmed its agreement with the tenant and completed the project.

As a result, the excluded party (Mr Fay) brought proceedings against the other joint venture party (Mr Chirnside) claiming, among other things, that their commercial relationship was a joint venture relationship giving rise to fiduciary obligations. This claim became the central focus of the case.

In the High Court, it was decided that a fiduciary relationship had existed during the relevant period and that the contracting party had therefore wrongfully excluded the other party from the project, resulting in the excluded party being entitled to \$495,000 in damages. This was calculated on the basis of half of the net value of the realised development (\$1,290,000), representing equitable compensation or damages assessed by analogy with disgorgement of profits, less a deduction of an allowance (\$300,000) for the *“substantially disproportionate contribution to the project which Mr Chirnside made”* prior to July 2000.

The Court of Appeal<sup>5</sup> upheld the High Court’s finding that a fiduciary relationship existed, noting that where there was a commercial joint enterprise in respect of which a joint venture agreement had not yet been entered into did not rule out a claim that a fiduciary relationship existed.

The court determined that a duty of loyalty existed between the joint venture parties with the result that *“there could be no presumptive hijacking”* of the transaction and that the relationship could not be discontinued without good faith efforts to reach agreement. However, the Court of Appeal substituted the High Court’s damages award<sup>6</sup> for a smaller amount of \$287,500 calculated on the basis of a “loss of chance” of participating in a profitable venture. In setting this amount the court also reduced the allowance deducted by the High Court for Mr Chirnside’s contribution to the development (which they considered to be overly generous) to \$100,000.

The findings that the joint venture between the parties was underway was not challenged in the Supreme Court but Mr Chirnside appealed against the determinations that he owed fiduciary duties to Mr Fay. Both joint venture parties appealed the damages awarded to Mr Fay.

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<sup>4</sup> *Chirnside v Fay* [2006] NZSC 68

<sup>5</sup> *Chirnside v Fay* [2004] 3NZLR 637

<sup>6</sup> *Chirnside v Fay (No 2)* [2005] 3 NZLR 689 (as to relief)

## Supreme Court's Decision

### *Fiduciary obligations*

The Supreme Court unanimously rejected Mr Chirnside's contention that since he had not undertaken or agreed to act for or on behalf of Mr Fay's interests the parties were not in a position of mutual trust and confidence which would give rise to fiduciary obligations.

The Chief Justice stated that *"where parties join together in a venture with a view to sharing the profit obtained, their relationship is inherently fiduciary within the scope of the venture while it continues"*. The fact that the parties haven't formalised their relationship through a corporate structure or agreement *"does not alter the character of the relationship already established and underway"*.

Justice Tipping (with whom Justice Blanchard agreed) noted that it was clear that it was not necessary for there to be an express undertaking or agreement to act in the interests of another before a fiduciary duty can arise. On the facts of this case they noted that:

- the parties were working together towards a common goal which they expected would be for their mutual benefit;
- there was no finding of a partnership on the facts but their relationship was analogous to that of a partnership;
- from the time the parties agreed to work together on the Dunedin property they could be regarded as having entered a joint venture;
- the fact that the parties had not thought it necessary to enter into a detailed formal agreement before embarking on their joint venture suggested that each was reposing trust and confidence in the other as they had in an earlier venture.

On the nature of joint ventures, Justice Tipping made the following general observations:

*"A joint venture will come into being once the parties have proceeded to the point where, pursuant to their arrangement or understanding, they are depending on each other to make progress towards the common objective. Each party is then proceeding on the basis that he or she is acting in the interests of all or both parties in the arrangement or understanding. A relationship of trust and confidence thereby arises; each party is entitled to expect from the others loyalty to the joint cause, loose as the formalities of the joint venture may still be."*

### *Damages*

The Supreme Court was also unanimous that the Court of Appeal had erred in the approach it took in calculating the monetary relief to which Mr Fay was entitled. They considered that the Court of Appeal's "loss of chance" approach was inconsistent with a finding that the parties were joint venturers. The loss of chance approach involves discounting for contingencies and on the facts there were no relevant contingencies. No element of chance came into the issue of the existence of a joint venture and the joint venture had already demonstrated its profitability.

The court agreed that the appropriate remedy for breach of fiduciary duties is disgorgement of the profit through an account. The Chief Justice did not however agree with the other members of the court on the question of the allowance deducted from the relief granted. In her opinion, granting Mr Chirnside an allowance simply for fulfilling the role expected of him within the scope of the joint venture was inconsistent with the "no-profit" rule and did not fit within any of the recognised exceptions.

After considering relevant authorities and recognised texts on this point, the majority of the court held that the High Court had been entitled to make an allowance for the disproportionate contribution Mr Chirnside had made to the joint venture. They noted that an appeal on this aspect was not open to an *"absolutely right or wrong answer"* and in relying on the approach in *Estate Realities*<sup>7</sup> and *Warren International*<sup>8</sup> the High Court had not erred in principle. However they considered that the allowance fixed by the High Court was not calculated on a basis which appropriately recognised the need for restraint in the amount fixed.

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<sup>7</sup> *Estate Realities Ltd v Wignall* [1992] 2 NZLR 615

<sup>8</sup> *Warman international Ltd v Dwyer* (1995) 182 CLR 544

Justice Tipping noted, "*In the same way as the court should be cautious and not make an allowance to an errant fiduciary unless a clear case for doing so is made out, so to should the court generally be restrained in the amount awarded.*" The court therefore reduced the hourly amount fixed by the High Court but retained the number of hours it had attributed to the disproportionate amount of work carried out by Mr Chirnside and arrived at a new allowance of \$200,000.

On the question of how the profits were to be calculated, this required an assessment of the rental stream to be derived from the Dunedin property. The court found it necessary to re-examine the evidence presented to the High Court over an area of vacant space that remained in the complex. The court determined that it had not been appropriate for the trial judge to assess the rental stream for the vacant space on the basis that usage would be for storage only and accordingly revised this figure upwards.

After deducting the revised allowance (\$200,000) from the adjusted net gain for the project (\$1.9 million), Mr Chirnside's entitlement to half the net value of the joint venture project was increased to \$850,000.

### **Practical implications**

- This case serves as a reminder that in any business venture between parties it is never too early to consider putting a formal contractual agreement in place. Once the relationship has advanced beyond preliminary discussions of possibilities and work has begun on implementing the venture, it is likely that the parties will be subject to a duty to the other not to act against their joint interest in the venture.
- Even in the absence of formal contractual arrangements, where there is a breakdown in the relationship of the parties to a joint venture or one party wishes to proceed without the other, it will usually require appropriate arrangements to be made in consideration of the severance of the joint interests and the release of the parties from their duties of loyalty to each other.
- The consequences of not dealing with another joint venture party appropriately can be substantial. A finding that a party is in breach of a fiduciary obligation to the other party will entitle the party to account for any profits made as a result of the breach (subject to being able to retain profits which the party is entitled on his or her own account and, in appropriate circumstances, less any allowance that may be given for additional contributions made by the other party).

## In the courts

### Commerce Commission continues active pursuit of breaches of the Fair Trading Act

*The Commerce Commission has been busy this quarter with a further run of high profile wins and out-of-court settlements from companies found to have breached the required standards of consumer law.*

The Commerce Commission has been criticised in the past for lacking “teeth” in its enforcement of competition and consumer protection laws. Clearly, this label has passed its used-by-date. In addition to the Commission’s recent record penalties in cartel cases (reported in previous issues of *Commercial Quarterly*), it has also been successful in achieving high fines and payouts in a series of actions brought under the Fair Trading Act 1986 (FTA). In October:

- Electricity retailer Energy Online was found in breach of the FTA for misleading potential customers over a “price freeze” advertising campaign<sup>9</sup>. In the campaign customers were told that the “energy portion” of their electricity bills would not be increased over a specified period. However, Energy Online did pass on increases to its customers for electricity distribution and its own overheads during the specified period. The District Court agreed with the Commission that the overall impression of the price freeze offer was that prices would not go up at all. Energy Online was fined \$140,000 and over \$800,000 is to be refunded to its customers in compensation.
- Qantas pleaded guilty (and was fined \$380,000) for breaches of the FTA over air travel advertisements from September 2001 to 2002<sup>10</sup>. The Commerce Commission maintained that in each advertisement Qantas had made a false or misleading representation about the price of travel by either:
  - not disclosing extra charges; or by
  - using extra charges to cover items that should have been treated as normal operating costs and included in the headline price.
- In the largest out-of-court settlement under the FTA, Telecom has agreed to return approximately \$3.3 million to its customers. Telecom accepts that it was in breach of the Act in so far as customers were being charged under both their old call plans and their new call plans on the day the plans were being swapped over.
- Carter Holt Harvey pleaded guilty to breaching the FTA by selling timber that did not meet the grade claimed on the packaging between July 2000 and November 2003<sup>11</sup>. The company was fined \$900,000.
- Following on from the Commission’s previous successful cases against the BNZ and ANZ National Bank, Westpac is the latest bank to plead guilty to breaches of the FTA for failing to disclose fees charged for overseas currency transactions on its credit and debit cards<sup>12</sup>. Westpac was fined \$570,000 by the District Court and has agreed to pay \$4.5 million in compensation to its customers who made foreign currency transactions on their cards.

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<sup>9</sup> *Commerce Commission v Energy On Line Ltd (Unreported, 16 October, 2006, Napier District Court)*

<sup>10</sup> *Commerce Commission v Qantas (Unreported, 10 October 2006, Auckland District Court)*

<sup>11</sup> *Commerce Commission v Carter Holt Harvey Ltd (Unreported, 12 October 2006, Auckland District Court)*

<sup>12</sup> *Commerce Commission v Westpac Banking Corporation Ltd (Unreported, 29 September 2006, Auckland District Court, CRN – 5004500677-782)*

## In the courts

### In brief

*A brief update on cases reported in recent issues of the Commercial Quarterly.*

#### **Debate over adequate notice for termination of a long-term joint venture**

On 2 June 2006, the Supreme Court granted leave to appeal the Court of Appeal's decision in *Paper Reclaim v Aotearoa*<sup>13</sup>. The case involves a dispute between two parties in a joint venture in the wastepaper and recycling industry. The relationship existed for nearly 20 years before falling apart in 2001. One of the issues in the case was to determine what length of notice would have been reasonable to terminate a joint venture of this length. The appeal is on the following grounds:

- whether the Court of Appeal erred in its approach to damages to be awarded to *Aotearoa*; and
- whether the Court of Appeal erred in fixing the length of the required notice at 12 months.

There are also two other issues on appeal relating to whether there was a fiduciary cause of action available to *Aotearoa* and on the issue of costs.

The date for the Supreme Court hearing on these issues has been set for 6 March 2007. *Commercial Quarterly* will keep you informed of further developments.

#### **Directors' contributions to creditors for failing to act in the best interests of the company**

In the Winter 2006 *Commercial Quarterly* we noted the case of *Sojourner and Anor v Robb*<sup>14</sup>. Two creditors had sought contributions from a company's directors on the basis that by "hiving down" the assets of the company they were in breach of their section 131 duty, namely to act in good faith and in the best interests of the company. The court found in favour of the creditors but had requested the parties to provide further details on the number, identity and amounts of other unsecured creditors before it finalised the relief. On 5 October 2006<sup>15</sup>, the court confirmed that other disappointed creditors could recover on the basis of the judgment regardless of whether they had already proved in the liquidation. The court directed the liquidator to notify such creditors of the judgment so they could decide whether or not they wanted to prove.

#### **Wood chemicals cartel**

In the 2006 Autumn *Commercial Quarterly* we reported on the record penalties awarded in the *Commerce Commission v Koppers Arch*<sup>16</sup> case for cartel behaviour in the wood preservative chemicals industry between 1998 and 2002. In October the Commerce Commission had a further round of successes against other participants in the cartel. Osmose New Zealand and Osmose Australia were fined a total of \$1.8 million and two Australian-based executives have been fined \$100,000 and \$20,000 respectively. The Commission is pursuing proceedings against seven further corporate and individual defendants.<sup>17</sup>

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<sup>13</sup> *Paper Reclaim Ltd v Aotearoa International Ltd* (Unreported, CA 70/04, 14/3/2006)

<sup>14</sup> *Sojourner and Anor v Robb* (Unreported, HC Christchurch, CIV 2004-476-000568, 4 July 2006)

<sup>15</sup> *Sojourner v Robb* (Unreported, HC Christchurch, CIV 2004-476-000568, 5 October 2006)

<sup>16</sup> *Commerce Commission v Koppers Arch Wood Protection (NZ) Limited and Ors* (Unreported, High Court, Auckland, 6 April 2006, CIV2005-404-2080)

<sup>17</sup> For further information on these cases visit the Commerce Commission's website at [www.comcom.govt.nz](http://www.comcom.govt.nz)

## In the journals

### **Insider Trading Reform**

One of the more controversial changes to the securities law landscape is the new insider trading regime introduced in the latest round of the Government's securities law reform programme. In this article, Roger Partridge looks at the key changes to insider trading and provides some background to the new provisions, together with a discussion on some outstanding issues.

### **Information trading in Australia and New Zealand: Information that is "generally available"**

New Zealand's new insider trading regime is largely based on Australia's insider trading provisions and includes the adoption of the term "generally available" as part of the test to determine whether information constitutes "inside information". In this article the authors background how the Australian courts have addressed the term "generally available" and explore how it is likely to be interpreted in New Zealand.

### **Mind the gap: director indemnified for costs of own action**

A recent New South Wales Supreme Court decision has highlighted potential gaps in Directors' and Officers' Liability insurance policies. This article looks at the case and discusses the potential ramifications for companies, their insurers and their shareholders.

### **Evaluating New Zealand's Evolving Corporate Governance Regime in a Comparative Context**

This article provides an interesting account of the relevance of New Zealand's emerging corporate governance regulatory regime. The author explores the possibility that it may not be necessary for New Zealand to wholeheartedly embrace the increasingly complex corporate governance principles being adopted in other jurisdictions. To do so may, rather than encourage the development of our securities markets, lead to more New Zealand companies seeking funding from private equity sources.

### **Of Arsenic, Antitrust and Agreed penalties for Price Fixing**

In the wake of the recent wood chemicals cartel cases where record penalties have been awarded for price fixing, Chris Noonan reviews the basis on which penalties for price fixing are calculated and finds that a more principled approach is required if deterrence is to be the primary outcome.

### **Personal Liability of Directors under the Fair Trading Act**

Following a recent Court of Appeal decision, the authors of this article question the appropriateness of the basis for establishing a director's statutory liability for breaches of the Fair Trading Act over conduct engaged on behalf of a company.

### **Parallel importing and trade marks**

The 2003 amendment to the Trade Marks Act 2002 was to ensure that registered trade marks could not be used to prevent parallel importing. In this article Alexandra Sims discusses how a recent court's narrow interpretation of the new provisions may frustrate the Government's parallel importing policy.

## In the journals

### Insider Trading Reform

**Roger Partridge, The New Zealand Law Journal, September 2006 p.311**

*One of the more controversial changes to the securities law landscape is the new insider trading regime introduced in the latest round of the Government's securities law reform programme. In this article, Roger Partridge looks at the key changes to insider trading and provides some background to the new provisions, together with a discussion on some outstanding issues.*

The new insider trading regime represents an important philosophical shift in approach to insider trading in New Zealand. The focus is now directed at the threat insider trading will have on market integrity in New Zealand and, as the author notes, the new insider trading provisions extend potential liability to a much wider group.

This article addresses each of the elements of insider trading in some detail with particular attention to the meaning of and issues surrounding the terms "material information" and "generally available to the market".

The author also provides details and commentary on some issues arising from the exceptions and defence provisions which remained after the Bill emerged from the select committee. Of particular note are the issues surrounding the "knowledge of own intentions" and "takeovers" exceptions which if not addressed in the Supplementary Order Paper would have precluded a range of normal commercial transactions.

Another key change to the insider trading regime is the wider enforcement provisions and remedies, including the introduction of criminal liability. In the article, Roger Partridge outlines the new provisions and provides a detailed discussion on some of the more unusual provisions relating to the conduct of proceedings under the legislation.

The author is sceptical about the effectiveness of the new regime. He notes in particular that New Zealand has ended up with insider trading provisions that are more complex than those they replace and are likely to be equally difficult to enforce.

Roger Partridge is a partner in Bell Gully, leading the firm's litigation practice.

Since this article was first published the Securities Legislation Bill has been passed (in the form of four separate Acts). However the new insider trading regime will not take effect until the insider trading regulations have been finalised.

An updated copy of this article is available on Bell Gully's website  
[http://www.bellgully.com/resources/resource\\_00687.asp](http://www.bellgully.com/resources/resource_00687.asp)

For an overview of all of the changes made by the Securities Legislation Bill see the **Legislation/In Parliament** section of this issue of *Commercial Quarterly*.

## In the journals

### Information trading in Australia and New Zealand: Information that is “generally available”

**Keith Kendall and Gordon Walker, *Company and Securities Law Journal*, Vol 24, September 2006, p.343**

*New Zealand's new insider trading regime is based largely on Australia's insider trading provisions and includes the adoption of the term “generally available” in place of “publicly available” as part of the test to determine whether information constitutes “inside information”. In this article the authors background how the Australian courts have addressed the term “generally available” and explore how the term is likely to be interpreted in New Zealand.*

The authors note that the term “generally available” in the Australian legislation remains uncertain in its interpretation despite being in place since 1991. They illustrate this by providing an analysis of each of the three tests set out in the legislation as guidelines to the meaning of the term, namely:

- the “readily observable” test;
- the publishable information test (which has two aspects: the information must be disseminated in an appropriate manner and a reasonable period for the dissemination to be effective must have elapsed); and
- the market analysis test.

Of these, only the first has been the subject of recent reported case law<sup>18</sup>, the decisions of which the authors' note continue to cause confusion. In particular, questions remain as to whether information needs to be “readily observable” to the public at large or whether it is restricted to the Australian investing public.

The author's discussion on the New Zealand legislation begins by looking at the current insider trading regime with particular reference to how the courts have approached the meaning of “publicly available” information. They note that the only significant case to have considered what may have constituted this term is the Court of Appeal's decision in *Wilson Neill*<sup>19</sup>.

In the authors' opinion a strong argument can be put forward to show that the terms “generally available” in the continuous disclosure regime provisions and “publicly available” in the insider trading provisions are synonymous or at the very least an extension of the current core concept. The article addresses this in some detail leading to the conclusion that it would be open to a court considering the new insider trading provisions to use the Court of Appeal's decision in *Wilson Neill* as relevant jurisprudence. The authors contend that it may assist the interpretation of the new provision by specifying means by which information becomes publicly/generally available.

They discuss the possibility that the New Zealand courts may have to choose between adopting the developed Australian jurisprudence and the position established in New Zealand. Various reasons are put forward to show that even though the New Zealand jurisprudence doesn't feature in the Australian interpretation of the term “generally available”, New Zealand courts are free to regard the New Zealand precedent (*Wilson Neill*) as entirely consistent with the Australian jurisprudence. The authors note that there are aspects of the New Zealand legislation which are likely to avoid some of the Australian problems and provide greater certainty to the application of the term. These include the more detailed second limb of the New Zealand definition which specifies particular parties (i.e. those who commonly invest in relevant securities) who must be able to readily obtain the relevant information; and the clarification that information disclosed under the continuous disclosure regime will be considered “generally available” as soon as it is made available to participants on the registered exchange's market.

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<sup>18</sup> *R v Firms* (2001) 51 NSWLR 548 and *R v Kruse* (Unreported, District Court, NSW, 2 December 1999, O'Reilly J, No. 98/11/0908)

<sup>19</sup> *Colonial Mutual Life Assurance Society Ltd v Wilson Neill Ltd* [1994] 2 NZLR 152

## In the journals

### Evaluating New Zealand's Evolving Corporate Governance Regime in a Comparative Context

Joshua Blackmore, *Canterbury Law Review*, Vol 12 2006 p.34

*This article provides an interesting and analytical account of recent corporate governance developments in the United States, Australia and New Zealand. The author explores the possibility that it may not be necessary for New Zealand to wholeheartedly embrace the increasingly complex corporate governance principles being adopted in other jurisdictions. He contends that rather than assist the development of New Zealand's capital markets, the opposite may occur with more New Zealand companies choosing to seek funding from private equity sources.*

The article begins with an examination of the concept of corporate governance and the recent reforms in the United States and Australia in this area.

In the author's overview of the United States' Sarbanes-Oxley Act of 2002 (SOX), he notes that although its effect on the market is still difficult to evaluate, it appears that it has already had an effect on the number of foreign companies listing in the United States. SOX adds considerably to the costs of going public particularly through the costs associated with section 404 of SOX which requires certification of internal controls by management.

His analysis of SOX includes a discussion on the decision in *Re Walt Disney Company Derivative Litigation*<sup>20</sup> which involved disputes over the recruitment and subsequent termination of the employment of Michael Ovitz as president of Disney. He provides this as an illustration of one of the points he makes in the course of the article namely, *"a rule based, 'tick the box' mentality is not a fully effective solution to corporate governance problems unless it's allied with an effort to improve the culture in which decisions are made"*. In the author's view there is little evidence to suggest a SOX-type programme would work to prevent corporate fraud. In his opinion it is much better to focus on the fostering of high standards of business ethics and organisational behaviour.

Joshua Blackmore outlines and provides background to Australia's key regulatory corporate governance provisions (which he notes are a balance between a rules and principles based regime) set out in:

- the Corporations Act 2001;
- the Corporate Law Economic Reform program (Audit Reform and Corporate Disclosure) Act 2004 (CLERP 9);
- the ASX's Market Rules; and
- the ASX Corporate Governance Council's Principles of Corporate Governance and Best Practice Recommendations.

He notes that the Australian approach is of particular relevance to New Zealand given the current programme in place to coordinate both countries' business legislation.

The article sets out the core legal duties contained in the Australian Corporations Act 2001 and provides details of the cases and Australian corporate collapses which led to the introduction of CLERP 9.

In the author's view CLERP 9 represents a *"response to corporate governance difficulties that is similar in response to that of the United States with SOX"*. The problem in his opinion is that CLERP 9 amendments do little to address the reasons for the Australian corporate collapses which were, in his opinion, the result of poor business ethics, substandard board participation and bad judgment.

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<sup>20</sup> 825 A 2d 275 (Del.Ch. 2003)

The author's analysis of New Zealand's corporate governance regime includes a discussion on the core legal duties under the Companies Act 1993, the roles played by the Securities Commission and NZX, and the various best practice codes and guidelines in place.

The key aspects of New Zealand's corporate governance regime he identified as requiring further consideration for improvement include:

- the disjointed nature of our current legislation (particularly in respect of ss135 and 136 of the Companies Act 1993);
- questioning the value of the continuous disclosure regime over the truly principled approach to corporate governance which would allow directors to depart from the ideal of continuous disclosure where it is in the best interests of the company;
- addressing the requirement for independent directors in New Zealand. The author considers this to be problematic given the small pool of qualified directors which may lead to a dilution of the quality of directors on the boards of large companies. He also notes that independence in itself could lead to detachment of the affairs of the company. Maintaining independence should be limited to preventing cross-directorships which give rise to conflicts of interests and undisclosed family ties;
- questioning the Securities Commission's approach which is increasingly being equated with accountability rather than "*the mechanisms and strategies designed to make a company a more efficient and effective means of wealth creation*". In the author's opinion focus of the board should not be seen as merely an institution for supervising management; and
- introducing a comprehensive business judgement defence for directors of the type found in the United States and Australia.

On a comparative basis, Joshua Blackmore suggests that New Zealand lies closer to a classical contractual conception of corporate governance, based on a dual approach of board independence and greater disclosure of information. There is no parallel to the more reactionary approach adopted in the United States and Australia. The closest example in New Zealand is the introduction of the Securities Commission's Principles and Guidelines document published in 2004. However the author questions whether "*even this relatively light handed regulatory approach is appropriate to New Zealand conditions*".

He points out that there are key differences in New Zealand's capital markets that should be taken into account including the fact that most of its listed companies are controlled by either a single shareholder or small group of shareholders. Rather than allow New Zealand's regime to be shaped by overseas requirements, the author advocates that future legislation should be based on New Zealand's particular circumstances to ensure that a competitive advantage for New Zealand's companies is retained.

## In the journals

### Mind the gap: director indemnified for costs of own action

Dean Carrigan, *Australia Corporate News*, Issue 16, 6 September 2006, p.1

*A recent New South Wales Supreme Court decision has highlighted potential gaps in Directors' and Officers' Liability insurance policies. This article takes a look at the case and discusses the potential ramifications for companies, their insurers and their shareholders.*

In August this year, the New South Wales Supreme Court required a company (NRMA) to indemnify its director (Mr Whitlam) for costs incurred in pursuing a defamation action initiated by the director against a third party under the terms of a deed of indemnity. NRMA had denied it was liable to the director because the indemnities sought were not liabilities that arose from Mr Whitlam defending a claim made against him in his capacity as an officer of the company. Although Mr Whitlam had been acting in his capacity as a director at the time the alleged defamation occurred, it had been Mr Whitlam and not the third party who had commenced proceedings.

The court was of the view that there was nothing in section 199A of the Corporations Act or the relevant indemnity deed that would prohibit an indemnity for costs incurred in pursuing a defamation action. The court found that by incurring costs and bringing the defamation proceedings, Mr Whitlam had taken steps in defending allegations made against him as an officer of the company. The deed was very broad and promised indemnity for all liabilities incurred by Mr Whitlam as an officer of NRMA subject to sections 199A(2) and 199A(3) of the Corporations Act.

The author points out that the finding is of particular significance because generally Directors and Officers Liability insurance policies do not require the insurer to pay the costs of legal actions initiated by directors, leaving a gap which a company must then fund out of its own pocket.

The author makes it clear that this decision is ultimately based on the wording of the deed of indemnity. The indemnities were broader than the company intended because the court found that they included not only actions brought against Mr Whitlam but also actions commenced by Mr Whitlam when defending defamatory allegations made against him in his capacity as an officer. The author notes that the key lessons to be drawn from this case are:

- companies should ensure that the indemnities that they provide to their officers are aligned with their own directors' and officers' insurance where possible; or
- at a minimum, at least be aware of any gaps between their insurance cover and the indemnities given to their officers.

Section 199A of the Australian Corporations Act 2001 restricts the company's ability to exempt or indemnify persons for liabilities to the company that are incurred as an officer. Comparable restrictions are provided for in section 162 of the New Zealand Companies Act 1993.

## In the journals

### Of Arsenic, Antitrust and Agreed penalties for Price Fixing

Chris Noonan, *New Zealand Business Law Quarterly*, Volume 12, September 2006, at p.255

*In the wake of the recent wood chemicals cartel cases where record penalties have been awarded for price fixing, Chris Noonan reviews the basis on which penalties for price fixing are calculated and finds that a more principled approach is required if deterrence is to be the primary outcome.*

In the 2006 Autumn issue of *Commercial Quarterly* we noted the case of *Commerce Commission v Koppers*<sup>21</sup> in which the High Court awarded the largest pecuniary penalty to date under the Commerce Act 1986 for price fixing. The case involved price fixing by a group of suppliers of wood preservative chemicals in the period from 1998 to 2002. Chris Noonan notes that the court case pointed out that even higher penalties will be appropriate in future cases given that most of the actions in *Koppers* took place before the new penalty regime came in force in May 2001.

The author makes the point that many factors are taken into consideration by courts in determining a penalty amount but there is a general failing on the courts' behalf to articulate why factors are significant. In his view this makes the outcome of price fixing cases unpredictable with the flow on consequences of lessening the deterrence effect of penalties and raising the costs of administration of justice. Furthermore it does not ensure penalties are just.

Chris Noonan notes that although deterrence was seen as a factor in *Koppers*, the court did not indicate how deterrence was linked with the underlying facts of the case nor did it give any indication on the principles it considered appropriate to calculate the level of the penalty.

In his opinion, deterrence is more than one factor, it also provides a framework in which a number of other factors can be analysed.

The author discusses the use of economic analysis to assist in calculating optimal deterrent penalties. He points out that there is a considerable body of scholarship discussing the economics of punishment and antitrust penalties which could assist New Zealand courts. He also notes that New Zealand courts have been traditionally receptive to using economic analysis to determine the content of the substantive rules of the Commerce Act and so should be open to using it to determine an appropriate penalty. Further, the adoption of an economic approach is consistent with the 2001 amendments to the Commerce Act.

In situations involving a cartel, the author notes how lower penalties may be sufficient if the internal dynamics of the cartel can be exploited especially through the use of leniency programmes. Higher penalties could be imposed on ringleaders to:

- increase the expected costs of being a ringleader;
- make cartels less stable;
- provide members of a cartel with an incentive to cooperate with the Commission.

Comparison of penalties between countries are also noted as being relevant. The author points out that New Zealand will need to have particular regard to the proposal to introduce criminal penalties for executives involved in price-fixing in Australia.

The article also considers the application of deterrent principles in practice. In particular Noonan notes that:

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<sup>21</sup> *Commerce Commission v Koppers Arch Wood Protection (NZ) Limited and Ors* (Unreported, High Court, Auckland, 6 April 2006, CIV2005-404-2080)

- the actual harm (which is inherently difficult to prove) is not the appropriate variable upon which to base a deterrent penalty. Instead the focus should be on the subjective expectation of the defendant of harm or gain at the time of the contravention; and
- for effective deterrence the minimum penalty must exceed the gain from the anti-competitive conduct.

Chris Noonan suggests that based on the experience of the United States an appropriate approach for price fixing would include starting with a presumption that the penalty should be based on a certain percentage of the turnover of the defendant firms in the products that were subject to the price fixing arrangement and making the necessary adjustments to reflect the circumstances of the case. In New Zealand, the adjustments would include consideration of:

- whether the firm was a ringleader;
- whether the firm had cooperated with the Commission;
- the monetary limitations set out in section 80(2B) of the Act;
- actual proof of the harm or gain (if able to be established by either the Commission or the firm); and
- the ability of the firm to pay.

Other aspects considered in the article include discussions on:

- whether the defendant's ability to pay should be taken into account in setting penalty levels;
- the use of leniency policies and the setting of reductions for cooperation with the Commerce Commission; and
- the role of the court in agreed penalty settlements.

His final points relate to the effect of agreed penalties on other parties involved in a cartel. Noonan argues that *"the law should seek to maintain proportionality in penalties so that the equally culpable defendants get treated approximately the same"* and goes on to say that *"clear and consistent application of penalty principles would reduce the risk of inconsistent treatment of co-defendants"*. He points out that in the *Giltrap*<sup>22</sup> case, the Court of Appeal considered that the agreed penalty settlement had tied the hands of the court to determine the penalty for the other participants in a cartel. In his opinion a rigid application of the rule in *Giltrap* may discourage the Commission from accepting agreed penalties until after it is closer to completing its preparation to litigate a case. It may also undermine the Commission's leniency policies which are seen as critical to uncovering and deterring cartels.

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<sup>22</sup> *Giltrap City Ltd v Commerce Commission* [2004] 1NZLR 608

## In the journals

### Personal Liability of Directors under the Fair Trading Act

Debra Wilson and Lindsay G S Trotman, *New Zealand Business Law Quarterly*, Vol 12, September 2006. p. 201

*Following a recent Court of Appeal decision, the authors of this article question the appropriateness of the basis for establishing a director's statutory liability for breaches of the Fair Trading Act over conduct engaged on behalf of a company.*

Section 45 of the Fair Trading Act 1986 (FTA) provides that, "Any conduct engaged in on behalf of a body corporate...by a director, servant or agent or...by any other person at the direction....of a director, servant or agent...shall have been engaged in also by the body corporate."

The authors note that the courts have interpreted this section to provide for the possibility that both the company and the director (or servant, agent or, any other person acting at their direction) could be liable as principals under the FTA.

The article discusses the appropriateness and problems with the two tests which have been applied by the courts to determine whether individual liability should be founded under section 45 namely, the personal assumption of liability test and the presumption of automatic liability test. They conclude the article with a discussion on their preferred approach to determining liability of the individual under section 45 by focussing on the question of whether the individual's conduct was "in trade" beyond that which the company was involved in.

Personal assumption of responsibility is a common law test developed in tort which has been extended by analogy to the FTA section. The authors note that there have been difficulties over how this test is to be applied. In the case of a limited liability company, the courts have been reluctant to find an individual has assumed responsibility unless an actual assumption of liability is found on the facts. To do otherwise would be inconsistent with company law principles.

The test was rejected by the High Court and the Court of Appeal in *Kinsman* in favour of a presumption of automatic liability on the part of the director. It was noted that "it will be a rare case where a director who participates directly in negotiations as to his or her company's business will be able to avoid section 9 liability simply on the basis that he was acting only on the company's behalf".<sup>23</sup> The authors note that the Court of Appeal read the insertion of the word "also" in section 45 as suggesting that the conduct of a director on behalf of a company remains also the conduct of the individual.

The authors' note that in their opinion the Court of Appeal in *Kinsman* was arguably incorrect in its interpretation of section 45 for the following reasons:

- the section does not establish liability, it suggests that the conduct of the individual acting on behalf of the company remains also the conduct of the individual. Liability requires [under section 9] that the conduct be misleading or deceptive and that it occur in trade; and
- the strict liability nature of section 9, the extension of the section 45 to "servants" of a company and, the lack of defences available for a breach of the FTA suggest that there are policy reasons against such an interpretation.

The authors also canvass a number of cases decided since *Kinsman* which have demonstrated a reluctance on the part of the courts to apply the presumption of automatic liability test including a reference in the recent decision of *Newport v Coburn*<sup>24</sup> where a comment made by O'Regan J suggests that the presumption of automatic liability in *Kinsman* might be incorrect.

The authors contend that the better approach for the courts is to apply section 45 as written and instead focus on whether the director is acting "in trade" as a means for establishing or excluding liability. In their

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<sup>23</sup> *Cornfields Ltd v Gourmet Burger Co. Ltd* (2000) 9 TCLR 698, para 27

<sup>24</sup> 17/5/06, CA 234/04

opinion there is no basis under the FTA for assuming that the director of a company which is *"in trade"* will himself also be in trade and note two judicial comments which could be used to support this proposition.

The nature of the considerations which would be used to determine whether the individual was carrying out a business or activity of commerce beyond that which the company was engaged in would be similar to those used to determine a personal assumption of responsibility. But unlike the existing tests, it would provide a more sound basis for imposing liability and lead to consistency in decisions.

The authors go on to demonstrate that their *"in trade"* test when applied to the facts of existing cases would lead to a fair outcome. They note that their test would be unlikely to lead to different results than the application of the personal assumption of liability test but would provide more acceptable results for cases decided with a presumption of automatic liability.

## In the journals

### Parallel importing and trade marks

**Alexandra Sims, The New Zealand Law Journal, September 2006 p. 285**

*The 2003 amendment to the Trade Marks Act 2002 was to ensure that registered trade marks could not be used to prevent parallel importing. In this article Alexandra Sims discusses how a recent court's narrow interpretation of the new provisions may frustrate the Government's parallel importing policy.*

The case<sup>25</sup> in question involved an interlocutory injunction to prevent Elite Fitness from importing "Infiniti" fitness equipment into New Zealand through an Australian distributor. Leisureworld, the applicant, is the owner of the intellectual property rights (including copyright and two registered trade marks) over "Infiniti" equipment in New Zealand. It also has an exclusive distribution agreement with the manufacturer of the Infiniti equipment which includes terms stating that the manufacturer cannot supply the goods directly or indirectly to others inside New Zealand or in circumstances where the goods may be re-supplied to New Zealand.

The judge took the view that there was a serious question to be tried over trade mark infringement. Section 97A of the Trade Marks Act provides that:

*"A registered trade mark is not infringed by the use of the mark...in relation to goods that have been put on the market anywhere in the world under that trade mark by the owner or with his or her express or implied consent."*

On the facts, the judge was of the opinion that Leisureworld had neither expressly nor by implication given its consent.

The author contends that the judge's finding of no implied consent on these facts is problematic. In her opinion this is an example of a classic case in which the Government-intended parallel importing should be allowed to occur. After providing an overview of the history behind the enactment of section 97A and an analysis of the judge's decision she notes that there was, in her opinion, no need for the judge to reach that conclusion. In particular:

- on the facts the goods were clearly being traded with Leisureworld's knowledge in markets outside New Zealand (the only restriction was that the goods were not to be supplied directly or indirectly to New Zealand, or in circumstances where the manufacturer ought to have known that the goods would be resold);
- a different construction of section 97A from its source provision (section 12 of the United Kingdom's trade mark legislation) was possible because whereas the United Kingdom legislation refers only to "consent", the New Zealand legislation uses the wording "express or implied consent"; and further
- the judge's concern that on these facts a New Zealand company (X) would be detrimentally affected by parallel importing are ill founded given that there will be no legitimate goods to import. *"If the manufacturer did produce additional goods bearing the trade mark beyond those supplied to X, those additional goods would not have been produced with X's consent."*

In her conclusion the author recommends that the Trade Marks Act is amended to ensure that it is not used to prevent legitimate parallel importing.

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<sup>25</sup> *Leisureworld Ltd v Elite Fitness Equipment Ltd* (HC Auckland, CIV-2006-404-4399, 21 July 2006)

## Legislation/In Parliament

### **Securities Legislation Bill completes the parliamentary process**

After some delay the Securities Legislation Bill was passed on 12 October 2006 as four separate Acts. Most of the changes came into effect after their assent on 24 October but some, such as the new insider trading and market manipulation provisions, will not come into force until regulations for the new provisions have been finalised. Here we provide an update on the events leading to the passing of the securities legislation and provide an outline of the key changes.

### **Business Law Reform Bill fast tracks its way into law**

The Commerce Select Committee released its report on the Business Law Reform Bill on 18 October with only a few notable changes. This was followed by further amendments to the Bill through a Supplementary Order Paper on 14 November with passage of the Bill on 15 November.

### **Voluntary administration - will it work?**

More than a decade after the Australians did it, New Zealand has this month introduced a new insolvency regime to help financially troubled companies stay afloat.

### **Update on the KiwiSaver Act 2006**

The KiwiSaver Bill has made speedy process through its final stages receiving royal assent on 6 September. The implementation date for the new saving scheme is 1 July 2007.

### **Draft regulations on the trans-Tasman mutual recognition of securities offerings released**

Both the Australian and the New Zealand governments have released draft regulations to give effect to the Mutual Recognition of Securities Offerings agreement signed between them earlier in the year.

## Legislation/In Parliament

### **Securities Legislation Bill completes the parliamentary process**

*After some delay the Securities Legislation Bill was passed on 12 October 2006 as four separate Acts. Most of the Securities Act and Takeovers Act changes came into effect after their assent on 24 October but some, such as the new insider trading and market manipulation provisions, will not come into force until regulations relating to the new provisions have been finalised. Here we provide an update on the events leading to the passing of the securities legislation and outline of the key changes under each of the amendment Acts.*

The Securities Legislation Bill took nearly two years to make its way through the system and has been the subject of much controversy. One might have expected more media coverage following its passage into law but there has been little to date. This is no doubt in part due to the fact that we are still waiting on regulations to come through before some of the key provisions can take effect. It is however a major new suite of legislation and is likely to have wide implications for market participants. The legislation was passed as:

- the Securities Amendment Act 2006;
- the Securities Markets Amendment Act 2006;
- the Takeovers Amendment Act 2006; and
- the Fair Trading Amendment Act 2006.

#### **The Supplementary Order Papers**

The Securities Legislation Bill was stalled to allow the Ministry of Economic Development (MED) to address some outstanding gaps identified by market participants after the Bill emerged from the select committee process. The gaps were addressed in the form of a Supplementary Order Paper (SOP No.59) which was released in September. A further Supplementary Order Paper (SOP No. 58) divided the omnibus Securities Legislation Bill into four separate bills.

One of the key changes requested by market participants was related to concerns that advisers acting in a professional capacity could find themselves inadvertently in breach of the new insider trading provisions. This would have had serious consequences for a number of normal commercial transactions especially in the context of intending bidders acting on advice from corporate advisers and/or officers or executives of the bidder.

The Government had indicated that this was not intentional and through the SOP has added provisions to the Securities Markets Amendment Act to clarify that an adviser acting in a professional capacity will not be in breach of the "no dealing", "no disclosure", and "no advice or encouragement rules" in the new insider trading provisions (namely, sections 8D and 8E of the Securities Markets Act).

The other substantive changes arising from SOP (No 59) include:

- a new provision in the Securities Act 1978 to ensure conduct which is not able to be prosecuted under the Securities Act or the Securities Markets Act 1988 (SMA) can also not be prosecuted under the Fair Trading Act 1986 (this is to make the Securities Act consistent with the new section 19 in the SMA);
- the extension of the insider trading regime to cover conduct in relation to a futures contract that is listed on an authorised futures exchange;
- a further defence for persons in contravention of an issuer's continuous disclosure obligations if it is proved on the balance of probabilities that the person took all reasonable steps to procure compliance and believed (on reasonable grounds) that the issuer had complied with its obligations; and

- changes to the requirements for disclosure to be made by investment advisers prior to giving advice if subsequent disclosure is permitted by regulations made under the SMA.

### **Overview of securities legislation changes**

The passing of the new securities legislation amendments represents the completion of part three of the Government's four part securities and financial market reform programme.

The Government began its shift in direction on securities law in 2000 with the introduction of the Takeovers Code in 2001. This was followed in 2002 with the reform of the stock exchange and the regulation of listed issuers. The fourth and final part of the securities reform programme is currently under way as part of the Government's Review of Financial Products and Providers. This addresses issues relating to securities offerings under the Securities Act 1978.<sup>26</sup>

The key components of the latest legislation includes:

- fundamental changes to New Zealand's 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; and
- changes to the Takeovers Act and the Takeovers Code.

There are also substantive changes to the way these laws can be enforced through wider powers given to the Securities Commission and the Takeovers Panel and harsher penalties for those found in breach of the law.

A brief outline of the key amendments in each Act are set out below.

### **Securities Amendment Act 2006**

The Securities Act 1978 establishes the Securities Commission and regulates offers of securities "to the public" in New Zealand. As noted above, changes to the provisions relating to securities offerings under the Act are to be dealt with in part four of the Government's securities reform programme. However in this round of changes, the Securities Act has been amended to strengthen the Securities Commission's enforcement options under the public offering provisions of the Act. The amendments to the Securities Act include:

- providing the Commission with the power to seek civil remedies and penalties through Court action if:
  - securities offer documents or advertisements contain any false or misleading statements; or
  - if there is a breach of the contributory mortgage regulations relating to the offer, sale or management of interests in contributory mortgages;
- allowing the Commission to seek pecuniary penalties of up to \$500,000 for individuals and up to \$5 million for bodies corporate and/or a declaration of civil liability which subscribers can then rely on in proceedings for compensation;
- provision for Court compensation orders on the application of the Commission or a subscriber whereby the Court may order a person to pay compensation to all or any of the subscribers where civil liability has been established;
- the imposition of an automatic management banning order for a period of five years on any director or other person who is convicted of a criminal offence against section 58 (for

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<sup>26</sup> For details on this review see the **Recent Developments** section in this issue of *Commercial Quarterly*.

misstatements in advertising or a prospectus) or section 59A (obstructing the exercise of powers) or receives a pecuniary penalty under the Act;

- in the case of serious offenders, the right for the Commission (and other specified persons) to apply to the court for a management banning order to be imposed of up to 10 years; and
- amendments to the regulation-making provisions of the Act to allow regulations under the Act to incorporate by reference approved financial reporting standards and to require compliance with generally accepted accounting practice.

### **Securities Markets Amendment Act 2006**

The SMA (under the Securities Markets Amendment Act 2006) has been subject to substantial amendments in this round of reforms. However, none of the amendments will take effect until an Order in Council is made on the promulgation of regulations currently being drafted. The MED website indicates that this is not likely to be before the middle of 2007. The amendments to the SMA include:

- Part 1 of the SMA has been repealed and replaced with a new insider trading regime and market manipulation provisions;
- some minor amendments have been made to the directors' and officers' disclosure requirements;
- the substantial security holder disclosure rules have been clarified and simplified in parts;
- a new Part 4 of the SMA has been inserted to provide for additional disclosure obligations on investment advisers and investment brokers prior to giving advice or receiving investment money or property;
- a new Part 5 which overhauls and collects together the enforcement powers and remedies available for breaches of securities trading law; and
- a new section collects together the Commission's exemption and regulation empowering provisions. These are largely a restatement of the existing powers, shifted from elsewhere in the Act, but they do include some substantive changes.

The key provisions for the amendments in Part 1, the disclosure regimes and the new Part 5 of the SMA are outlined below.

#### **New insider trading regime**

##### *New approach*

The insider trading reforms reflect a new rationale for the prohibition of insider trading and are based on the Australian insider trading provisions. The philosophy behind the new philosophical approach is to treat insider trading as involving harm to the integrity and efficiency of the market as a whole. Consistent with that philosophy, a person's status as an "insider" no longer depends on their connection with the public issuer itself. Formerly, a person was only an "insider" if they received the information directly or indirectly through their relationship with the public issuer.

##### *Who is an information insider?*

Under the new legislation, the insider trading prohibition applies to any person – described as an "information insider" – who "has material information" that is "not generally available to the market" and who "knows or ought reasonably to know" that this is the case. Information is "material information" where "a reasonable person would expect it to have a material effect on the price of the relevant securities if generally available to the market".

##### *Prohibitions*

As under the present law, the proposed new laws prohibit an information insider from trading, disclosing information or encouraging or procuring another person to trade (tipping).

The new feature of these prohibitions is the introduction of liability where the disclosure of information, or the advice or encouragement, results in a person deciding to hold securities. This feature is not present in the Australian legislation. It also introduces a necessary asymmetry into the prohibitions because there is

no prohibition on an information insider itself deciding to hold securities where the person has inside information (for obvious reasons).

### *Defences*

Given the breadth of the prohibitions, the defences are especially critical to the operation of the legislation.

There is an extended range of defences to the new insider trading liability provisions. Briefly these include:

- a takeover defence (for buyers and sellers);
- a defence where the trading or disclosure of information is required by law;
- an underwriting defence (for disclosing, advising or procuring and dealing);
- a knowledge of own intentions defence (to allow a trader to build a stake in a company in advance of its takeover bid);
- a broker defence; and
- a company buyback/redemption defence (for buyer and seller only).

There are also new affirmative defences where:

- the insider does not have knowledge of the trading;
- the information insider establishes the inside information was obtained by independent research;
- the trading takes place on the basis of "equal information" (that is, where the other party to the transaction or the person to whom the inside information was communicated knew or ought reasonably to have known of the information before entering into the transaction or before the information was communicated); and
- the trading occurs pursuant to fixed price options or fixed price trading plans.

In addition, the existing Chinese Wall defence is retained.

There is however a significant gap in the defences with the removal of the Approved Procedure for Company Officers<sup>27</sup> which permits company directors and executives to trade during designated window periods provided they comply with the procedure approved under the existing regime.

The Government's view is that these procedures cannot be justified under a law that is based on market efficiency or fairness. Under the new model, directors and executive trading is required to take place at the times when the market is clearly informed about the company and when the directors/executives in question are not in possession of inside information.

In practice this will mean that directors/executives will always have to go through a process to determine whether they have "material" information classed as inside information before trading in shares.<sup>28</sup>

### *Regulations to create further exemptions*

A further possible avenue for exclusion from insider trading provisions is through the power under the Act to make regulations for the purposes of exempting conduct from being insider conduct. This is to ensure that market efficient conduct will not be caught under the new regime. The Government has also stated that its aim is to provide certainty for market participants where there may be a risk that a particular behaviour will be caught by the legislation. At this stage it is envisaged that such regulation will be made only in respect of passive investment instruments such as index funds and exchange-traded funds.

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<sup>27</sup> Insider Trading (Approved Procedure for Company Officers) Notice 1996 and Schedule

<sup>28</sup> Please refer to the Practical Implication section of this article for Bell Gully's recommendations on how listed issuers should address the removal of this defence.

The insider trading reforms will not take effect until these regulations have been finalised.

#### *New criminal liability*

As under the previous legislation, civil liability arises for anyone who contravenes the insider conduct prohibitions. This includes pecuniary penalties and management banning orders. The new legislation retains those civil penalties and goes further by imposing criminal liability if the defendant had actual knowledge of certain elements of the offence.

The sanctions prescribed by the new legislation are substantial. Individuals face a maximum penalty of five years' imprisonment and a \$300,000 fine. Bodies corporate face a \$1,000,000 maximum fine. The imposition of criminal liability is especially grave given that the ordinary criminal standard of guilt beyond reasonable doubt is not required.

For further commentary on the new insider trading regime, please refer to the article by Bell Gully Partner, Roger Partridge, "*Insider Trading Reform*" which is available on our website at [www.bellgully.com/resources/resource\\_00687.asp](http://www.bellgully.com/resources/resource_00687.asp)

#### **Market manipulation**

Another key area of change under the new regime is the introduction of dedicated provisions prohibiting forms of market manipulation (or market rigging).

Insider trading and market manipulation issues are closely linked. They both involve a person having some prior knowledge of the likely effect of the information they have acquired and using this information to gain some transactional advantage.

The Government saw the lack of any dedicated laws against market manipulation as one of the most obvious gaps in New Zealand's securities markets regulation when compared with other countries.

#### *Three new offences*

The legislation creates three new offences for manipulating or interfering with the operation of a securities market. The rules are intended to prohibit practices that are considered to impermissibly affect the price of listed securities and distort the operation of the market in listed securities.

The three offences are set out in sections 11, 11B, 11C and section 13 of the SMA.

Under section 11, it is an offence to make a statement or disseminate information if a material aspect of that statement or information is, and the person knows that it is, materially misleading. In addition, under section 11B a person must not do or omit to do anything that will have the effect of creating or causing the creation of a false or misleading appearance with respect to the trading of securities or the supply of, demand for, price or value of those securities.

There is a rebuttable presumption under section 11C that a defendant has breached section 11B in two situations:

- if the defendant is a party to trading in the securities of a public issuer from which no change in beneficial ownership results; or
- if the defendant makes corresponding and opposite offers to trade in the securities of a public issuer where the opposite offers are substantially matching as to the number and price of the securities.

The presumption under section 11C will not apply if the defendant establishes on the balance of probabilities that the trading in securities occurred for a legitimate reason, that the defendant was acting on behalf of another person, or that the defendant neither knew nor ought reasonably to have known that no change in beneficial ownership would result.

Finally a new section 13 introduces a general catch-all prohibition against misleading or deceptive conduct, in relation to any dealings in securities, similar to that which currently exists under the Fair Trading Act 1986.

### *Exceptions*

There are four exceptions to the market manipulation offences:

- sections 11 and 13 do not apply to conduct in relation to a takeover offer because that conduct is regulated under the Takeovers Act;
- section 13 does not apply to conduct in relation to the acquisition or redemption by a company of its own shares under the Companies Act because the companies legislation provides its own rules;
- section 13 does not apply to public offers of securities for subscription because that is governed by the Securities Act; and
- section 13 does not apply to advertising or disclosure by brokers to the extent that such conduct is now regulated by the new rules for brokers.

### *Regulatory exemptions*

The MED has acknowledged that the breadth of the prohibitions may require regulations exempting certain forms of efficient and desirable market conduct from the operation of the rules. There are three such exemptions presently under consideration:

- market stabilisation following an initial public offering;
- short selling; and
- crossing of trades (where securities are traded between clients of a single exchange participant itself without the orders having first been matched in the order screen).

As for the insider trading provisions, the market manipulation provisions will not come into force until the regulations have been finalised.

### **Continuous disclosure and directors' and officers' disclosure**

The continuous disclosure and directors' and officers' disclosure regimes under the SMA remain substantially unchanged. Mostly the amendments are in the form of consequential changes to the penalty and remedy provisions.

However as noted above, a last minute change in the SOP now includes in the SMA a provision to protect a person from liability for contravention of an issuer's continuous disclosure obligations if the person has taken reasonable steps to comply with the obligation.

### **Disclosure by substantial security holders**

The review of the substantial security holders' disclosure regime indicated that on the whole the existing system works well. The amendments do however attempt to simplify the previous regime by requiring disclosure of relevant interests by class of securities in respect of listed voting securities only (although this is to include classes of listed securities that are convertible into voting securities). The intention is that these changes will clarify the situations in which disclosure is required and reduce compliance costs over the medium to long term.

A new power is also given to the Securities Commission. In addition to the four existing mandatory "event" disclosure obligations the Commission now may require persons to disclose all relevant interests that the person has in the securities of a public issuer and all powers that the person has to acquire a relevant interest in the securities in the public issuer. The Securities Commission may require disclosure of any relevant interests in securities whether they are voting interests or not, listed or unlisted, or issued or yet to be issued. The Government has indicated that the Commission would exercise such an order upon being satisfied that the person is, or may be in the future be, entitled to control or influence significant voting rights in the issuer.

The 1997 regulations relating to the disclosure regime will require amendment to give effect to the new substantial obligations and are being considered by the Government at present.

## **Enforcement and remedies**

One of the major changes in the new legislation is the complete overhaul and improvement in the enforcement powers and remedies available for breaches of securities trading law. These have been collected into a new Part 5 of the SMA and include:

- Commission orders;
- court enforcement orders;
- civil remedies;
- criminal offences; and
- management bans.

The Commission orders include:

- prohibition orders, directed at breaches of the market manipulation or general dealing provisions;
- disclosure orders requiring compliance with the continuous disclosure or substantial shareholder disclosure obligations; and
- temporary banning orders in relation to investment adviser or broker activities.

The Act provides that it is a criminal offence for a person to breach a Commission order. The courts' enforcement powers include injunctions and interim injunctions, corrective orders and disclosure orders, as well as the civil remedy provisions and criminal sanctions. These remedies exist in addition to automatic or discretionary management banning orders.

## **Takeovers Amendment Act 2006**

The Takeovers Act and the Takeovers Code have been altered by the Takeovers Amendment Act in four significant areas:

- the definition of "specified company" in the Act and "code company" in the Code have been changed. Under the new definitions, the Code applies to listed companies with securities that confer voting rights quoted on the exchange and to companies that have been listed and had securities that confer voting rights quoted on the exchange in the preceding 12 months. For unlisted companies, the new definition removes the asset threshold (of \$20 million) so the Code now applies to every company that has 50 or more shareholders;
- the Act and the Code will empower the Takeovers Panel and the Court to deal with misleading and deceptive conduct in relation to all Code-related transactions and events by essentially importing section 9 of the Fair Trading Act (which prohibits misleading and deceptive conduct in trade);
- the penalties and remedies under the Takeovers Act are increased and broadened. In particular the Takeovers Panel may now apply to the Court for management banning orders against directors who contravene the Takeovers Code. In addition, the new regime provides for the High Court to make compensatory orders which may be awarded to a person for loss or damage caused by a contravention of the Code as well as a new pecuniary penalties regime; and
- the Panel's enforcement powers are expanded:
  - through their extension to not only the person breaching the Code but also to persons with secondary involvement such as persons who have assisted, counselled, induced or conspired with others to contravene the Code or who are just knowingly involved in Code contraventions; and
  - by being able to make a number of permanent compliance orders in addition to the previous temporary restraining orders.

Apart from the new market manipulation provisions (dealing with misleading and deceptive conduct) in sections 44B, 44C and 44DAA of the Takeovers Act and in the new Part 8 of the Takeovers Code, all of the Takeovers Amendment Act provisions came into effect on 25 October. The market manipulation provisions

will come into effect once the regulations for the new SMA provisions have been finalised. At that time, the Fair Trading Act will no longer apply to misleading and deceptive conduct that is regulated by the Code and the Takeovers Act.

For further details on these amendments visit the Takeovers Panel's website for their latest issue of their newsletter "Code Word" at [http://www.takeovers.govt.nz/publications/code\\_word/17-1106/index.html](http://www.takeovers.govt.nz/publications/code_word/17-1106/index.html).

### **Fair Trading Amendment Act 2006**

The amendments to the Fair Trading Act 1986 follow on from the changes made to the Securities Act, SMA and the Takeovers Act. Under the Fair Trading Amendment Act 2006 two new sections have been inserted to:

- clarify that the Fair Trading Act can not be used to establish liability for a person's conduct if that conduct is already regulated under the Securities Act and the SMA and the person would not be liable for such conduct under the relevant provisions in those Acts; and
- provide that the Fair Trading Act does not apply to any conduct regulated by the Takeovers Code.

A further section authorises the Commerce Commission to share information with the Securities Commission and the Takeovers Panel. As noted already, similar provisions have been added in the other legislation to allow the Securities Commission and Takeovers Panel to do the same.

### **Securities Legislation Bill regulations**

The MED released a discussion document on the Securities Legislation Bill regulations in March.

As noted above, the four areas in the new legislation that require regulations to be passed to bring into effect substantial obligations in the Securities Markets Amendment Act and the Takeovers Amendment Act are:

- investment advisers and brokers disclosure obligations;
- substantial securities holders disclosure;
- insider trading exemptions; and
- market manipulation exemptions.

Submissions on the discussion document closed in May 2006 and the MED website indicates that policy proposals for the regulations will be sent to Cabinet before the end of 2006 followed by draft regulations to Cabinet in April 2007.

### **When will the new securities provisions come into force?**

Most of the Securities Act amendments and Takeovers Act amendments (aside from the market manipulation provisions in the Takeovers Act and Code) came into effect after their assent on 24 October 2006.

However, the Takeovers Act amendments relating to market manipulation, and all of the amendments to the Securities Markets Act require regulations to be promulgated before the amendments can come into force. This is not likely to be before the middle of 2007.

To view more background information on this topic visit the Ministry of Economic Development's website at [http://www.med.govt.nz/templates/ContentTopicSummary\\_11044.aspx](http://www.med.govt.nz/templates/ContentTopicSummary_11044.aspx).

## Practical implications of new insider trading regime

### (1) Securities Trading Policies

The introduction of the new insider trading regime and market manipulation provisions combined with the removal of the Approved Procedure for Company Officers means that all listed companies (if they have not already done so) should revisit their securities trading policies for their directors and employees as soon as possible. Bell Gully will be contacting listed company clients on this aspect as part of assisting clients prepare for the new provisions coming into effect.

Clear guidelines and procedures should be provided to cover situations where directors and/or employees are in possession of price sensitive information which has not been made public. It may also be advisable to extend these policies to apply to any other person (such as advisers and consultants) who may possess inside information from time to time.

It will be important in formulating the new guidelines to clarify the scope of what constitutes inside information. In particular, it should be made clear to directors and employees that it is no longer possible to focus just on information received from or through the director's or employee's relationship with the company. As noted, under the new regime all information that is potentially relevant to the price of the company's securities is important.

Preventing any appearance of insider trading can be equally as important as preventing an actual breach. Some of the steps that can be taken to minimise this risk include:

- a requirement for internal approval procedures to be followed for any trading in the issuer's securities. This may draw on the sorts of processes that were set up to comply with the Approved Procedures programmes put in place but will require some amendment;
- implementing a policy to prohibit short-term or speculative trading in an issuer's securities;
- providing specified trading windows as a guide for when trading in the company's securities would be most appropriate. In other jurisdictions it is common for listed companies to prohibit "insiders" from trading outside these times except in exceptional circumstances.

It is important to remember that under the new insider trading regime, if trading windows are used these time periods will not operate as a defence to the legal prohibitions. Trading during the specified periods should be always made subject to compliance with the insider trading provisions and separate approval requirements. From now on, trading windows can only be used as a management tool in relation to risk.

### (2) Employee incentive schemes

Trading under a fixed trading plan or under options with a fixed exercise price is now an affirmative defence under the insider trading regime. The defence is however very narrow in its application.

A fixed trading plan is one that does not give the investor any right to withdraw before the end of a specified period nor must it be subject to any influence by the investor as to trading decisions after the plan has begun.

Directors and other affected employees will therefore need to review existing share trading and option incentive plans to check if they comply with the defence. If they do not, it may be worth considering amending the scheme to allow directors and employees to participate in a scheme without risking being in breach of the new insider trading regime.

### (3) "Stop" lists and Professional Service firms

A further area that may need to be reviewed by professional service firms, in particular, is the practice of using "stop lists" to prohibit members of the firm from trading securities where the firm has inside information. This arises from the addition of a new prohibition to the insider trading regime which provides for liability where the disclosure of information, or the advice or encouragement, results in person deciding to hold securities. Arguably, this new prohibition may put firms using "stop" lists at risk of liability for tipping members of the firm to "hold" their shares.

## Legislation/In Parliament

### Business Law Reform Bill fast tracks its way into law

*The Commerce Select Committee released its report on the Business Law Reform Bill on 18 October with only a few notable changes. This was followed by further amendments to the Bill through a Supplementary Order Paper on 14 November with passage of the Bill on 15 November.*

Commerce Minister Lianne Dalziel has welcomed the passing of the Bill, which she notes demonstrates the Government's willingness to listen to business.

*"The benefits provided by this legislation are tangible because the business sector, legal practitioners and enforcement agencies have suggested them. The passing of this legislation is yet another strong signal that the government is prepared to improve the regulatory environment for business."*

The Business Law Reform Bill includes amendments to five Acts:

- the Companies Act 1993;
- the Dumping and Countervailing Duties Act 1988;
- the Financial Reporting Act 1993;
- the Friendly Societies and Credit Unions Act 1982, and
- the Insurance Companies' Deposits Act 1953.

Its aim is to increase the clarity, efficiency, and effectiveness of the law around the operation of business. Specific changes to the Companies Act 1993 and the Financial Reporting Act 1993 (FRA) will be of particular importance to businesses.

Most of the proposed amendments in the Bill survived the Committee process but there are a few notable changes arising from the Report and the Supplementary Order Paper (SOP) issued on 14 November. The key additional changes to the Companies Act and FRA are outlined below.

#### **Companies Act**

##### *Annual reports*

The proposal to provide for the distribution of annual reports by electronic means was accepted but additional changes have been made to the new provisions, largely to improve the operation of the new system in practice. In brief these are:

- the wording of the provisions have been clarified to ensure that a company must send either a notice to shareholders informing them of their right to receive the annual report (or concise report where available) or a copy of the annual report each year. Both cannot be waived by shareholders;
- shareholders will be given 15 days to respond to the notice if they want to be sent a copy of the annual report; and
- if a shareholder elects to receive a report, the company must continue to send out the report each year until the shareholder revokes the request.

## Financial Reporting Act

### *Further relaxation of rules for overseas issuers*

One of the main new additions to the FRA amendments is the introduction of a new exemption power given to the Securities Commission over share purchase and option plans offered by overseas companies to their New Zealand employees.

The Committee's report noted that they had received a number of submissions indicating that the current requirement to prepare non-consolidated financial statements was cost prohibitive for many overseas companies that were not required to prepare such reports in their home jurisdiction.

Under the new section 35A of the FRA, the Securities Commission will be able to exempt any directors of an overseas issuer from the preparation, auditing and filing requirements for financial statements (and the associated offence provisions). The exemption, however is not available if it would cause hardship to New Zealand subscribers having regard to the different reporting requirements in the issuer's own country. The extent of exemption given can also go no further than what is reasonably necessary to address the matters that gave rise to the exemption.

Complementary powers of exemption have been given to the Registrar of Companies for non-issuer overseas companies.

The SOP has also removed the "fit and proper" test from the Securities Commission's and Registrar's exemption powers for these provisions.

### *Conduit issuers*

The proposed extended definition of "issuer" to capture "conduit issuers" for recipients of money has been limited to situations where a recipient has received 10% or more of the money raised by the conduit issuer from the public, and the aggregate amount provided to the person and all related parties constitutes 75% or more of the money raised from the public.

The SOP has amended the provisions relating to the receipt of money from conduit issuers so that they are brought into force by Order in Council. This is to allow the Securities Commission to consider possible exemptions from the relevant provisions. These provisions have also been amended to clarify that they apply in relation to offers to the public that are made under the Securities Act.

### *Accounting Standards Review Board*

The select committee's report notes that despite strong arguments against including the proposed new powers given to the Accounting Standards Review Board (ASRB) to exempt entities from unnecessary requirements in circumstances which can not be provided for in the FRA, the Committee has decided to retain the provisions. However in the SOP the ASRB's exemption making powers have been modified to:

- remove the ability to make individual exemptions;
- replace the "exceptional circumstances" test with a test that focuses on whether compliance with the relevant provision of the financial reporting standard would result in financial statements that are misleading or are likely to mislead; and
- remove the "fit and proper" test which is no longer considered to be necessary.

To access a copy of the Commerce Committee's report on the Business Law Reform Bill visit Parliament's website at [www.clerk.parliament.govt.nz](http://www.clerk.parliament.govt.nz).

To view Bell Gully's previous commentary on the Bill refer to the 2006 Winter *Commercial Quarterly* on our website.

## Legislation/In Parliament

### Voluntary administration - will it work?

*More than a decade after the Australians did it, New Zealand has this month introduced a new insolvency regime to help financially troubled companies stay afloat.*

Voluntary administration is the new insolvency framework that forms the centrepiece of the Companies Amendment Act 2006. The Act passed into law on 7 November. It's a regime that will be used to help rehabilitate companies that are in real financial trouble. It is based on an Australian model which has proved to be the most used form of insolvency procedure across the Tasman since it was introduced over 12 years ago.

Despite this, our own legislation didn't have a smooth ride with opposition from the National camp. This was mostly a result of the Government's refusal to follow two aspects of the Australian scheme that National says will make voluntary administration much less successful than it has been in Australia. A number of insolvency experts agree.

#### **What is the new regime about?**

Voluntary administration is a collective corporate rescue mechanism that can be initiated by a company's directors. They can do this by the appointment of an administrator to the company.

An administrator can be appointed if the company is insolvent or if the directors think the company may become insolvent. The object of the process is to bring the company back to financial health, or if that does not prove possible, to deliver a better return to the company's creditors than they would get if the company was placed in liquidation.

Voluntary administration works in large part because of the moratorium it imposes on creditor claims for the short time the administrator has to make an assessment as to whether the company can survive financially. If the administrator thinks the company can survive then he or she will recommend that they enter into a deed of company arrangement - the deed being a voluntary plan to enable the company to trade on while still managing its debts. To do this, the administrator needs the support of a majority of the company's creditors in number representing at least 75% in value of the company's debt.

#### **Continued priority for the New Zealand tax authorities**

In Australia, the Tax Office no longer has priority in a company liquidation for tax instalment deductions from salaries and wages. In return for losing that priority, company directors have been made personally liable for the company's unremitted tax liabilities if not made to the Tax Office by the company itself. However the directors can avoid personal liability if they have appointed an administrator.

Here, the Government has refused to abandon the Inland Revenue's status as a preferential creditor in a company's liquidation. It has also refused to accept that company directors should have personal liability for their company's tax liabilities if they should fail to put the company into administration. It is these two aspects of the Australian scheme that the Government has declined to adopt, which has caused most of the fuss.

The National Party and many insolvency experts are concerned that the Government has not followed the Australian lead. They say that the Inland Revenue will have no incentive to support a corporate rescue through the adoption of a deed of company arrangement, when it is likely to be able to recover all or most of its debt as a preferential creditor in a liquidation. And if the company's directors do not have the "stick" of personal liability for the company's unpaid taxes, it is said that they are unlikely to move to appoint an administrator early enough.

#### **Are the experts right?**

All of this may or may not be true. But it does assume that the Inland Revenue will, more often than not, have the voting power to stymie a proposed deed of company arrangement. This ignores the fact that the new legislation gives the administrator a casting vote. In Australia this casting vote has been used to decide whether a resolution supported by a majority of creditors by number will or will not be adopted in circumstances where that same resolution is opposed by creditors that hold the requisite majority when measured by value.

In other words the Inland Revenue may not have the power to stop a deed of company arrangement unless that deed is also opposed by a majority of the company's creditors when measured by number. If opinion is divided between the "number" creditors and the "value" creditors and the administrator genuinely considers that interests of the creditors as a whole are better served by a deed of company arrangement, then it may not be possible to stop the deed being signed.

However this does not mean that an Inland Revenue opposed to a company deed of arrangement is without any remedy, especially if the terms of the deed of company arrangement purport to limit the priority that the IRD would otherwise have as a preferential creditor in the company's liquidation. Under the new Act the court may terminate a deed of company arrangement if it finds that the deed is unfairly prejudicial to a creditor. In Australia it is generally understood that a deed is vulnerable to termination by the court if it disturbs the statutory priority of those that would be preferential creditors in a company liquidation.

All of this should mean that the Government's refusal to abandon Inland Revenue's status as a preferential creditor in a company's liquidation will not necessarily result in deeds of company arrangement being blocked because the IRD holds sufficient votes to vote down the relevant creditor's resolution. But it also means that deeds that are implemented need to observe the statutory priorities if they are not to be vulnerable to premature termination by the court.

It is true that the directors do not have quite the same incentives to put a company into administration. There is no "sword of Damocles" hanging over their heads over the company's unpaid tax liabilities. However an amendment to section 301 of the Companies Act, now means that the court can take into account any action taken by a director over the appointment of an administrator when deciding whether as a result of breach of duty or negligence a director should personally contribute to the assets of a company in liquidation. This should provide an additional incentive to the directors to appoint an administrator at an early stage.

#### **Will voluntary administration work?**

This remains to be seen. It can be strongly argued that retaining the Inland Revenue's status as a preferential creditor will not by itself mean that company work outs under voluntary administration are less likely to proceed. It is true that directors in New Zealand will not have all the incentives that their counterparts in Australia have to consider administration as an option. However recent enquiries into the effectiveness of the voluntary administration procedure in Australia have revealed that the directors of Australian companies are also invoking the procedure too late in order to enable an effective business rescue.

Director education and the risks associated with insolvent or reckless trading are more likely to be factors that marginalise the use of voluntary administration here in New Zealand. Many directors are unfamiliar with the concepts of "company turnaround" and will not know much about voluntary administration until they are faced with a financial crisis. And if a work out under the auspices of a deed of company arrangement should fail, there will be arguments about when the company became insolvent and whether and to what extent the directors should have personal liability for losses incurred as a result

While there is general ongoing support for voluntary administration in Australia, submissions to a 2004 parliamentary enquiry into Australia's insolvency laws argue that another generation of corporate rescue processes being introduced in the UK (such as corporate voluntary arrangements) are cheaper and more efficient than voluntary administration. It would be ironic if New Zealand in "catching up" with the Australians after 12 years, found itself to be behind again in a few years in the adoption of best practice business rehabilitation regimes.

This commentary is by Bell Gully corporate/commercial partner Stephen Revill.

Note: The Insolvency Law Reform Bill was passed as three separate Acts:

- Insolvency Act 2006 which repeals and replaces the Insolvency Act 1967;
- Companies Amendment Act 2006 which amends the insolvency provisions of the Companies Act 1993; and
- Insolvency (Cross-Border) Act 2006 which creates new legislation on cross-border insolvency.

The legislation will be implemented later next year once regulations are in place.

## Legislation/In Parliament

### Update on the KiwiSaver Act 2006

*The KiwiSaver Bill has made speedy process through its final stages receiving royal assent on 6 September.*

The KiwiSaver Act is an attempt to encourage retirement savings by encouraging employees to join a voluntary scheme where retirement savings are deducted from their wages or salaries.

After 1 July 2007, the scheme will start automatically for people who begin employment, change employers and those who opt-in to join. It will not apply to existing employees, except for those that opt-in.

Employees may already be starting to think about whether they wish to be part of the scheme.

Employers may wish to consider whether they should nominate a scheme for their employees; whether they wish to add employer contributions and the future of any existing superannuation schemes in place. Closer to the introduction, employers will also need to become alert to their administrative obligations under the KiwiSaver scheme - including information that needs to be provided to new employees and obligations in deductions for savings.

To access detailed information about KiwiSaver visit the Government's new official KiwiSaver website at <http://www.kiwisaver.govt.nz/>.

## Legislation/In Parliament

### **Draft regulations on the trans-Tasman mutual recognition of securities offerings released**

*Both the Australian and the New Zealand governments have released draft regulations to give effect to the Mutual Recognition of Securities Offerings agreement signed by them earlier in the year.*

Under the current regulatory regime, Australian and New Zealand issuers cannot use their home jurisdiction offer documents when making a trans-Tasman offer of securities or managed investment scheme interests. Instead, issuers must comply with the relevant requirements in the host jurisdiction unless the issuer is operating under an exemption in the host jurisdiction.

The trans-Tasman Mutual Recognition of Offers of Securities and Managed Investment Scheme Interests regime will allow an issuer to extend an offer that is being lawfully made in one country (the home jurisdiction) to investors in the other country (the host jurisdiction) without being required to comply with most of the substantive requirements of the host jurisdiction's securities laws that apply to domestic offers.

The draft regulatory frameworks which were released in September cover the activities that are inherent in the making of offers, including:

- content and registration requirements for offer documents;
- the manner in which offers may be made;
- advertising and other communications with offerees in relation to offers; and
- the manner of acceptance of offers and other consequential matters.

The new framework will apply to offers of securities and interests in managed investment schemes.

The home jurisdiction regulator will have all its usual powers (in the home jurisdiction) in connection with offers made in the host jurisdiction under the regime. These powers include the power to suspend or stop the offer being made. These powers will be exercisable in respect of offers to investors in either country.

The host jurisdiction regulator will have certain powers in respect of offers made under the mutual recognition regime if entry requirements are not satisfied, or ongoing requirements are not complied with.

Submissions on the draft Corporations Amendment (NZ Closer Economic Relations) Bill 2006 closed on 13 October 2006 and submissions on the Securities (Mutual Recognition of Securities Offerings – Australia) Regulations 2006 closed on 24 October 2006.

For further information on the proposed New Zealand regulations visit the Ministry of Economic Development's website at [http://www.med.govt.nz/templates/MultipageDocumentTOC\\_22296.aspx](http://www.med.govt.nz/templates/MultipageDocumentTOC_22296.aspx).

For further information on the proposed Australian Bill visit the Australian Government's website at <http://www.treasury.gov.au/contentitem.asp?NavId=037&ContentID=1155>.

## Recent developments

### Corporate

#### **Commerce Minister's speech to insolvency group**

Lianne Dalziel highlights some of the key hopes the Government has for the new voluntary administration regime introduced under the Insolvency Law Reform Bill.

#### **Insolvency practitioners rules up for discussion**

The Government has released proposals for the regulation of insolvency practitioners, company liquidators and administrators in preparation for the new voluntary administration regime.

#### **Securities Commission issues its Financial Reporting - Cycle 3 report**

Cycle 3 of the Securities Commission's ongoing financial reporting surveillance programme has been completed. The focus was on issuers' disclosures over their transition to NZ IFRS.

#### **Doing Business with Government**

In October, Lianne Dalziel spoke at Bell Gully's "Crunch" Thought Leadership Series on *"Doing Business with Government"*.

### Capital markets

#### **Latest on the Takeovers Panel's moves to amend provisions of the Companies Act relating to schemes of arrangement and amalgamations**

Since the last issue of Commercial Quarterly the Takeovers Panel has been very active in its attempt to amend the provisions of the Companies Act relating to schemes of arrangement and amalgamations to effect acquisitions of Takeovers Code companies.

#### **Securities Commission completes first annual oversight review of NZX**

The Securities Commission has published the report on its first oversight review of NZX's performance as a registered exchange. Overall the Commission's findings were favourable but it had some recommendations for improvements.

#### **Discussion document on "securities offerings" released in September**

The fourth and final part of the Government's four part securities law reform programme is part of its Review of Financial Products and Providers.

### Competition and consumer protection

#### **Speech to Trans-Tasman Business Circle**

Commerce Commission Chair Paula Rebstock gave a speech on a regulator's view of the current trans-Tasman economic relationship. She provided a general overview of the current activities of the Australian and New Zealand governments to facilitate greater cooperation, coordination and integration of the general competition and consumer protection regimes in both countries.

#### **Review of Commerce Act is to include the electricity supply provisions**

Part 4A has been included in the review of Parts 4 and 5 of the Commerce Act.

### Resources and energy

#### **Updated Government Policy Statement on Electricity Governance**

On 26 October, the Energy Minister released an updated Government Policy Statement on Electricity Governance designed to improve the quality and timeliness of decision-making on transmission.

### Intellectual property

#### **An update on New Zealand's battle against spam**

The Commerce Select Committee has reported back on the Unsolicited Electronic Messages Bill. The Bill is expected to be passed by the end of this year or early next year and will come into force six months after it receives Royal assent.

## Recent developments

### Corporate

#### Commerce Minister's speech to insolvency group

*Lianne Dalziel highlights some of the key hopes the Government has for the voluntary administration regime being introduced as part of the new insolvency legislation.*

Lianne Dalziel describes the new insolvency regime as forming part of the Government's economic transformation agenda in so far as it aims to improve the confidence that both New Zealand and overseas based investors have in the regulatory environment in this area.

The Government's objectives in developing the insolvency reform package were:

- to establish a predictable and simple regime that can be administered quickly and efficiently in the event of financial failure, which does not impose unnecessary compliance costs or stifle innovation and responsible risk taking;
- to establish a regime that distributes proceeds to creditors in accordance with their pre-insolvency entitlements and maximises returns to creditors, through flexible and effective methods of administration and enforcement;
- to encourage early intervention when financial distress becomes apparent by providing alternative avenues of administration and opportunities for individual bankrupts to participate fully again in the economic life of the community; and
- to promote international co-operation in cross-border insolvency cases where assets are being held in different jurisdictions.

Ms Dalziel views the new voluntary administration regime has being particularly significant to New Zealand's insolvency regime by providing companies with a chance to rehabilitate and become productive and contributing participants in the economy again. She notes that when a similar system was introduced in Australia in 1993 there was an immediate take-up and it has since become the dominant formal proceeding in that country. She also points out that by co-ordinating the Australian and New Zealand regimes, it will be easier and more cost efficient to conduct rehabilitations for trans-Tasman businesses.

Her speech also addresses the discussion document on the regulation of insolvency practitioners which is seeking submissions on the introduction of a competitive licensing scheme. This would require all persons carrying out corporate insolvency processes to be members of a professional organisation that is approved by an approval body.

To access a copy of this speech visit the Government's website at <http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=27387>.

## Recent developments

### Corporate

#### **Insolvency practitioners rules up for discussion**

*The Government has released proposals for the regulation of insolvency practitioners, company liquidators and administrators in preparation for the new voluntary administration regime.*

The discussion document follows on from submissions the Government received during the initial consultation process on its review of the insolvency law regime in 2004. Concerns about the lack of a regulatory framework for insolvency practitioners were also raised in submissions on the Insolvency Law Reform Bill, particularly in relation to the introduction of the voluntary administration regime.

The Government's preferred option for the regulation of insolvency practitioners is a competitive licensing scheme. This would require all people carrying out corporate insolvency processes to be members of a professional organisation approved by the Registrar of Companies. It would also mean that all insolvency practitioners would have their skills and competencies tested and be subject to investigation and disciplinary processes.

The closing date for submissions on the discussion document is Friday 2 February 2007.

To access a copy of the Discussion Document visit the Ministry of Economic Development's website at [http://www.med.govt.nz/templates/MultipageDocumentTOC\\_22651.aspx](http://www.med.govt.nz/templates/MultipageDocumentTOC_22651.aspx).

## Recent developments

### Corporate

#### Doing Business with Government

*In October, Lianne Dalziel spoke at Bell Gully's "Crunch" Thought Leadership Series on "Doing Business with Government".*

Ms Dalziel began her speech by noting that under her portfolio "*doing business with government*" is about "*a commitment to high quality regulation and ease of compliance for business*".

Her speech covered three key topics:

- what the Government is doing to improve regulation in the securities legislation and the financial services industry;
- how New Zealand compares internationally; and
- the Government's Quality Regulation Review.

On the Government's current Review of Financial Intermediaries, she indicated that there has been general support for its proposed co-regulatory framework whereby the Approved Professional Bodies provide frontline supervision and the Securities Commission provides the next level of supervision.

Ms Dalziel discussed the Government's commitment to a strengthened regulatory impact analysis process to ensure that any new legal framework met the "fit for purpose" test.

She encouraged industry to engage with Government officials with examples of changes they would like to see in regulatory frameworks to help ensure that they do not present a barrier to growth.

To access a copy of this speech visit the Government's website at <http://www.beehive.govt.nz/ViewDocument.aspx?DocumentID=27462>.

## Recent developments

### Corporate

#### **Securities Commission issues its Financial Reporting - Cycle 3 report**

*Cycle 3 of the Securities Commission's ongoing financial reporting surveillance programme has been completed. The focus was on issuers' disclosures over their transition to NZ IFRS.*

The Commission reviewed 45 financial reports with balance dates from 31 March 2005 to 30 September 2005. Nineteen issuers had matters that needed to be addressed and three matters relating to continuous disclosure notices have been referred to the NZX for consideration.

For the first time, the Commission looked into disclosures required for the transition to New Zealand Equivalents to International Financial Reporting Standards (NZ IFRS). More than half of the reports either did not include information about the transition or only partially complied with the requirements.

*"These disclosures are very important for issuers to signal to the market the likely impact of adopting NZ IFRS," Chief Accountant Alastair Boulton said. "A great deal of effort is going into NZ IFRS transition but the Commission is disappointed with the level of response to these disclosures in the financial statements examined in Cycle 3."*

The Commission is continuing its Financial Reporting Surveillance Programme and is currently reviewing financial reports of early adopters of NZ IFRS with a 31 December 2005 balance date.

The stated aim of the reviews is to encourage issuers to improve the quality of their financial reports and in doing so help contribute to the integrity of New Zealand's securities markets.

To access a copy of the Cycle 3 Report visit the Securities Commission's website at <http://www.sec-com.govt.nz/publications/documents/cycle-3/>.

## Recent developments

### Capital markets

#### **Latest on the Takeovers Panel's moves to amend provisions of the Companies Act relating to schemes of arrangement and amalgamations**

*Since the last issue of Commercial Quarterly the Takeovers Panel has been very active in its attempt to amend the provisions of the Companies Act relating to schemes of arrangement and amalgamations to effect acquisitions of Takeovers Code companies.*

#### **Submissions to Select Committee and Minister of Commerce**

On 24 August, the Takeovers Panel appeared before the Commerce Select Committee hearing on the Business Law Reform Bill to press the committee to include in the Bill the Panel's proposed reforms of certain provisions of the Companies Act 1993 and the Takeovers Code.

The Panel also made a separate submission to the Minister of Commerce on its recommendations.

The Panel recommends that the provisions in the Takeovers Code for schemes and amalgamations should be removed from the Code and instead be incorporated as part of the Companies Act provisions in Parts XIII and XV of the Companies Act. In particular the Panel has recommended that:

- Part XIII of the Companies Act, which deals with amalgamations, be amended to require that:
  - parties to a proposed amalgamation must obtain the approval of the Panel to the amalgamation process; and
  - the Panel, in giving approval for an amalgamation process, shall take into account the principles of the Takeovers Code; and
- Part XV of the Companies Act, which deals with schemes of arrangement, be amended to require that:
  - the courts take into account the principles of the Takeovers Code when deciding the requirements for approval of a scheme of arrangement, including the level of shareholder approval required and the information to be provided to shareholders; and
  - before approving a scheme of arrangement the court receives and takes into account recommendations from the Panel as to the requirements to be met for the scheme of arrangement to be approved.

The Commerce Select Committee rejected the Takeovers Panel's last minute proposal to add its measures to the Bill. The committee noted that it considered the changes were beyond the scope of the Bill and would be more appropriately addressed in future legislation.

Subsequently it was reported that a Supplementary Order Paper (SOP) to the Business Law Reform Bill addressing the Panel's recommendations was to be presented to Cabinet on Monday 13 November. This was followed by a second report that the SOP was not to be presented because it had failed to gain the support of the National Party on the basis that it would have circumvented due process. The consent of all the political parties was necessary because the amendments to the Business Law Reform Bill requested by the Panel were beyond the scope of the Bill.

A New Zealand Herald article<sup>29</sup> reported the Commerce Minister, Lianne Dalziel as saying:  
*"[the amendments to the Business Law Reform Bill] would have gone part way to addressing the Takeovers Panel's concerns....It would have created new regulation-making powers, meaning shareholders could have received additional information about a proposed amalgamation...It would have also required the court to take account matters specified in regulations about whether an amalgamation proposal would have unfairly prejudiced a shareholder and whether a proposed scheme of arrangement should be approved."*

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<sup>29</sup> "Officials try again to close the Takeovers Code loophole", Adam Bennett and Christopher Niesche, The New Zealand Herald, 13 November 2006.

## Commentary

We do not believe that amendments of this nature should be introduced without an opportunity for these substantive matters of company law reform to be subject to a proper process of analysis and consultation. Our particular concerns on the Takeovers Panel's recommendations are:

- The proposed amendments are not "closing a loophole" in the current regime. Rather, they would result in fundamental changes to principles of company law that have been established over many years with the benefit of case law from New Zealand, Australia, the United Kingdom and Canada. In our view, changes of that type should be subject to proper scrutiny, including analysis of their likely economic effects and a proper opportunity for consultation with interested parties. None of that occurred in respect of the changes that we understand were to be proposed in the SOP. There was, however, an extensive period of analysis and public debate preceding the introduction of the Takeovers Act and Code. That resulted in a deliberate decision to retain the amalgamation and scheme of arrangement provisions in their current form.
- The proposed changes are unnecessary. The courts already have a supervisory role and a discretion to set voting thresholds and procedures to protect the interests of shareholders in schemes of arrangement. These issues were addressed by the Court of Appeal in a decision released in October in the *Dominion Funds* case<sup>30</sup>. The Court of Appeal confirmed that the Takeovers Panel can be heard on these matters and that in appropriate cases the court will take into account the matters raised by the Panel. Significantly, however, the Court of Appeal did not accept the Panel's view that Takeovers Code thresholds should apply to all amalgamations and schemes of arrangement.
- The proposed changes would also put New Zealand out-of-step with the Australian law on this issue. After a period of lengthy debate on the issue, the Australian courts recognise the benefits of the scheme of arrangement procedures and allow arrangements to proceed under the normal rules (i.e. a 75% voting majority) even in circumstances where the same transaction could have been structured as a takeover.
- The proposed changes would confer disproportionate power on a small number of shareholders who would effectively be able to veto transactions that are supported by the vast majority of shareholders. They are, in particular, contrary to the interests of small shareholders.
- There is no urgency. The law relating to amalgamations and schemes of arrangement has been unchanged since the introduction of the Companies Act 1993. Over that period many beneficial transactions have successfully been completed under Court supervision. There is no evidence to suggest that the court procedures have been abused or that unfair or prejudicial transactions are being approved. This point is also discussed in the Court of Appeal's decision in *Dominion Funds*.

For further commentary, please refer to Bell Gully's submissions on the Takeover Panel's consultation paper released earlier this year on this topic at:

[http://www.bellgully.com/resources/pdfs/Bell\\_Gully\\_submission\\_26052006.pdf](http://www.bellgully.com/resources/pdfs/Bell_Gully_submission_26052006.pdf)

To view a copy of the Takeovers Panel's recommendations to the Commerce Minister and a copy of its select committee submissions, visit the Takeovers Panel's website at

<http://www.takeovers.govt.nz/publications/index.html>.

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<sup>30</sup> *Dominion Income Property Fund Limited and Ors v Takeovers Panel* (Unreported, 26 October 2006, Court of Appeal CA229/06). For a commentary on this case, please refer to the **In the courts** section of this issue of *Commercial Quarterly*.

## Recent developments

### Capital markets

#### Discussion document on “securities offerings” released in September

*The fourth and final part of the Government’s four part securities law reform programme forms part of its Review of Financial Products and Providers (RFPF).*

This follows on from:

- the introduction of the Takeovers Code in 2001;
- the reform of the stock exchange and the regulation of listed issuers in 2002; and
- the passage of the omnibus Securities Legislation Bill in October 2006.

In addition to the review of securities offerings, the RFPF considers the regulation of insurance (health, life and general), superannuation, collective investment schemes, platforms and portfolio management services, non-bank financial institutions (friendly societies, credit unions, building societies, finance companies, industrial and provident societies) and consumer dispute resolution and redress in the financial sector.

Nine separate discussion documents have been released for each of these areas as part of the Government’s third stage of the RFPF.

#### Problem areas identified

The discussion document on securities offerings identifies a number of areas of the regime under the Securities Act which require improvement. These include ensuring that:

- the Securities Act is targeted at those investors who need the protection of regulatory intervention;
- there are appropriate entry requirements for all issuers who offer securities to public investors;
- investors receive effective disclosure over the life of the security;
- the Securities Commission has sufficient and appropriate enforcement powers; and
- trustee supervision provides appropriate and consistent protections for investors, without reducing the flexibility of trustees and issuers to tailor a trust deed to a particular issue of securities.

#### Objectives

The Government’s aim is to ensure that any improvements made:

- provide clarity for issuers as to when the disclosure regime applies;
- simplify access to capital for those making offers to sophisticated and professional investors; and
- ensure that the disclosure regime is more relevant and more accessible.

The discussion document also reiterates that the review is being conducted in the context of the Memorandum of Understanding on Business Law Coordination between New Zealand and Australia and the trans-Tasman mutual recognition regime for securities and compliance with IOSCO objectives, principles and standards, where appropriate. This will mean that any changes to New Zealand’s securities regime will need to be consistent with the Australian regime unless there are good reasons for the laws to be different.

#### Application of Securities Act being re-considered

The Government proposes to retain the concept of “offer of securities to the public” for the purposes of determining what type of offers are regulated under the Act. However, in practice, it is not always clear

whether an offer is made to the public. The proposal is that the Securities Act be amended to clarify this issue. In particular, the scope of the existing exemptions for "relatives and close business associates" and "professional and habitual investors" would be clarified.

As a related point, the discussion document also seeks feedback on whether investors under these exempt offers should nonetheless have the protection of certain parts of the Securities Act. For example, it might be that, while the disclosure regime in the Act would not apply to exempt offers, the misstatement liability regime would apply.

#### **Proposal for single offer documents**

Currently, the disclosure regime in the Act is based upon a dual offering document approach – that is, a prospectus and an investment statement. The discussion document proposes to revert to a single offer document, having a Part A and a Part B. Part A will, like the investment statement, be targeted at retail investors. It will be in a prescribed form for the relevant security type and will, in theory at least, be concise (the proposal is to limit it to five pages). Part B will, like the prospectus, be targeted at professional investors. It is not clear at all how this approach would differ from the not uncommon practice now of combining the prospectus and investment statement.

The financial literacy of the average New Zealand retail investor has long been of concern to the Government. There is little point in requiring comprehensive disclosure by issuers if the target audience cannot understand the information provided. In an attempt to improve financial literacy, it is proposed that the single offer document must contain educational material on financial concepts.

#### **Extension of the continuous disclosure regime**

Finally, a contentious issue raised by the discussion document is whether a continuous disclosure regime should be extended beyond listed securities to all securities where there is an established secondary market. If adopted, this proposal would significantly increase the cost of capital for non-listed issuers.

#### **Closing Date for submissions**

Submissions on the nine discussion documents are due by 1 December. The Ministry of Economic Development (MED) will then develop policy proposals for consideration by Cabinet by April 2007. Assuming Cabinet endorsement, the supporting legislation will then be drafted. The Government hopes to have the legislation in force by 2008.

For further information on the Review of Financial Products and Providers, please see the article by Bell Gully Partner David Craig, *"Mega reform of financial sector law a step closer"* on Bell Gully's website.

For further information on all of the nine discussion documents including the Review of Securities Offerings discussion document visit the MED's website at [http://www.med.govt.nz/templates/ContentTopicSummary\\_479.aspx](http://www.med.govt.nz/templates/ContentTopicSummary_479.aspx).

## Recent developments

### Capital markets

#### Securities Commission completes first annual oversight review of NZX

*In September, the Securities Commission published the report on its first oversight review of NZX's performance as a registered exchange. Overall the Commission's findings were favourable but it had some recommendations for improvements.*

The review of NZX's regulatory functions by the Securities Commission focussed on NZX's arrangements in the 2005 calendar year for discharging its obligations in:

- conflict management;
- arrangements for supervision of market participants;
- arrangements for supervision of listed issuers;
- arrangements for release of market information;
- market operations and infrastructure;
- disciplinary arrangements and NZX Discipline;
- supervision of NZX as a listed issuer by the Special Division; and
- governance.

The Commission's key recommendations to NZX arising from the review include:

- NZX needs to use a mechanism to penalise repeat breaches by market participants;
- NZX should consider enlarging the membership of the Listing Subcommittee to address potential issues arising from conflicts of interest;
- NZX and NZX Discipline should together review the administrative support and resource arrangements in place for NZX Discipline. These resource arrangements should be reviewed regularly to ensure that NZX Discipline receives all the resources it requires to enable it to continue to carry out its functions effectively;
- NZX should set an example of full compliance with all lawful directions or requests of the Special Division;
- NZX and the Special Division should develop and implement a communication strategy about the role of the Special Division; and
- in respect of waiver and ruling applications involving contentious matters, the Special Division should use its external advisers and these advisers should be given access to precedents and other relevant information.

The Commission considers that there is currently in practice effective separation between NZX's supervisory functions and its corporate activities, and that the conflicts of interest between these functions are managed satisfactorily. But it noted that it was concerned over the unwillingness of the NZX Board to acknowledge that there is an inherent conflict within any demutualised exchange between commercial and regulatory functions. In the Commission's view this may preclude the NZX Board from giving sufficient and necessary consideration to potential organisational developments within NZX regarding the regulatory function.

To view a copy of the Securities Commission's Report visit the Commission's website at <http://www.sec-com.govt.nz/>.

## Recent developments

### Competition and consumer protection

#### Speech to Trans-Tasman Business Circle

*Commerce Commission Chair Paula Rebstock gave a regulator's view of the current trans-Tasman economic relationship, providing an overview of the current activities of the Australian and New Zealand governments to facilitate greater cooperation, coordination and integration of the general competition and consumer protection regimes in both countries.*

Paula Rebstock begins by noting that there is already a high level of integration between Australia and New Zealand illustrated by the general similarity in New Zealand and Australia's competition and consumer protection laws and in the institutions responsible for administering and enforcing those laws, and the generic competition law remedies in section 36A of New Zealand's Commerce Act and section 46A of Australia's Trade Practices Act which effectively extend extraterritorial jurisdiction of the respective laws in relation to unilateral abuses of market power in markets not exclusively for services.

One of the current goals is to increase cooperation between the Commerce Commission and the Australian regulatory body (ACCC) on enforcement and information gathering, including the ability to investigate on each other's behalf. A specific measure recommended by the Productivity Commission is providing scope for businesses to have certain approvals considered on a single track, but with separate decisions.

Ms Rebstock outlines key features of the ACCC's and Commerce Commission's new protocol on cooperation in merger review and noted:

- it is proposed that the agencies may discuss timing and other process issues with the merging parties to facilitate coordinating key stages of the review;
- consent by applicants will be completely voluntary, but it was noted that it would be in the applicants' interests to facilitate a timely consideration of their application;
- the merging parties, and any third parties as relevant, would be encouraged to allow joint ACCC and Commission meetings with parties and their experts; and
- agencies should discuss coordinating requests for additional information, documents and meetings or conferences.

On CER, Ms Rebstock noted that the focus will generally be on the theme of efficient rationalisation of resources and an extended export base to third countries. Public benefits that the Commission has considered in the past include:

- rationalisation of production between or within Australia and New Zealand industries creating efficiencies of resource use;
- cost cutting moves in response to the lowering of frontier barriers, for example, would enhance international competitiveness and use of local resources; and
- improved off-shore links would enhance opportunities for the export of New Zealand made goods.

The speech also discusses the Commission's recent cartel investigations with particular emphasis on the leniency policies employed by both regulatory bodies. Ms Rebstock notes that some of the issues arising from the ACCC's recent review of its leniency policy which the Commission might consider include paperless applications, providing for full immunity until the point that the Commission has obtained legal advice on the evidence, and introducing a marker system allowing people to reserve a place in the leniency queue. She noted that the Commission and the ACCC plan to formalise arrangements for cooperation in enforcement of both consumer law and competition in a further protocol, to be made publicly available.

For a copy of this speech visit the Commerce Commission's website at <http://www.comcom.govt.nz/MediaCentre/Speeches/spechtotranstasmanbusinesscircle.aspx>.

## Competition and consumer protection

### Review of Commerce Act is to include the electricity supply provisions

*Part 4A has been included in the review of Parts 4 and 5 of the Commerce Act.*

In the 2006 Autumn *Commercial Quarterly* we noted that the Ministry of Economic Development (MED) is to review Parts 4 and 5 of the Commerce Act 1986.

The Commerce Act 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 review of Parts 4 and 5 of the Commerce Act has been split into two streams:

- a review of the regulatory control provisions; and
- a review of the authorisation and clearance provisions.

In addition, Commerce Minister Lianne Dalziel and Energy Minister David Parker announced in September that the electricity supply provisions in Part 4A of the Commerce Act will be included as part of this review. This was seen as a sensible move given that the initial proposed review may have implications for Part 4A.

Part 4A provides a targeted control and information disclosure regime for large electricity lines businesses and allows for individual electricity lines businesses to be placed under regulatory control, if they breach thresholds set by the Commerce Commission. The line businesses include Transpower and 28 distribution businesses.

In the terms of reference released for the review of the regulatory control provisions, it is noted that the review is to ensure that:

- regulatory control is consistent with providing for the long-term benefit of consumers within New Zealand;
- there is sufficient legislative clarity and that any regulatory uncertainty is minimised; and
- the provisions are consistent with the government's objectives around infrastructure investment.

The terms of reference relating to the authorisation and clearance provisions note that the review will only involve consideration of the processes and procedures and will not include a review of the thresholds for business acquisitions or restrictive trade practices (since these were substantively amended in 2001). This review is to ensure the provisions provide the appropriate degree of:

- accountability and transparency of decision making;
- participation by interested parties;
- analytical rigour and due process;
- timeliness of decision making; and
- business and administrative costs.

The reviews have been set to different timetables. It has been proposed that a discussion paper on the regulatory control provisions will be released in February 2007 followed by the discussion paper on the authorisation and clearance provisions in April 2007.

The Commerce Commission is also undertaking an investigation, under Part II of the Commerce Act, into the wholesale and retail electricity markets.

This investigation includes the question of whether or not the electricity generator-retailers have market power and are abusing it to keep new players out and is expected to be completed by the end of the year.

For further information visit the Ministry of Economic and Development's website at [http://www.med.govt.nz/templates/ContentTopicSummary\\_22451.aspx](http://www.med.govt.nz/templates/ContentTopicSummary_22451.aspx).

For previous commentary on the review of Parts 4 and 5 of the Commerce Act see the article in Bell Gully's July Competition Update at [http://www.bellgully.com/newsletters/03Competition/comp06\\_MED.asp](http://www.bellgully.com/newsletters/03Competition/comp06_MED.asp).

## Recent developments

### Resources and energy

#### Updated Government Policy Statement on Electricity Governance

*On 26 October, the Minister of Energy released an updated Government Policy Statement on Electricity Governance designed to improve the quality and timeliness of decision-making on transmission.*

This follows consultation with the Electricity Commission on a draft statement released in August and consideration of comments by other industry stakeholders.

The October 2006 version of the *Government Policy Statement* is a limited revision of the *October 2004* statement. It sets out the Government's objectives and outcomes for the Electricity Commission.

In his press release Mr Parker noted that the new policy is designed to:

- emphasise the importance of security of supply in transmission, including in extreme events, by providing for diversity of supply routes, especially for large load centres like Auckland;
- ensure that the grid facilitates competition in generation and minimises transmission constraints;
- ensure that business and stakeholder confidence in security of supply is maintained during transmission upgrade processes;
- ensure that transmission planning supports the government's goal of facilitating renewable energy;
- emphasise that, to the extent possible, grid upgrade plans should be as comprehensive as possible and should be considered in a wide framework; and
- allow Transpower to recover the reasonable costs of acquiring land corridors in advance of approval of specific grid upgrade plans.

A related document, the New Zealand Energy Strategy, which was referred to in the 2006 Winter issue of *Commercial Quarterly* is expected to be released as a draft at the end of November and finalised in 2007. The Strategy will identify priorities to achieve the Government's energy objectives.

To access a copy of the updated *Government Policy Statement on Electricity Governance* visit the Ministry of Economic Development's website at <http://www.med.govt.nz>.

## Recent developments

### Intellectual property

#### An update on New Zealand's battle against spam

*The Commerce Select Committee has reported back on the Unsolicited Electronic Messages Bill. The Bill is expected to be passed by the end of this year or early next year and will come into force six months after it receives Royal assent.*

The Bill represents the Government's attempt to bring us in line with other countries such as Australia, the United Kingdom and the United States, in fighting the increasing cost of spam.

#### Purposes of the Bill

The purposes of the Bill are to:

- prohibit the sending of unsolicited commercial electronic messages that have a New Zealand link to:
  - promote a safer and more secure environment and reduce impediments to the uptake and effective use of information and communications technology; and
  - reduce costs associated with such messages;
- require all electronic messages with a New Zealand link to identify the person authorising the sending of the message and to include a functional unsubscribe facility embedded into the electronic message in order to enable the recipient to instruct the sender that no further messages are to be sent to the recipient;
- prohibit the use of software to harvest electronic addresses, and the use of harvested address lists; and
- deter people from using information and communications technologies inappropriately.

The committee notes that the Bill is *"only one part of a multi-pronged approach that is necessary to tackle the problem"* and encourages the internet service provider community to take an active role in the reducing eliminating spam.

#### Key changes

The key changes to the Bill recommended by the committee include:

- removing the requirement for business to distinguish between commercial electronic messages (which required an "opt-in" process) and purely promotional electronic messages (which required an "opt-out" process). It was considered that having a dual regime for these types of messages would create uncertainty and confusion. It would also encourage businesses to claim that messages were promoting the business as a whole rather than its goods and services;
- expanding the definition of "commercial electronic message" to include messages that seek to market goods or services merely by providing links to other websites or messages;
- removing the requirement in the definition of "commercial electronic message" that marketing or promoting goods or services must be the "primary purpose" of the message so that it is clear that the Bill catches all messages that seek to market and promote goods and services;
- removing the legal obligation on internet service providers to deal with complaints from spam recipients as this was considered to place an unreasonable burden and significant enforcement costs on service providers;
- allowing spam recipients to forward their complaints directly to the enforcement agency;

- expanding the functions and powers of the enforcement agency to include the monitoring the industry, taking public awareness and information dissemination action when required and engaging in international cooperation and liaison; and
- allowing the District Court to hear matters except where the amount claimed or penalty sought exceeds \$200,000 or if an injunction is sought.

### **An overview of the Bill**

#### *Who will it affect?*

The Bill changes the “ground rules” for businesses involved in digital marketing by requiring an “opt-in” process before commercial electronic messages (as defined by the Bill) can be sent to customers or potential marketing targets.

Once enacted, fines of up to \$200,000 for individuals and up to \$500,000 for organisations can be incurred for breaching the Act.

#### *Rules for electronic messaging*

##### *Electronic messages*

The Bill applies to messages sent to an electronic address using a telecommunications service, and includes email, instant messaging or text messaging. It doesn't apply to voice calls (including voice messages using voiceover internet protocol technology) or to fax transmissions.

##### *New Zealand link*

The Bill only applies to electronic messages with a New Zealand link. The definition “New Zealand link” is very wide and covers not only messages originating in New Zealand, but also, among other things, any electronic messages accessed by a computer located in New Zealand. However, liability for breaches of the Act apply only to people resident in or organisations carrying on business or activities in New Zealand.

##### *Commercial electronic messages*

A commercial electronic message is a message whose:

- purpose is the marketing or promoting of goods or services; or
- object is to obtain a dishonest financial advantage (to cover off the kind of messages used by Nigerian scam operators).

There are exceptions as to what represents a commercial electronic message. These include quotes or estimates (if requested); messages facilitating, completing or confirming an already agreed commercial transaction; and messages that provide the recipient with information about goods or services offered by a government body.

##### *Consent*

This is fundamental to stopping unsolicited commercial electronic messages. Consent can be either express or inferred (from the conduct and business and other relationships between the parties). The Bill also deems consent to have occurred where:

- an electronic address has been published by a person in a business capacity,
- there is no accompanying statement that there is no consent to the sending of messages; and
- the message sent is relevant to the business, role, functions, or duties of that person.

##### *Required particulars*

The Bill requires that any electronic message covered by it clearly and accurately identify the person who authorised the sending of the message and include accurate information about how to “readily” contact that person. The information must reasonably be likely to be valid for at least 30 days after the message is sent.

It also mandates that electronic messages must include a functional “clear and conspicuous” unsubscribe facility allowing the recipient to opt out from receiving further messages. Again this facility must be reasonably likely to be functional for at least 30 days after the principal message is sent.

#### *Defences*

The Bill offers two defences against the violation of its core requirements. A person who sends or who authorises the sending of an electronic message in breach of the Bill’s rules on electronic messaging, has a defence if that person can show the message was sent by mistake, or if the message was sent without the sender’s knowledge (for example, because of a computer virus).

#### *Enforcement*

Any person affected by a breach can complain to the Enforcement Department (they may also seek an injunction in the High Court or sue for damages if they have suffered damage arising out of, for example, a denial of service attack).

The Enforcement Department on receiving a complaint may not only initiate legal proceedings for breach, but also has powers to apply for and execute search warrants, issue formal warnings, issue contravention notices (which will require the payment of a fine) or accept an enforceable undertaking, the breach of which will result in “fast track” legal remedies before the courts.

#### **Regulations**

The Bill itself does not complete the picture on electronic messaging prohibitions. Regulations may be passed to further streamline its application. Some areas of importance that may be affected by such regulations include:

- what amounts to inferred consent;
- exceptions to the definition of commercial electronic message; and
- conditions for unsubscribe facilities.

To read Bell Gully’s comments on this Bill in an earlier newsletter visit our website at [http://www.bellgully.com/resources/resource\\_00533.asp](http://www.bellgully.com/resources/resource_00533.asp).

To access a copy of the select committee’s report on the Bill visit Parliament’s website at <http://www.parliament.govt.nz>.

## Bell Gully news

### **More top recognition for Bell Gully in Asia Pacific guide**

A guide to the leading commercial law firms in Asia and Australasia has again awarded Bell Gully top New Zealand ranking. For the fifth consecutive year, Bell Gully has secured the most top tier rankings in practice areas for New Zealand and has the highest number of partners named as "leading individuals" in *Asia Pacific Legal 500*.

### **Bell Gully lawyers go bald to support leukaemia**

A corporate Shave for a Cure® challenge in Auckland and Wellington has seen Bell Gully and PricewaterhouseCoopers raise an incredible \$63,360 to provide vital support for patients with leukaemia.

### **Bell Gully succeeds in first New Zealand internet dispute service claim**

The holder of a disputed domain name has been ordered to hand over the internet address in a decision on the first claim lodged with New Zealand's new domain dispute service. The Hon. Sir Ian Barker, QC has ordered Tauranga-based Traction Group Limited to transfer the address [www.intercity.co.nz](http://www.intercity.co.nz) to passenger coach service company, InterCity Group, ruling it had been unfairly registered.

### **Bell Gully advises key energy supplier on IT agreement**

Transpower, owner and operator of New Zealand's national electricity grid, has awarded Fujitsu New Zealand a multi-million dollar contract to provide IT infrastructure services for the next three years, with potential to extend by up to a further five years.

## Useful web links

### *New Zealand government*

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

### *New Zealand regulatory agencies and organisations*

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

### *New Zealand commercial sites*

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

### *Australian sites*

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

### *International sites*

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