





Welcome to the Autumn 2007 issue of *Commercial Quarterly*, Bell Gully's digest of current corporate and commercial law issues.

Each quarter we preview upcoming developments and summarise recent cases, articles and legislation of interest under the following headings:

- Commercial business law
- Company law
- Securities and capital markets
- Competition and consumer law
- Intellectual property and information technology
- Utilities and resources

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Previous issues of Commercial Quarterly are available on our website.

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

Need more information? For more information on any of the cases, articles and features in *Commercial Quarterly*, please email Diane Graham at diane.graham@bellgully.com or tel 64 9 916 8849.

Disclaimer: This publication is necessarily brief and general in nature. You should seek professional advice before taking any action in relation to the matters dealt with in this publication.

Commercial business law

Key ruling on cancelling open-ended contracts

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Far-reaching implications for public sector from Auckland labs decision

In March the High Court released its decision in the high profile dispute between competing laboratory service suppliers in Auckland. In this article Bell Gully partners [Simon Watt](#) and [Mike Colson](#) review the wider implications arising out of this decision for not only public health providers but also for any party involved in public sector procurement processes.

Cancellation: make sure you do it the right way

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Vendor due diligence - an increasing trend in Australasian M&A

The due diligence investigation of a target company in M&A transactions has traditionally been performed by the purchaser's own advisers. In this article Bell Gully partner [Jayne Kirton](#) provides some insight into why these investigations are increasingly being performed by the vendor's advisers.

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Commercial business law

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This is an important judgment for people in business as contracts are often entered into informally, for example, through the exchange of letters or emails, or sometimes even as a result of discussions only. In such circumstances, the contract will normally be open-ended (i.e. it will not have a fixed term), and will not contain express provisions on how it is to be terminated. Even some formal contracts do not address these important issues.

The Supreme Court, in its decision in *Paper Reclaim Limited v Aotearoa International Limited* of 1 May 2007, has confirmed contracts of this sort can be terminated upon the giving of "reasonable" notice. The court also provided guidance on how a "reasonable" notice period is to be determined, and set limits on the time period over which a party in receipt of a cancellation notice can claim damages from the cancelling party.

The decision in *Paper Reclaim* is, therefore, a useful reminder of the practical considerations that must be taken into account when seeking to bring to an end an open-ended contractual arrangement. Such a contract will usually contain an implied term that it can be terminated on reasonable notice. That period of notice will vary from case to case, and businesses must take into account the need for the other party to:

- carry out and conclude existing commitments;
- bring any current negotiations on the table to fruition;
- wind down matters in an orderly way;
- have an opportunity to explore the market for alternative opportunities; and
- obtain the fruits of any "extraordinary expenditure" carried out under the agreement.

Importantly, in setting out these practical considerations, the Supreme Court rejected the suggestion that sufficient time must be given to enable the non-cancelling party to establish a similar, alternative arrangement to that operating under the relevant contract, which had led the High Court to the rather startling conclusion that an eight-year notice period was reasonable in the circumstances.

The facts in Paper Reclaim

Aotearoa International Limited (Aotearoa) and Paper Reclaim Limited (Paper Reclaim) were parties to a long standing contract under which Aotearoa exported Paper Reclaim's waste paper on an exclusive basis. Aotearoa sued Paper Reclaim following Paper Reclaim's attempt to summarily terminate the arrangements between them.

The High Court had determined the work carried out by Aotearoa for Paper Reclaim was pursuant to an oral contract made at a meeting of representatives of the two companies in or about 1985. Nearly 20 years later, Paper Reclaim wished to end the arrangements. In February 2001, Paper Reclaim wrote to Aotearoa stating it did not believe any contract existed between them and, as a result, arrangements were at an end.

Fifteen months later Aotearoa gave a notice of cancellation of the contract it believed to exist between them on the basis that Paper Reclaim's earlier letter had itself amounted to an unlawful rejection of the contract.

The High Court held there was a contract between them, and the parties agreed that such a contract could be terminated on reasonable notice. They disagreed, however, over what constituted "reasonable" notice of termination.

The lower courts' decisions

In arriving at an eight-year notice period, the High Court had accepted the proposition that, in fixing the appropriate period of notice, the emphasis should be on the time necessary for the non-cancelling party to create a replacement trading situation. The Court of Appeal disagreed, and stated the matters relevant to determining the notice period were the carrying out of existing commitments, giving notice of the termination of supply to existing customers, bringing current negotiations to fruition and, where appropriate, obtaining the fruits of any "extraordinary expenditure or effort carried out within the scope of the agreement". The Court of Appeal noted the first three factors would point to a short notice period, and in this case, the last factor ("extraordinary expenditure") was not relevant. On this basis, the Court of Appeal concluded that 12 months was a reasonable period of notice.

The Supreme Court's decision

The Supreme Court agreed with the Court of Appeal's observations, and in particular, that the period of notice should not be longer than 12 months. In doing so, it rejected the trial judge's approach that the period must be sufficient to enable the party on the receiving end of a cancellation notice to build up a business comparable to that which it carried out under the contract in question. Taking a pragmatic approach, the court noted that if a contracting party desired such a situation, then that contracting party should have taken steps to ensure it had a formal contractual arrangement in place which contained sufficient notice periods and termination provisions to enable it to do so.

On this basis, the Supreme Court agreed with the Court of Appeal that a period of 12 months would have given Aotearoa "sufficient breathing space" in which to take stock of its situation, complete ongoing work under the contract and to explore any opportunities which might exist for it in the waste paper market or other lines of business.

The question of damages

The Supreme Court took a different approach, however, to the Court of Appeal on the question of over what period Aotearoa could claim damages from Paper Reclaim for Paper Reclaim's unlawful termination of the contract.

The period over which damages may be claimed will often be important in a falling or rising market, which may have a significant impact on the amount of money able to be claimed. The Court of Appeal had held that the contract only came to an end as of 3 May 2002, i.e. when Aotearoa (finally) accepted Paper Reclaim's rejection. Thus, on the Court of Appeal's analysis, the 12-month period ran from May 2002.

The Supreme Court disagreed. It stated the 12-month period for calculating damages ran from February 2001, the date of Paper Reclaim's original, but invalid, termination letter. The Supreme Court reiterated earlier authority which makes it clear that, in the case where a notice of termination has been given invalidly, it should be assumed that a valid notice of termination would have been given by the party wanting to cancel a contract "at the earliest possible date". On this basis, the Supreme Court concluded:

"In accordance with this principle, therefore, damages for Paper Reclaim's repudiatory breach of contract should be assessed on the assumption that, if it had adhered to the contract, it would have chosen to give twelve months notice on 2 February 2001, and that the contract would have terminated upon expiry of that period."

Thus, the correction period over which damages could run was February 2001 to February 2002.

Business implications

The decision highlights the need to take care when seeking to cancel an open-ended contract, or may give further ammunition if on the receiving end of an unwanted notice of cancellation of such a contract.

For a contract which has been on-foot for any reasonable length of time (for example, a period of five or more years), it is probably safe to assume a period of less than four to six months' notice of termination would likely be considered too short and, therefore, unreasonable.

As noted above, what is reasonable will of course depend on the factual circumstances in each individual case. However, business people should give a reasonably generous period of notice, so the party receiving the quite often unexpected and unwanted cancellation notice will have little room to challenge the decision to terminate.

Commercial business law

Far-reaching implications for public sector from Auckland labs decision

In March the High Court released its decision in the high profile dispute between competing laboratory service suppliers in Auckland. In this article Bell Gully partners [Simon Watt](#) and [Mike Colson](#) review the wider implications arising out of this decision for not only public health providers but also for any party involved in public sector procurement processes.

The recent High Court decision on Auckland's lab testing contract has much wider implications for public sector procurement. In particular:

- Unsuccessful proposers will be in a stronger position to rely on both contractual and public law claims concurrently to challenge public procurement processes.
- The case sets very high expectations for communication to proposers of what an entity is looking for in its procurement. It leaves little or no room for subtlety or generality by a procurer when it comes to consulting on or communicating its procurement intentions.
- If entities are looking to make significant changes to the funding or service model through their procurement they need to be completely up front and "in your face" about it.
- Requests for Proposals (RFPs) and tenders may need to preserve the priority of public law obligations, such as consultation, more extensively than is currently the practice.
- The courts are intolerant of self-imposed time constraints from procurers as an excuse for failing to meet consultation obligations. Procurers may need to be more flexible in this regard.
- Obligations to consult can arise from a whole range of policy and framework documents that may long pre-date, and not be closely connected to, the particular procurement, and which can therefore be easily overlooked.
- Conflict of interest disclosure needs to be much fuller and more explicit than is currently common practice.

Process contracts and judicial review

In the labs decision, Justice Asher considered that entering into service agreements under section 25 of the New Zealand Public Health and Disability Act 2000 (NZPHD Act) constituted the exercise of a statutory power and was, therefore, open to judicial review. The case indicates a major shift away from previous court decisions (in particular *Southern Community Laboratories Limited & Ors v Healthcare Otago Ltd & Ors* HC DUN CP30/96 19 December 1996) where tendering processes undertaken by public bodies were seen not to be amenable to judicial review given their highly commercial nature. Justice Asher justified his departure from the decision in *Southern Community Laboratories* on the basis that it was decided under the predecessor of the NZPHD Act, the Health and Disability Services Act 1993 (HDS Act), which "brought a commercial edge to public health". The judge considered that unlike the NZPHD Act, the HDS Act provided that Crown Health Enterprises should be as successful and efficient as comparable businesses. Notwithstanding the absence of a similar provision in the NZPHD Act, it is difficult to conceive of a more commercial decision than selecting a proposer under a competitive tendering process – not to mention for a half-billion-dollar contract.

Previous decisions involving the Ministry of Defence and the Auckland City Council conducting competitive procurement processes have analysed the status of an RFP or tender document and the management, through the use of exclusion clauses, of any contractual obligations and liability that arose. In these previous decisions the existence of a process contract has also led the court to conclude that judicial review was not appropriate.

Whereas the prior case law has generally chosen to give a remedy under either contract or judicial review, in this case Justice Asher seems to consider both are available. The decision seems to assume the existence of a process contract, with the judge regarding the RFP as having contractual force from the moment it was issued. At the same time, Justice Asher states that legitimate expectations arise where a

public authority promises to follow a certain procedure, and accepts in general terms that two of the three legitimate expectations claimed by the plaintiff could be seen as arising from the RFP.

The case puts unsuccessful proposers in public sector procurement processes in a better position to challenge those processes than they were previously. They can now more forcefully argue contractual and public law claims concurrently rather than having to choose between them.

Running procurement processes

The labs decision indicates organisations need to be very clear in the procurement processes in the messages they give to proposers about what they are looking for.

The Auckland Regional district health boards (ARDHBs) were criticised for not being upfront with Diagnostic Med Lab – the unsuccessful proposer – that they were looking for dramatic savings and possibly a radical change to the status quo (in that they were considering a different model of service supply).

If organisations want proposers to think outside the square they have to convey this adequately, rather than allowing them to labour under the impression that incremental changes to an existing arrangement will suffice.

One onerous implication from the case is that the inclusion of unqualified confidentiality clauses in RFPs (agreeing not to disclose information contained in proposals) may be contrary to the obligation to consult. Justice Asher considered that the contractual constraints imposed by the RFP prohibiting release of proposers' information without their consent could not excuse the DHBs from their duty to consult. Public sector procurement documentation may need to preserve the priority of public law obligations such as consultation more explicitly than is currently the practice.

Consultation

Tight timeframes contained in an RFP were seen as self-imposed constraints and did not excuse inadequate consultation. The court considered it was open to the DHBs to give Diagnostic Med Lab a further extension and suspend the RFP process in order to consult after the RFP proposals foreshadowed much more significant changes than had been signalled by the DHBs in their initial consultation.

Non-statutory guideline documents, especially those issued by ministries, form part of the framework through which organisations must determine their public law obligations. To determine the DHBs' consultation obligations, the court specifically relied upon the New Zealand Health Strategy, December 2000; the Consultation Guidelines for the Ministry of Health and District Health Boards, September 2002; the operational policy framework issued by the Ministry of Health, July 2005; and the Crown Funding Agreements between the DHBs and Ministry of Health. Justice Asher looked at these guideline documents as being binding on the DHBs and creating stringent public law obligations to consult.

A bland discussion document which needs to be closely analysed to appreciate the full significance of any potential changes will not be adequate consultation. Consultation needs to be more "in your face", and not just talk in generalities, so that consultees are aware if an organisation is seriously contemplating significant changes.

The urgency of the consultation was self-created given the impending contract end-date (which could have been extended) and consultation over the Christmas period was inadequate. By contrast, Justice Asher commented that the timeframe for some other DHB consultations of at least six working weeks, with a discussion document containing very detailed strategic options and a response template with particular questions, was adequate consultation.

Conflicts of interest

The court concluded that it is not sufficient simply to list the organisations a board member is involved in that could give rise to a conflict; the nature and effect of the potential conflict must be sufficiently disclosed so that other board members can understand the true nature of it and be able to respond to, and deal with, the conflict if it materialises.

In the court's view a strict approach to managing conflicts must be taken, with rigorous exclusion from all relevant aspects of a process if any conflict of interest arises. The court was highly critical of the decision of the Auckland District Health Board not to exclude board member Dr Tony Bierre from the moment they realised he had a conflict of interest.

The onus on organisations is not limited to avoiding conflicts in its own decision-making process, it also extends to ensuring that proposers do not benefit from any conflict of interest. The judge considered that the knowledge and, therefore, advantage the Lab Tests consortium had gained through Dr Bierre's involvement meant that the proposal should have been excluded and the consortium should have been prevented from participating.

Watch this space

Given the wide-reaching implications of the judgment (e.g. a public body's decisions of an obviously commercial nature may be subject to judicial review) it will be interesting to see whether the DHBs appeal the case, at least in order to narrow and refine the legal precedent value of the decision.

The stark nature of the facts in the case probably influenced the judge to make stronger and more unqualified statements about the legal position than one might typically see in judgments. As a result there are likely to be statements and findings in the judgment that health providers and public sector tenderers will seize upon to support their arguments when future disputes arise in other procurement processes.

*For a full summary of the facts and findings of the case *Diagnostic Medlab Ltd v Auckland District Health Board, Waitemata District Health Board, Counties Manukau District Health Board and Ors* HC Auckland CIV 2006-404-4724, 20 March 2007, please see Bell Gully's [Litigation Update](#) (21 March 2007).

Commercial business law

Cancellation: make sure you do it the right way

More often than not, when entering into an agreement the parties' focus is far removed from the cancellation and notice provisions buried among the terms of the document that they sign. A recent case illustrates that those express notice provisions can be costly if not followed to the letter.

In this case¹, a contractor entered into a written agreement to carry out a 12-year painting programme on a property owned by the defendants. Under the terms of the contract the defendants had agreed to pay a fixed annual amount to the contractor by instalments invoiced monthly. A clause in the agreement stated that failure on the part of the defendants to pay a monthly invoice would constitute an event of default and would entitle the contractor to terminate the agreement. The agreement further provided that if the contractor gave a "*written notice of termination*" the contractor would be entitled to a termination sum (calculated by a formula set out in a liquidated damages clause).

The defendants defaulted in payments in early 2006 and summary judgment proceedings were brought by the contractor for payment of the unpaid invoices and the termination sum.

The notice provision in the agreement required notices to be signed by any "*Director, Secretary or Manager*" of the contractor and went on to state that the notice "*may be given by post or hand*" to a specified address and addressee set out in an appendix to the agreement.

However, on the facts, the notice given by the contractor to cancel the agreement was in the form of a letter signed by the contractor's financial controller and sent by post to one of the defendants at his address contrary to the details set out in the agreement.

The contractor argued that although the notice did not strictly comply with the terms of the notice provisions in the agreement it was nevertheless still legally effective because:

- by sending it to one of the defendants it was sufficient to bring notice of the cancellation to both of them; and
- the notice provisions in the agreement were not compulsory and did not exclude notice being given by other means.

The Court disagreed with these arguments and dismissed the contractor's claim for the payment of the termination sum. In its view:

- the wording of the notice provisions were both prescriptive and exclusive on the mode of service of cancellation; and
- the existence of express notice provisions ruled out the ability to apply common law or statutory rules allowing for service to be effected by other means.

Commentary

As is illustrated by this case, little importance is often given by parties to notice provisions both at the time of entering an agreement and when purporting to give notices under the agreement. Yet as this case also illustrates these provisions deserve to be addressed with more than just a cursory glance as they often play a key role, especially around issues of default and termination.

One issue that has arisen in more recent times with notice clauses is the question of whether a notice by email should be included as a prescribed means of service for written notices. Email notices were made possible under the Electronics Transactions Act 2002 and it is now common to find email communications included in standard notice clauses.

¹ *Programmed Maintenance Services (NZ) Ltd v Witters* (Unreported Judgement HC, Auckland, Harrison J., CIV-2006-416-193, 29 March 2007)

If you do agree to receive a notice by email it is always a good idea to include a specific email address in the notice provision of the agreement to ensure that the relevant person within your business receives the email. It is also advisable to specify in the notice clause when receipt of the notice occurs to avoid any later arguments on this point.

Commercial business law

Vendor due diligence - an increasing trend in Australasian M&A

The due diligence investigation of a target company in M&A transactions has traditionally been performed by the purchaser's own advisers. In this article Bell Gully partner [Jayne Kirton](#) provides some insight into why these investigations are increasingly being performed by the vendor's advisers.

Why would a company invest time and money conducting due diligence on a business it plans to sell, even when it has had years of ownership to get to know the operation?

It may seem counter-intuitive but many are now electing to do just that. Across Australasia, vendor due diligence is becoming an increasingly common feature of M&A transactions and New Zealand-based transactions are no exception.

With competitive sales processes on the rise, it is now almost an expected part of the sales package.

What is vendor due diligence and what are its benefits for a vendor?

Vendor due diligence is a process by which the vendor, itself and through its advisers, undertakes a systematic review of the business it is proposing to sell. In addition to the commercial aspects, including the obvious issue of identifying what is for sale, the review generally covers the legal and financial aspects of the business and may include a review of environmental issues. The aim is to provide an orderly collation of all material information relevant to the sale business.

The extent of the process will vary depending on what the information will be used for. It is important to determine at the outset whether the due diligence outcomes are simply for the eyes of the vendor or may also be viewed and, as a next step, relied on by potential purchasers.

Many of the high profile competitive sales processes that have occurred in the last 18 months have included vendor due diligence. In almost all cases, some degree of reliance on the due diligence findings has been made available to the purchaser.

From a vendor's perspective, a full due diligence prior to entering into discussions with potential buyers can be very helpful. A full review should:

- Give bidders an orderly set of information that can act as a road map through any data room disclosure material, assisting them to determine their priorities.
- Reduce the time bidders need for any due diligence review they may wish to undertake themselves.
- Reduce the disruption to the vendor otherwise created by having multiple bidders trawling through the same issues one by one.

Vendor due diligence can also be used to great benefit for both parties in relation to regulatory consents. For example, in a transaction involving considerable land interests, relevant due diligence information on the land can be provided to the Overseas Investment Office and to bidders at the start of the sales process. This means that the OIO analysis can already be underway prior to bidders providing the buyer-specific information, potentially reducing timeframes considerably.

Potential pitfalls

But there are some significant potential pitfalls that both vendors and purchasers should bear in mind, particularly regarding purchaser reliance on vendor due diligence.

It will be critical to clearly determine exactly the extent to which a purchaser may rely on a vendor due diligence report. It must be clear whether disclosure of the report is on an information only but no reliance basis, or if the purchaser can rely partially or fully on the information.

The vendor's advisers will be concerned to avoid possible conflicts of interest issues and undue potential professional liability issues. Practically, for a vendor, this means that some attention is required at the outset to the terms on which advisers are engaged. In addition to agreeing a clear scope for the due diligence with their advisers, including materiality thresholds and the nature of the report, vendors will also need to agree the extent to which others, such as bidders or financiers of bidders, may rely on the advisers' reports.

Advisers will also be concerned to ensure their report, if relied on by a purchaser or financier, is limited to factual matters and qualified by the parameters of the review and the assumptions made. Advisers may also seek to cap their liability to a certain value.

These aspects translate to a number of possible limitations that should be understood and factored into the use of a vendor due diligence report. Questions to be considered by both vendor and purchaser include:

- What limitations apply to the scope of vendor due diligence? For a purchaser, does it cover everything they need to know? Was the review undertaken to the same level of materiality that the purchaser requires?
- Did the advisers themselves check the accuracy of information provided to them for the purposes of their review, or was that simply assumed? Can a purchaser adequately protect against any assumption of accuracy through a vendor warranty, or should the purchaser attempt to verify this itself?
- How current is the report? Does it need updating?
- What limits have been placed by the relevant adviser on purchaser reliance on the report? What limits exist with respect to any vendor representations in respect of the report or its contents?
- Are there any liability caps?

A vendor may also seek to pass some of the costs of a vendor due diligence - at least to the successful purchaser.

In the current climate, it seems vendor due diligence is likely to continue to play a role in M&A transactions. With careful management and an awareness of potential risks or limitations on the part of both the vendor and the purchaser, that should be to everyone's benefit.

This article was first published in *The Independent Financial Review*, 4 April 2007.

Commercial business law

Bell Gully authors New Zealand overview for global M&A publication

Bell Gully has provided an overview and insight into the New Zealand M&A market in the latest edition of global publication PLC Cross-border Mergers and Acquisitions Handbook.

Partner Peter Castle, who has authored the New Zealand chapter of the handbook previously, has contributed to the 2007 handbook which will be launched at the International Bar Association's annual M&A event in New York next month.

The handbook provides a detailed and accessible guide to the latest market happenings, as well as legislation and regulation as it applies to mergers and acquisitions.

[Click here](#) to read the chapter.

This chapter was first published in the *PLC Cross-border Mergers and Acquisitions Handbook 2007/08* and is reproduced with the permission of the publisher, Practical Law Company. For further information or to obtain copies please contact ian.plummer@practicallaw.com, or visit www.practicallaw.com/acquisitionshandbook.

Commercial business law

Overseas Investment Office publishes new guidelines for international transactions

This publication provides guidance on the application of the Overseas Investment Act 2005 to international transactions involving sensitive land, significant business assets or investment in fishing quota.

This latest publication from the OIO clarifies its interpretation of certain definitions in the new Act which have caused some concern. The OIO confirms that in its view:

- overseas investment in sensitive land only refers to New Zealand land;
- overseas investment in significant business assets only refers to New Zealand significant business assets; and
- overseas investment in fishing quota refers to all fishing quota defined by the Fisheries Act 1996.

The publication also includes a flowchart for use when determining whether an international transaction involving sensitive land or significant business assets will require consent.

A copy of this OIO publication is available on the OIO's website at www.oio.linz.govt.nz.

For further information on the Overseas Investment Act 2005 refer to Bell Gully's [Overseas Investment Guide](#) on our website and an article by Bell Gully senior associate Andrew Petersen, *The Overseas Investment Act – one year on*, in the October 2006 issue of [Commercial Property](#).

Commercial business law

Big changes afoot at LINZ: mandatory e-dealing has begun

Land Information New Zealand (LINZ) is phasing out manual registration of real property dealings in favour of a new online electronic registration system known as Landonline (or, e-dealing).

Electronic registration for the standard discharges of mortgages became compulsory on 1 May 2007. Other land title documents will have to be registered electronically from the dates below.

1 August 2007	Standard transfers and standard mortgages
1 September 2007	Survey transactions
1 July 2008	All remaining land title documents – for example, paper non-standard mortgages, easements, caveats and rights of way

What will change?

Instead of signing a paper transfer or mortgage, an authority and instruction form (A&I), which sets out the details of the transaction, will be signed. The A&I is not registered – it is an instruction form to the solicitors to create and register the dealing online.

What does this mean in practice?

Signing paper discharges of mortgage, transfers and standard mortgage documents will become a thing of the past.

Individuals will need to sign the A&I form in front of a solicitor and also attach a copy of their current photo identification (e.g. a driver's licence or passport). If selling a property, individuals will also need to supply a copy of an insurance, rating or utilities invoice linking them to the property address.

Corporate clients will now need to supply photo identification of the authorised signatories, which will be attached to the A&I form. Copies of the board and/or shareholder resolutions authorising the transaction may also be requested.

If the A&I is signed under power of attorney, a copy of that power of attorney and a certificate of non-revocation of power of attorney will be required, along with a copy of the attorney's photo identification.

How does this affect corporate lawyers?

LINZ and the New Zealand Law Society have issued guidelines on the role of in-house lawyers. In-house lawyers can witness the signing of the A&I and certify the copies of photo identification of the corporate signatories. However, they cannot process the electronic registration unless they are registered with LINZ for e-dealing.

Useful websites to visit for further information on e-dealing are:

- [New Zealand Law Society](http://www.nz-lawsoc.org.nz/hmedealing.asp): www.nz-lawsoc.org.nz/hmedealing.asp
- [Landonline](http://www.landonline.govt.nz): www.landonline.govt.nz
- [Land Information New Zealand](http://www.linz.govt.nz): www.linz.govt.nz

Company law

Arbitrator's decision upheld in minority buy-out dispute on share price

In 2001, the Law Commission recommended changes to the minority buy-out provisions in the 1993 Companies Act in response to criticism from the bench that the provisions lacked detail and were "substantially flawed". In this article Bell Gully solicitor Connie Tregidga examines a recent High Court case which confirms that there is still a need for these recommendations to be addressed.

Directors' business decision questioned in reckless trading case

In the Autumn 2006 issue of *Commercial Quarterly* we reported on *Mason v Lewis* where, according to the court, the directors had fallen short of the mark in their monitoring and management of a company even though they had acted honestly and in good faith throughout the life of the company. In this recent case, once again, the court indicates that directors' business decisions and practices will be scrutinised closely in the event of insolvency.

New rules for companies' annual reports all set for June implementation

Regulations required for the implementation of the new rules aimed at lowering the compliance costs associated with the preparation and dissemination of a company's annual report were enacted on 14 May. These regulations and the main amendments to the Companies Act will come into force on 18 June in time for companies with 30 June balance dates.

Updates from the Companies Office

In this issue we discuss why companies that no longer need to register financial statements may still need to have their financial statements audited. We also note the Companies Office's new fee structure.

Company law

Arbitrator's decision upheld in minority buy-out dispute on share price

In 2001, the Law Commission recommended changes to the minority buy-out provisions in the 1993 Companies Act in response to criticism from the bench that the provisions lacked detail and were "substantially flawed". In this article Bell Gully solicitor Connie Tregidga examines a recent High Court case which confirms that there is still a need for these recommendations to be addressed.

The Law Commission report – Minority Buy-Outs

The Companies Act 1993 provides an exit option for minority shareholders who have unsuccessfully opposed a company from undertaking a fundamental change in its structure or operations by providing a mechanism for their shares to be purchased by the company at a fair and reasonable price.

In its current form the mechanism has been the subject of some criticism. In 2001 the Law Commission reviewed the provisions and issued its recommendations for changes to be made in a report entitled *Minority Buy-Outs*. These recommendations mainly address concerns raised around the basis for calculating a fair and reasonable price for the shares. The Law Commission has recommended that more guidance be given around this issue in the Act.

In particular, the Law Commission recommends that the price of the shares should be an "honest estimate" of the value of the shares as at the date the company gives the notice to the shareholders setting out the price the company is offering to pay for the shares by:

- adjusting the value of the shares to exclude any element of value arising from the accomplishment or expectation of the event authorised by the resolution that entitled the shareholder to require the company to purchase the shares²; and
- assessing the value of the relevant class of shares and then allocating that value pro rata among all shareholders.

While it has yet to be decided whether the Law Commission's recommendations will be adopted, the Ministry of Economic Development (MED) is currently considering reform of the minority buy-out provisions based upon the recommendations in the Commission's report.

Trans Tasman v Gibson

A recent High Court case³, where a company sought leave to appeal against the award of an arbitrator on the price to be paid for minority shareholder's shares under section 112 of the Companies Act 1993 (the Act), provides a further illustration of the problems that can arise from the lack of clarity in the current minority buy-out provisions.

The background facts

On 28 September 2005, Trans Tasman Properties Ltd announced a reconstruction proposal. This proposal involved Trans Tasman retaining its Australasian assets, while a subsidiary company that held the Asian assets, Asian Growth Properties Ltd, was to be sold with a view to obtaining a separate listing on the Alternative Investment Market of the London Stock Exchange.

A special resolution approving the sale of Asian Growth was passed at a shareholders' meeting on 15 December 2005. The sale constituted a major transaction of Trans Tasman under section 129 of the Act. Several shareholders who voted against the resolution subsequently gave notice to Trans Tasman pursuant to section 111 of the Act requiring Trans Tasman to purchase their shares.

² Unless the resolution is one approving an amalgamation under section 221 of the Companies Act under which all the shareholder's shares are not to be converted into shares in the amalgamated company, in which case the valuation must take into account any benefit of the amalgamation to the company, its shareholders and directors.

³ Trans Tasman Properties Ltd v Gibson (Unreported Judgement, CIV 2006 404 6919, Williams J, HC Auckland, 9 March, 13 April 2007).

On 24 January 2006 Trans Tasman advised the dissenting shareholders that they would purchase the shares for a nominated price of \$0.4506 per share. This price was advised to be the weighted average trading price of the shares in Trans Tasman for the one month prior to the 28 September 2005 announcement.

Eleven shareholders objected to this price and required a fair and reasonable price to be determined under section 112 of the Act. Where an objection to the price nominated by the Company is received within a set time, the Company must refer the question of what is fair and reasonable to arbitration.

The decision at arbitration

In determining a fair and reasonable price under section 112, the arbitrator assessed the value to be \$0.56 per share. He calculated this value by taking the net asset value of Trans Tasman (which was the value submitted as the fair and reasonable value by the dissenting shareholders), discounting this by 20% and allocating that value pro rata among Trans Tasman shares.

The arbitrator attributed about 5% of the discount to the discount to net asset value that shares of listed property entities were generally observed to trade at, and 15% of the discount to net asset value to factors unique to Trans Tasman, such as the intended transition from property ownership to property development and the limited liquidity of the shares.

Importantly, the arbitrator determined that the price of the shares was to be determined at 24 January 2006, the date Trans Tasman advised the dissenting shareholders that they would purchase their shares⁴. After discounting the net asset value of the shares at this date, the resulting price was 24% above the value nominated by Trans Tasman⁵.

Trans Tasman sought leave from the High Court to appeal against this award. They submitted that the arbitrator erred in law in determining the fair and reasonable value by referring to the minority shareholders' contended reasons for voting against the transaction, and to information attributable to the transaction from which the minority shareholders dissented.

The High Court's decision

In dismissing the application for leave to appeal, the High Court found that the arbitrator exercised his expert knowledge in determining the fair and reasonable price, and that there was no error of law. The court found that the arbitrator determined his value by applying his experience and judgement.

Further, the High Court relied on *Gold and Resource Developments (NZ) Ltd v Doug Hood Ltd*⁶ in finding that Trans Tasman would need to demonstrate that there were "very strong indications of error" in the arbitrator's decision before they would be granted leave to appeal.

The current proposal

Given that the MED is now considering the Law Commission's recommendations, it is interesting to consider whether the arbitrator's decision in this case would have been the same had the Commission's recommendations been applied as the basis for calculating a "fair and reasonable" price.

The arbitrator used the date Trans Tasman agreed to purchase the shares as the date at which the value of the shares was assessed. This accords with the Law Commission's proposal. However, in assessing the discount to be applied from the value as at the date Trans Tasman agreed to purchase the shares, the arbitrator made no reference to excluding any element of value arising from the contemplated transaction. In fact, the arbitrator only adjusted the net asset value of the shares for factors specific to Trans Tasman generally and the industry they operate in.

The decision of the arbitrator, therefore, does not appear to be based on all of the Law Commission's proposed changes to section 112 of the Act. If the Law Commission's proposals were implemented in their current form, the arbitrator would have been obliged to assess the value of the shares by removing any value attributable to the transaction.

⁴ We note that this aspect of the award was not appealed.

⁵ That value being the weighted average trading price of the shares in Trans Tasman Properties Ltd for the one month prior to the 28 September 2005 announcement.

⁶ [2000] 3 NZLR 318

We look forward with interest to the MED's proposal with respect to the minority buy-out regime. However, we note that as the Law Commission's proposals are currently drafted, there is still room for discretion, both at a company and an arbitrator level, as to how the element of value attributable to the relevant transaction is calculated.

Furthermore, while the proposals (as currently drafted) may result in more accuracy on a case-by-case basis, they are unlikely to bring any additional comfort to companies planning transactions that may trigger the minority buy-out provisions, as they provide little certainty as to the costs to a company of a minority buy-out pursuant to section 111 of the Act.

To access a copy of the Law Commission's report on *Minority Buy-Outs* visit the Commission's website at www.lawcom.govt.nz.

Company law

Directors' business decision questioned in reckless trading case

In the Autumn 2006 issue of Commercial Quarterly we reported on Mason v Lewis where, according to the court, the directors had fallen short of the mark in their monitoring and management of a company even though they had acted honestly and in good faith throughout the life of the company. In this recent case, once again, the court indicates that directors' business decisions and practices will be scrutinised closely in the event of insolvency.

This judgment⁷ does not impose any new requirements on directors but it does highlight the need for directors to comply with orthodox commercial practice and exercise particular caution when a company's solvency is in issue. It also provides a useful illustration of the different type of decisions which can lead to directors being personally liable to contribute in cases of insolvency.

Background facts

In this case a husband and wife (the Borrells) owned some farm land which they were subdividing into four separate blocks for sale. In order to comply with the conditions of the subdivision they found themselves in the awkward position of having to acquire a new property for their farming business before they had the funds to pay the purchase price. However they managed to acquire a property by entering into an unconditional sale and purchase agreement with a 12-month settlement period (the vendors having refused to enter a conditional agreement) to allow sufficient time to fund the purchase from the sale of the subdivided blocks. The Borrells reached an agreement with the vendors to take immediate possession of the new property under a lease.

The decision to enter into the agreement does not appear to have been taken lightly by the Borrells. In fact the Borrells argued that they had assessed the risk of not completing the property transaction to be small – 5% at most. Among the reasons they gave for reaching this conclusion were:

- it was reasonable for them to assume a buyer would be found for at least one of the larger subdivided blocks over the course of the 12-month settlement period. This assumption was based on the fact that they had already entered into agreements for the sale of two of the smaller blocks;
- bridging finance was available if they sold one of the larger subdivided blocks before the completion of the sale; and
- their dealings with one of the trustees of the vendors suggested that the vendors would remain co-operative in the event of a delayed settlement.

They had also taken advice from a real estate agent on the likelihood of obtaining buyers for the subdivided land within the twelve month timeframe and a solicitor (specialising in property transactions) had indicated that the risk they were taking was manageable.

Unfortunately for the Borrells all did not go well. They were unable to find a buyer for the subdivided blocks of land in time to settle the new property transaction and the agreement was cancelled.

Basis for proceedings

The case came before the court because the Borrells had established a company (Goatlands Ltd) to use as a vehicle to purchase the new farm property and had named it as their nominee under the sale and purchase agreement. As the nominee purchaser, Goatlands received a GST refund for the purchase of the property. The Borrells used this GST refund to pay the deposit to the vendors; pay for the first six month's lease on the farm; and pay for some improvements to the property. However, when the agreement was

⁷ Goatlands Ltd (in liquidation) v Borrell (High Court Hamilton , CIV 2005-419-1643, 14 December 2006, Lang J)

cancelled, Goatlands became liable to pay back the GST refund to the Inland Revenue Department. Goatlands was unable to do so and was placed in liquidation.

The liquidators sought an order from the court under section 301 of the Companies Act 1993 (the Act) requiring the Borrells to contribute a sum to the assets of Goatlands for compensation on the basis that they had breached their statutory duties as directors. The liquidators contended that the directors were in breach of:

- section 135 for creating a "substantial risk of serious loss" to the IRD on the basis that they knew that if the subdivided land was not sold, Goatlands would not be in a position to repay the GST refund; and
- section 136 for permitting Goatlands to incur the obligation to repay the GST in circumstances where they did not have reasonable grounds to believe that it would be able to perform the obligation.

Court's decision

Section 135 (reckless trading) claim

The court noted that this was not a usual reckless trading claim under section 135 in so far as it related only to the one-off spending of the GST refund and did not involve the directors continuing to trade to the potential detriment of trade creditors in circumstances where they knew that the company was insolvent.

Nevertheless, Justice Lang considered that the "illegitimate risk" approach applied in previous authorities (and recently approved by the Court of Appeal in *Mason v Lewis*⁸) was still appropriate on the facts. Under this approach, the judge noted:

- directors will be permitted to take risks so long as those risks do not place the company's creditors at substantial risk of serious loss;
- creditors will generally only be at risk in the event that the company becomes insolvent to the point where it is in danger of becoming insolvent; and
- "sober assessment" of the level of risk must be given to any transaction that has the potential to cause the company's complete demise. In such cases, directors "*should only proceed to commit the company to the transaction if, objectively viewed, the risk of failure is sufficiently small to warrant the company taking it. If the risk of failure is substantial, in the sense of real and significant, it should not be taken.*"

On the facts Justice Lang did not consider that the Borrells had made such a sober assessment. He made note of the fact that they were in a catch 22 situation when they had made the decision to enter into the sale and purchase agreement which, in effect, had prevented them from making a "considered" decision. The judge also did not agree with the Borrells' assessment of the risk of failure on the facts. In particular, he did not think that it was reasonable for the Borrells to have relied solely on an extended settlement date for the sale of the subdivided properties as a means to fund the purchase of the farm. This coupled with the fact that they had no backstop such as bridging finance in the event of a sale not going through, led the judge to conclude that the risk they took was closer to 25% than the 5% estimate given by the Borrells. At 25% the risk was of such magnitude to amount to a "substantial risk" for the purposes of section 135. Their actions fell outside the scope of orthodox commercial behaviour because "*an orthodox approach would have been to protect the company against the risk*" that the Borrells had identified.

Section 136 (duty in relation to obligations) claim

Section 136 provides that:

"A director of a company must not agree to the company incurring an obligation unless the director believes at the time on reasonable grounds that the company will be able to perform the obligation when it is required to do so."

Justice Lang noted that in addition to the requirement that the directors have reasonable grounds for believing the company will be able to meet the obligation, the words "*will be able*" in this section suggested that there needs to be a degree of certainty in the directors' minds that the company will be able to

⁸ [2006] 3 NZLR 225 (CA)

perform the obligation when it is required to do so. On the facts the judge noted that the Borrells could not have believed with any degree of certainty that the blocks of land would sell in the required time period. Nor for the reasons given for the claim based under section 135 did the court find that there were "reasonable grounds" for the Borrells to have such a belief.

Defences rejected

The court also rejected the Borrells' contention that they had a defence under section 138 of the Act from any breaches of sections 135 or 136, on the basis that they had obtained favourable advice from a real estate agent and a solicitor who specialised in property transactions in respect of their plans to purchase the new property.

Under section 138, if directors can show they obtained advice from appropriately qualified professional advisers or experts and have followed that advice, the Court may find that there has been no breach of duty. However, this defence is only available if the directors had reasonable grounds to rely on the advice. In the case of the real estate agent, the Court did not consider that any reasonable person would have relied on his opinion as giving an assurance that the subdivided blocks would sell within the required period. Similarly the advice the Borrells received from the solicitor to the effect that the risks they were taking were "manageable ones" was not sufficient to come within this section because the solicitor was not aware of the Borrells' overall financial position (namely, that they had no access to bridging finance if they did not find a purchaser for one of the two large blocks of subdivided land).

Final outcome

In determining the amount the Borrells had to contribute under section 301, the court found that on the facts the only relevant factor to take into account was the extent to which the Borrells' decision to spend the GST refund could be regarded as culpable. This, the court considered, was not at the "top end of the scale" since they had tried to allow sufficient time for the sale of their existing property and had taken the advice of a real estate agent and their solicitor. Furthermore, it was noted by the Court that the failure of Goatlands was to a certain extent beyond their control.

The court concluded that it would be just and equitable for the Borrells to make a contribution that reflected the extent to which they took an "illegitimate risk" in deciding to use the GST refund before they knew whether they could arrange funding in time for completion. This had been assessed at 25% by the Court in the course of determining liability under section 135. Accordingly the Court made an order for the Borrells to contribute approximately 25% of Goatlands' outstanding debts to the assets of Goatlands.

Company law

New rules for companies' annual reports all set for June implementation

Regulations required for the implementation of the new rules aimed at lowering the compliance costs associated with the preparation and dissemination of a company's annual report were enacted on 14 May. These regulations and the main amendments to the Companies Act will come into force on 18 June in time for companies with 30 June balance dates.

The Companies Amendment Act 2006 introduced new rules relating to the obligation to provide hard copies of a company's annual reports to its shareholders. The amendments were passed at the end of last year as part of the Government's latest business law reform package aimed at improving the regulatory environment for business.

Obligation to send report "on request" only basis

Under the current regime a company must send out a hard copy of its annual report to each of its shareholders within 20 days of its annual general meeting unless the shareholder has waived their right to receive the report. Under the new provisions, a company will now have the option of sending a notice to its shareholders instead of the report in the first instance. Indeed, a hard copy of the annual report will only have to be sent if a shareholder requests a copy of the report within 15 working days after receipt of the notice⁹.

Section 209 Notice

The notice must meet the requirements of the new section 209 of the Companies Act 1993 and specify that the shareholders have a right to receive, free of charge and on request, a hard copy of the annual report and provide details of how an electronic copy of the report may be obtained. The notice is also to note whether a concise report is available for the same accounting period and, if there is, provide for it to be made available on the same basis as the full report.

If a shareholder does request a copy of the annual report, the company must send it "as soon as practicable". It also should be noted that once a request is received from a shareholder, the company must send that shareholder a hard copy of the report each year until the shareholder revokes the request.

No waiver available

Under section 212 of the Act, a shareholder may send a written notice to the company waiving the right to receive all or any documents from the company. However, section 212 has been amended so that a shareholder cannot validly waive the right to receive both a copy of the annual report and a section 209 notice. Accordingly, if a company has a general waiver from a shareholder, the shareholder will still need to be sent a section 209 notice.

Concise annual report

The 2006 amendments have introduced the possibility of the company preparing a concise annual report for the same accounting period. This is not a mandatory requirement and it is not an alternative to the requirement to prepare and make available a copy of the full annual report.

If the company does choose to prepare a concise report it must comply with the requirements set out in sections 209(5) and (6) of the Act and the new Regulation 11 of the Companies Act 1993 Amendment Regulations. These provide for a concise report to include:

- financial statements (including any group financial statements) and any auditor's report required under Part 11 of the Act;

⁹ Under section 392 of the Companies Act "receipt" by a shareholder of a section 209 notice will generally be deemed to have occurred 5 working days after it was posted or delivered to a document exchange.

- summary financial statements; and
- a description of any changes in:
 - the nature of the business carried on by the company or any of its subsidiaries; or
 - the classes of business in which the company has an interest,

in so far as the board believes it is material for the shareholders to have an appreciation of the state of the company's affairs and provided the information will not harm the company's (or its subsidiaries') business.

Electronic copies

The requirement to make available copies of annual reports (and concise reports if there is one) to shareholders by electronic means only arises if the company elects to send out a section 209 notice instead of the hard copy of the reports. However where the section 209 notice is given, the company must ensure that the reports are available (at all reasonable times) in the manner specified in the notice (such as on the company's website) from the date the notice is sent until a subsequent notice is sent for the next accounting period.

Listed Companies

NZX listed companies will be pleased to note that NZX is amending its rules to align them with the new Companies Act provisions on annual reports. For further details of NZX's proposed changes see the securities and capital markets section of this issue of Commercial Quarterly

Company law

Updates from the Companies Office

In this issue we discuss why companies that no longer need to register financial statements may still need to have their financial statements audited. We also note the Companies Office's new fee structure.

Companies Act audit requirements under review

Amendments to the Financial Reporting Act have resulted in some companies no longer being required to register financial statements with the Companies Office. However, the Ministry of Economic Development has pointed out that such companies may still be required to appoint an auditor and have their financial statements audited in compliance with section 196(3) of the Companies Act 1993.

Sections 19 and 19A of the Financial Reporting Act 1993 introduced changes to requirements for registration of financial statements for some companies. However, section 196(3) of the Companies Act 1993 requires the following companies to appoint an auditor to audit their financial statements, regardless of whether they are required to register them in accordance with the Financial Reporting Act:

- any company that is a subsidiary of a non-New Zealand company;
- any company in which 25 percent or more of the voting power at a meeting of the company is held by a subsidiary of a non-New Zealand company or a non-New Zealand resident; and
- any company that is an issuer within the meaning of section 4 of the Financial Reporting Act.

However, it should be noted that the audit requirements of section 196(3) of the Companies Act are currently under review and the ambiguity may be remedied through legislation to be introduced later this year.

Companies Office reviews fees

The Companies Office is introducing a new fee structure from July. The changes include:

- The fee to incorporate a company over the internet will increase from \$50 to \$150 and a fee of \$250 will apply where paper incorporation documents are lodged.
- There will no longer be a fee to view documents on the Companies Register.
- The fee for re-registration of financing statements on the Personal Property Securities Register will be reduced from \$5 to \$3.
- The fee to file financial accounts will be increased from \$100 to \$250.

Securities and capital markets

NZX amends its Listing Rules to bring them in line with the new annual report provisions in the Companies Act

Following the Government's lead to reduce compliance costs associated with providing companies' annual reports to shareholders, NZX proposes to amend the NZSX, NZDX and NZAX Listing Rules to allow annual reports and half-yearly reports to be sent out in line with the new section 209 Companies Act provisions.

NZX issues two new guidance notes

NZX has released guidance notes on Listing Rule 5.2.3 relating to when the NZX will be satisfied that the issuer of securities has a sufficient spread of security holders and on the legal requirements for fund raisings effected by way of a Share Purchase Plan.

Australia introduces Bill for trans-Tasman mutual recognition of securities

Progress continues to be made in bringing into effect the Australian and New Zealand governments' agreement to introduce a mutual recognition of securities regime. Australia's Corporations (NZ Closer Economic Relations) and Other Legislation Amendment Bill 2007 was introduced at the end of March and is expected to be passed during the winter parliamentary sessions. The necessary approvals to finalise the equivalent New Zealand regulations will be sought once the Australian legislation has been passed.

MED releases summaries of submissions received in its Review of Financial Products and Providers

The Ministry of Economic Development (MED) has finished reviewing submissions it received from over 135 organisations in response to the nine discussion documents released as part of the Review of Financial Products and Providers (RFPP). The review includes proposed changes to securities offerings regulated by the Securities Act.

Update on Takeovers Panel's reform proposals for schemes of arrangement

In late 2006 the Government failed to gain the necessary political support to include the Takeovers Panel's proposed reforms relating to code companies effecting a scheme of arrangement under the Companies Act as part of the Business Law Reform Bill. The Government has now referred the matter back to the Takeovers Panel for further review and consultation with the business community. The Takeovers Panel has also recently published its revised policy on the use of its exemption powers for schemes of arrangement.

Discussion paper released on derivative futures contracts

In response to requests from market participants, the Securities Commission has put forward a proposal to use its powers under the Securities Markets Act 1988 to declare certain derivative contracts known as contracts for difference in respect of shares or other securities to be futures contracts.

Securities and capital markets

NZX amends its Listing Rules to bring them in line with the new annual report provisions in the Companies Act

Following the Government's lead to reduce compliance costs associated with providing companies' annual reports to shareholders, NZX proposes to amend the NZSX, NZDX and NZAX Listing Rules to allow annual reports and half-yearly reports to be sent out in line with the new section 209 Companies Act provisions.

The NZX released its proposed rule changes for the NZSX/NZDX and NZAX Listing Rules for comment on 23 April. Submissions closed on 5 May 2007.

The rule changes were prepared in consultation with the Listed Companies Association Executive and have received the association's support.

Section 209 Notice

Under the proposed rule changes, hard copies of an issuer's annual reports and half-yearly reports will only have to be sent to a listed issuer's security holders if a security holder requests a copy of the report. Instead, issuers will be given the choice of either sending the hard copy of the report or sending out a notice which complies with section 209 of the Companies Act 1993. In brief, this notice will provide:

- that the recipient has a right to request, free of charge, a copy of the full report and can receive it by electronic means (with the appropriate details on how to access the report in this form); and
- a statement as to whether a concise report has been prepared for the same accounting period. If a concise report is available, the notice must provide information on how the security holder can obtain a copy of the report (in the same manner as the full report). However, a concise report cannot be provided for a half-yearly report under the proposed listing rule amendments.

The Listing Rules continue to provide for an electronic copy of the annual report or half yearly report to be sent to NZX before or at the same time as it is sent or "*made available*" (presumably through the section 209 notice) to its security holders.

Full waivers invalid under new regime

The time periods for when the reports (or notices, as the case may be) must be sent to the issuer's security holders have not been amended. For annual reports, it is within three months (or four months for NZAX issuers) after the end of each financial year, and within three months (or four months for NZAX issuers) after the end of the first six months of each financial year for the half-yearly reports.

However, where as previously this requirement did not apply to a security holder who had waived the right to receive hard copies of the reports (and had not revoked that right), under the new rules any such waiver is invalid if it relates to both the hard copy of the report and the section 209 notice. In this situation the issuer is required to either send out the hard copy of the report or the section 209 notice.

Additional requirements for concise reports

There are no new requirements relating to the contents of the annual report under the proposed Listing Rule amendments. However, if a concise report is prepared by an issuer, the proposed amendments to the Listing Rules provide that, in addition to the Companies Act requirements for these reports, they will have to contain:

- the current credit rating status (if any) of the issuer;
- a summary of all waivers granted by the NZX for the period specified in the Listing Rules (or a website link of the same); and
- details of any cancellation of its listing, trading cancellations, halts or suspensions; or conduct referrals (in relation to the exercise of the NZX's powers under rule 5.4.2).

Implementation dates

The amendments to the Listing Rules are expected to be implemented after the new provisions in the Companies Act have come into force on 18 June 2007.

A copy of the NZX's proposed amendments to the [NZSX/NZDX Listing Rules](#) and the [NZAX Listing Rules](#) are available on NZX's website.

For further information on the Companies Act amendments to the annual report requirements see the company law section of this issue of Commercial Quarterly.

Securities and capital markets

NZX issues two new guidance notes

NZX has released guidance notes on Listing Rule 5.2.3 relating to when the NZX will be satisfied that the issuer of securities has a sufficient spread of security holders and on the legal requirements for fund raisings effected by way of a Share Purchase Plan.

Guidance note – Spread

To ensure that there is a strong likelihood of a liquid market for an issuer's securities, Listing Rule 5.2.3 sets out the spread requirements for issuers by prescribing a minimum number of security holders and prescribing a percentage that must be held by the public.

In the 2005/2006 review of the Listing Rules it was suggested that the rules could be expanded to indicate other ways of determining a liquid market. However, NZX chose to retain the main criteria based on numbers subject to the following new wording:

".. and those requirements are maintained, or NZX is otherwise satisfied that the issuer will maintain a spread of security holders which is sufficient to ensure that there is a sufficiently liquid market in the Class of Securities."

This latest guidance note now sets out the factors that will be taken into account by NZX in determining whether a "sufficiently liquid market exists". These include:

- a free float methodology under which NZX state they would grant approval where the aggregate market capitalisation of securities held by at least 500 members of the public is at least \$50 million; and
- where there is a market maker in a class of securities, NZX state that they would grant approval if there is an ongoing commitment on the part of the market maker to make markets in the securities.

The Guidance note also reminds issuers that:

- the minimum prescribed percentage of securities must remain in public hands at all times; and
- where NZX has granted waivers for holdings by new owners in a back door listing, ongoing waivers will not be given in the event that the new owners are unable to sell down (to meet spread requirements) unless there are exceptional circumstances. In such cases the issuer may be required to transition to the NZAX market.

To view a copy of the [Spread Guidance Note](#) visit NZX's website at www.nzx.com.

Guidance Note - Share Purchase Plans

Share Purchase Plans (SPPs) are a relatively new concept in New Zealand and there have only been a handful of SPPs undertaken by companies listed on the NZX pursuant to specific exemptions from the Securities Act (NZX – Share and Unit Purchase Plans) Exemption Notice 2005. However, as companies begin to realise the benefits of undertaking a SPP, this is expected to increase.

SPPs allow a company to issue up to NZ\$5,000 worth of shares (to a maximum of 30% of the shares currently on issue) to existing shareholders utilising a fairly short, simple offer document. The rationale for the Exemption Notice is that a full disclosure document, such as an investment statement, is not necessary given that issuers are subject to the continuous disclosure requirements of the NZX and thus existing shareholders will be fully informed about the company.

The new Guidance Note has been prepared to assist issuers comply with the legal requirements of a SPP and includes discussion on:

- the SPP Exemption Notice requirements;
- the form and content of the offer document for a SPP;
- the necessity to note the difference between New Zealand and Australian treatment of custodians holding securities for beneficiaries when drafting limited offer documents;
- the subscription price statement for a SPP;
- NZX Listing Rule compliance issues; and
- NZX Participant Rule Compliance.

To view a copy of the [Share Purchase Plan Guidance Note](#) visit NZX's website at www.nzx.com.

Also see an article by [Louise Hill](#), a senior associate in Bell Gully's Corporate team, entitled [Changes to increase the benefits of share purchase plans](#) in the Summer 2007 issue of *Commercial Quarterly* for a discussion on a number of issues relating to SPPs including the effect the trans-Tasman mutual securities regime will have on SPPs.

Securities and capital markets

Australia introduces Bill for trans-Tasman mutual recognition of securities

Progress continues on bringing into effect the Australian and New Zealand governments' agreement to introduce a mutual recognition of securities regime. Australia's Corporations (NZ Closer Economic Relations) and Other Legislation Amendment Bill 2007 was introduced at the end of March and it is expected to be passed during Australia's winter parliamentary sessions. The necessary approvals to finalise the equivalent New Zealand regulations will be sought once the Australian legislation has been passed.

The Corporations (NZ Closer Economic Relations) and Other Legislation Amendment Bill 2007 gives effect to the Trans-Tasman Mutual Recognition of Offers of Securities and Managed Investment Scheme Interests regime. When enacted, the legislation will allow the offer of securities and managed investments to be made by a New Zealand company in Australia using the same offer documents that the company uses in New Zealand. Similarly, the equivalent New Zealand legislative amendments, the Securities (Mutual Recognition of Securities Offerings Australia) Regulations 2006, will allow Australian companies to offer securities in New Zealand using the Australian offer document.

The objective is to reduce duplicated and costly regulation, and thereby facilitate investment between New Zealand and Australia, enhance competition in capital markets, and reduce costs for business and increase choice for investors. The scheme achieves this by allowing entities from New Zealand to offer securities into Australia on the basis of compliance with the New Zealand fundraising requirements and with minimal additional requirements imposed by Australian law. This is intended to reduce costs significantly for New Zealand issuers, as they will no longer be required to prepare separate documents to comply with Australian regulation, and vice versa.

This new regime can come into force as soon as New Zealand's draft regulations under the Securities Act and the Australian Bill (together with any necessary regulations) have been passed.

In addition to providing for the mutual recognition of securities offerings, the Australian Bill makes provision for:

- reduced filing requirements for certain foreign companies carrying on business in Australia;
- information sharing between the Australian Competition and Consumer Commission and other agencies, bodies and persons; and
- the protection of certain information that is given to, or obtained by, the Commission.

The Bill also makes amendments to the Trade Practices Act 1974 following recommendations made by the Productivity Commission in its 2004 Research Report "*Australian and New Zealand Competition and Consumer Protection regimes*".

The Bill is available on the [Australian Commonwealth Law website](#).

For further information on the proposed Securities (Mutual Recognition of Securities Offerings Australia) Regulations 2006 visit the Ministry of Economic Development's website at <http://www.med.govt.nz/>.

For background information on the Australian Bill visit the Australian Government's website at <http://www.treasury.gov.au/>.

Securities and capital markets

MED releases summaries of submissions received in its Review of Financial Products and Providers

The Ministry of Economic Development (MED) has finished reviewing submissions it received from over 135 organisations in response to the nine discussion documents released as part of the Review of Financial Products and Providers (RFPP). The review includes proposed changes to securities offerings regulated by the Securities Act.

As was previously reported in the Spring 2006 issue of the [Commercial Quarterly](#), the RFPP encompasses 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. The review also addresses issues relating to offers of securities "to the public" under the Securities Act 1978.

The discussion document on securities offerings included requests for feedback on whether:

- the scope of the existing exemptions for "relatives and close business associates" and "professional and habitual investors" from the requirements for offers "to the public" required further clarification;
- the current dual offer document approach should revert to a single offer document having a Part A and a Part B where Part A will, like the investment statement, be targeted at retail investors and Part B will, like the prospectus, be targeted at professional investors;
- a new requirement for educational material should be included as part of the offer document to help improve the financial literacy of the average retail investor in New Zealand; and
- a continuous disclosure regime should be extended beyond listed securities to all securities where there is an established secondary market.

Submissions received on the last two items indicate little support for changes in these areas. Although the submissions acknowledge that the financial literacy of Kiwi investors is a concern, they do not consider that educational material should be included as part of the offer document. There is more support for this to be addressed at a national level by a government agency. Similarly, there was a generally negative response to the proposal to extend the continuous disclosure regime to unlisted issuers. It was noted that this would place unreasonable compliance costs on issuers and may lead to companies discontinuing their involvement in a secondary market.

There was some support for changes to be made in relation the scope of the existing exemptions for offers and the proposal for a single offer document. However, there appears to be no consensus on what form these changes should take.

MED is now preparing policy recommendations for consideration by Cabinet and the Minister of Commerce, Lianne Dalziel, has indicated that there will be a phased introduction of any proposed legislation over the 2007/2008 period.

The summaries of the submissions on all of the nine discussion documents including the Review of Securities Offerings discussion document are available on the MED's website at www.med.govt.nz.

For further information on the submissions received on the financial intermediaries discussion document under this Review, refer to the 2007 Autumn issue of the [Financial Services Quarterly](#) on our website.

Securities and capital markets

Update on Takeovers Panel's reform proposals for schemes of arrangement

In late 2006 the Government failed to gain the necessary political support to include the Takeovers Panel's proposed reforms relating to code companies effecting a scheme of arrangement under the Companies Act as part of the Business Law Reform Bill. The Government has now referred the matter back to the Takeovers Panel for further review and consultation with the business community. The Takeovers Panel has also recently published its revised policy on the use of its exemption powers for schemes of arrangement.

Government requests Takeovers Panel to progress work on proposed legislative changes

In 2006 the Takeovers Panel took a number of steps to address its concerns over schemes of arrangements and amalgamations being used by code companies to avoid the provisions of the Takeovers Code when seeking to change the ownership or control of code companies. This included making recommendations to the Minister of Commerce for legislative changes to be made to the Companies Act and the Takeovers Code, and asking the Commerce Select Committee for those changes to be included as part of the 2006 Business Law Reform Bill.

However, the Commerce Select Committee rejected the Panel's last minute proposal to add its measures to the Bill, considering that the changes were beyond the scope of the Bill and would be more appropriately addressed in future legislation.

Further attempts to include a modified version of the Panel's recommendations included in a Supplementary Order Paper to the 2006 Business Law Reform Bill also failed to gain the necessary political support.

The Government, by a formal request in March 2007, has now handed the matter back to the Panel to lead the required policy work on the Panel's 2006 proposals. In making the referral, the Minister of Commerce, Lianne Dalziel, said the Panel had the necessary commercial expertise to advise her on this matter.

The Panel has also been asked to prepare a Regulatory Impact Analysis (RIA) in accordance with the new regulatory impact analysis framework which took effect on 1 April 2007. This will require the Panel to:

- demonstrate that the status quo is unsatisfactory;
- consider all feasible options;
- identify all environmental, economic, social (including health) and cultural costs, risks and benefits of each feasible option;
- quantify or otherwise assess each impact;
- indicate any assumptions or judgments made by policy makers; and
- indicate why the preferred option has been chosen over others.

The Panel has indicated that it will consult further with the commercial community before reporting back to the Minister.

For further information on the Takeovers Panel's 2006 recommendations to the Minister of Commerce and to view Bell Gully's comments on those recommendations see the Spring 2006 issue of [Commercial Quarterly](#).

New exemption policy issued

The Takeovers Panel has issued a revised statement on the policy it is currently following in relation to its use of its exemption powers to facilitate changes of control of code companies effected through schemes of arrangement under Part XV of the Companies Act. This replaces its earlier statement issued on 1 July 2003 and follows on from a discussion document issued by the Panel in June 2006.

The policy statement is directed only at those schemes which cannot proceed without some form of exemption from the Takeovers Code. In such cases the Panel says it will consider each exemption application on its merits and in accordance with its published guidance note, *Takeovers Panel's Exemption Power (January 2005)*. The 2005 guidance note provides that, in considering an application, the Panel will consider whether compliance with the Code is possible and whether compliance would create an inappropriate, unreasonable, or unintended result.

The Panel notes that conditions of any exemptions to a scheme will focus on:

- the level of shareholder approval required for a transaction to proceed and who is entitled to vote on the relevant resolution; and
- the information given to shareholders about the proposed transactions (to ensure that shareholders have sufficient information to decide for themselves the merits of any scheme proposal).

Where a proposed scheme involves a merger of shareholder interests, the Panel has indicated that it will generally seek to require the proposed scheme to be approved by:

- at least 75% of the votes cast at a meeting, provided that the resolution represents more than 50% of the total voting rights in the code company; and
- at least 75% of the votes cast at the meeting of independent shareholders.

However, the Panel has made it clear that in the absence of a merger of shareholder interests, for example where a proposed scheme involves shareholders of one participating company exiting for cash, it is likely to impose a shareholder approval threshold representing 90% of the total voting rights in that company (being the same as the compulsory acquisition threshold under the Code).

The revised policy statement also affirms previous statements made by the Panel in 2006 that the Panel will seek to be heard by the High Court on schemes of arrangement involving code companies at the stage that initial orders are being made. Accordingly, the Panel encourages code companies to advise the Panel of their intentions in the early stages of the planning process.

A copy of the Takeovers Panel's [Policy Statement](#) is available on its website at www.takeovers.govt.nz.

Also see issue No. 19 of the Takeovers Panel's [Code Word](#) for the Panel's discussion on its general approach to schemes of arrangements involving code companies and the differences between the revised policy and its 2003 policy.

Securities and capital markets

Discussion paper released on derivative futures contracts

In response to requests from market participants, the Securities Commission has put forward a proposal to use its powers under the Securities Markets Act 1988 to declare certain derivative contracts known as contracts for difference (CFDs) in respect of shares or other securities to be futures contracts.

The reform of New Zealand's futures regulation is currently being addressed by the Ministry of Economic Development as part of its review of Financial Products and Providers. However, the Securities Commission considers that more immediate clarification is needed for the status of certain types of financial instruments known as CFDs in respect of shares or other securities.

At present it is unclear whether these products constitute a future contract for the purposes of the Securities Markets Act. If the Commission declared CFDs in respect of shares or other securities to be futures contracts, a futures dealer in these products would be able to take advantage of the Securities Act (Authorised Futures Dealers) Exemption Notice 2002. This notice unconditionally exempts persons who deal in authorised futures contracts from the trustee, statutory supervisor, prospectus and investment statement requirements of the Securities Act and all of the Securities Regulations 1983 (except in relation to regulation 8 for misleading information). Instead people dealing in these products will be required to obtain authorisation to deal in futures contracts under the Securities Markets Act.

The Securities Commission sought comments on its proposal to use its specific powers under the Securities Markets Act to declare CFDs in respect of shares and other securities to be futures contracts in a discussion paper released in April. Submissions closed on 4 May 2007.

To view a copy of the [discussion paper](#) visit the Securities Commission's website.

Competition and consumer law

Making claims: Ribena case a warning to industry

The prosecution of GlaxoSmithKline for making misleading vitamin C content claims underscores the need for food manufacturers to be careful of their claims.

'Made in New Zealand' claims "blatantly dishonest"

A clothing supplier's failure to sweep the factory floor made life easier for the Commerce Commission when it raided the company's premises following a confidential tip-off.

Review of price control provisions in the Commerce Act

The Ministry of Economic Development has released its long awaited discussion document reviewing the price control provisions under Parts 4, 4A and 5 of the Commerce Act.

Bell Gully authors New Zealand chapter of global competition publication

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Competition and consumer law

Making claims: Ribena case a warning to industry

The prosecution of GlaxoSmithKline for making misleading vitamin C content claims underscores the need for food manufacturers to be careful of their claims.

In the age of the obesity epidemic it is common for food manufacturers to try to influence consumer purchasing decisions by touting a product's nutritional, natural or health qualities. But if the product's contents do not deserve the producer's claims, the consequences can be severe as we have seen in the recent high profile Ribena case.

One of the world's largest multinational food companies, GlaxoSmithKline has been fined NZ\$227,500, and ordered to undertake a nationwide campaign of corrective advertising for misleading its customers about the blackcurrant drink Ribena. The company had promoted Ribena by claiming that blackcurrants had four times the vitamin C of oranges.

The Commerce Commission argued that this claim, while literally true, was likely to mislead consumers about vitamin C in Ribena and orange drinks. As an example of the true comparison, Ribena syrup diluted in the recommended way has only one-and-a-half times the vitamin C of orange juice. GlaxoSmithKline pleaded guilty to 10 charges of breaching the Fair Trading Act in relation to these "four times" claims and a further five charges over the incorrect labelling of the ready-to-drink product which contains no detectable level of vitamin C.

The Fair Trading Act 1986

The Fair Trading Act protects consumers from false, misleading and deceptive claims and representations regarding goods and services. Specifically, it prohibits misleading or deceptive conduct generally (section 9), conduct that is liable to mislead over "the nature, manufacturing process, characteristics and suitability for a purpose" of goods (section 10) and false or misleading representations as to the quality, composition, style or nature of products (section 13).

In practical terms, these requirements apply to both product labelling and advertising. Labelling will breach the Fair Trading Act if, through words or pictorial representations, they mislead or deceive or have the potential to mislead or deceive shoppers about characteristics of the food such as composition, origin, quantity or desirability.

Under the Fair Trading Act it is necessary to consider the overall impression created by labelling. Labelling may comply with the requirements of the Food Code, Food Act and other advertising regulations and codes of practice, however be found in breach of the Fair Trading Act if the overall impression given by the advertising is misleading. It is, therefore, essential to seek expert guidance if there is any doubt as to whether a product's labelling or marketing creates an overall false or misleading impression.

Across the Tasman

Last year the Australian Competition and Consumer Commission (ACCC) released new food descriptor guidelines in an attempt to assist food manufacturers to comply with the Australian Trade Practices Act (largely equivalent to our Fair Trading Act). The guide was developed with Food Standards Australia New Zealand (FSANZ) and, in recognition of the trans-Tasman nature of the food and beverage industry, the New Zealand Commerce Commission.

As New Zealand's comparable publication is no longer in print, the guide provides an up-to-date indication of the ACCC and Commerce Commission's current views on what constitutes misleading representations in food labelling and packaging. It covers the following key compliance issues:

- fine print and disclaimers;
- omissions;
- qualifying claims;
- images and pictures;

- comparative claims;
- the overall impression; and
- representations about the quality, quantity, composition and origin of the food or beverage.

Risky descriptors

Specific food and beverage descriptors that have been identified as likely to raise issues under the Fair Trading Act are 'pure', '100%', 'fresh', 'natural', 'trim/lean', 'genuine' and 'real'. For example, the descriptor '100% pure' should not be used when the product contains added preservatives or additives, nor should 'natural' be used to describe foods that have been altered by chemicals.

This year in the United States, a multinational food and beverage company announced its decision to change the labelling of a soft drink, after public debate on the validity of its 'all natural' claims. In April last year the product was reformulated to contain what it termed only '100 per cent natural' ingredients. TV advertisements claimed it "tastes better than ever because we stripped out all the artificial stuff," and showed cans of the drink being picked from fruit trees or harvested from the ground. However, these ads and the company's "all natural" claim were criticised because the product contains high fructose corn syrup – an ingredient which is arguably not 'natural' because its chemical bonds are broken and rearranged in the manufacturing process.

Health claims

As regulators seek to prevent health-conscious consumers being misled by labels that exaggerate the presence of healthy ingredients, new laws are being created to curb market behaviour. The European Commission has introduced new legislation which provides that nutrition claims can only be made if the product meets a so-called 'nutritional profile'. For example, food products with lots of fat and sugar cannot be labelled with claims such as 'contains vitamin C'. In 2003, the Australia and New Zealand Food Regulation Ministerial Council agreed to a new policy for Health, Nutrition and Related Claims. It was intended to guide FSANZ in developing a new standard to allow certain recognised health claims and provide a framework for investigating and approving other health claims. The final recommendations on the new standard are expected to be ready for consideration by the Council in October 2007. Until a new health claims standard is adopted, all health claims on food and beverage labelling remain prohibited.

This article was written by Bell Gully senior solicitor [Tania Goatley](#) and solicitor [Kristy Newland](#) and was first published on 3 April 2007.

Competition and consumer law

'Made in New Zealand' claims "blatantly dishonest"

A clothing supplier's failure to sweep the factory floor made life easier for the Commerce Commission when it raided the company's premises following a confidential tip-off.

The contract awarded to New Zealand sports clothing supplier, Sports Resources Ltd, to supply official Olympic games team clothing to Adidas and the New Zealand Olympic Committee, stipulated that most of the clothing – including the iconic Kiwi black singlet – was to be made in New Zealand.

But, after the tip-off about a possible breach of the Fair Trading Act, the Commerce Commission executed a search warrant at Sports Resources' South Auckland factory. There, the Commission's investigators found goods in their original packaging with 'Made in China' labels attached, clothing with 'Made in China' labels cut out that had been relabelled as 'Made in New Zealand', and literally hundreds of the cut off 'Made in China' labels strewn over the factory floor. The court found the company director had instructed staff to cut out the 'Made in China' labels from the imported clothing and sew in new 'Made in New Zealand' labels. Neither the Olympic Committee nor Adidas were in any way aware of the mislabelling, although Sports Resources had already supplied over 1,800 items of clothing to the Olympic Committee before the Commission's raid, and several thousand more were yet to be delivered.

Sports Resources was last month fined \$23,750 in the Auckland District Court for two charges of breaching the Fair Trading Act, and its company director has been convicted and discharged. It is illegal under the Fair Trading Act to make false or misleading representations concerning the place or origin of goods. As the maximum penalties that can be imposed under the Fair Trading Act are \$200,000 per offence for companies and up to \$60,000 per offence for individuals, many may consider that Sports Resources was let off relatively lightly. This is especially so given the comment from Commerce Commission's Director of Fair Trading, Deborah Battell that "It's hard to think of a more blatantly dishonest act than cutting off the words 'Made in China' and sewing on a new 'Made in New Zealand' label.

The Commission ensured that all items were relabelled before being distributed to the games team.

Each year the Commission investigates a large number of complaints in relation to misleading representations about place of origin. While the Sports Resources proceedings centred on the wording that appeared on clothing labels, firms should be aware that a false or misleading impression can also be created by the use of symbols, such as Kiwis, flags or other national emblems.

Competition and consumer law

Review of price control provisions in the Commerce Act

The Ministry of Economic Development (MED) has released its long awaited discussion document reviewing the price control provisions under Parts 4, 4A and 5 of the Commerce Act.

In its present form, the regulatory control provisions in the Commerce Act provide:

- generic price control provisions under which any firm may be regulated if competition in the relevant market is limited or likely to be lessened and regulation is considered in the interest of acquirers of the firm's goods or services (under Part 4);
- a specific thresholds regime for electricity lines businesses which allows the Commerce Commission to place an electricity lines business under control if it breaches the thresholds (under Part 4A); and
- in cases where a decision to control has been made (under Part 4 or Part 4A) the controlled good or service must be authorised by the Commerce Commission under Part 5.

The decision of whether to impose price control is functionally separate from the decision on how control should be designed and imposed.

Key discussion issues

The discussion document raises a number of issues for the purpose of determining whether the current controls are consistent with the objective of providing for the long-term benefit of consumers in New Zealand. It also addresses whether any amendments to the Act are necessary to meet the Government's policy objectives on infrastructure investment. The issues raised for discussion include whether:

- the regulatory provisions would benefit from the inclusion of specific purpose statements in the Act and guidance on when regulation should (and/should not) be imposed on a firm or sector;
- more light-handed types of economic regulation (such as a negotiation/arbitration regime or an information disclosure/price monitoring regime) should be provided for in the Act;
- key input methodologies/decisions should be set as a stand-alone process in advance of an inquiry and recommendation to regulate;
- the regulatory processes would be more cost-effective and timely if the decisions on whether and how to impose regulations are considered concurrently;
- the existence of the thresholds regime in Part 4A of the Act and the Commerce Commission's use of a certain methodology to set thresholds has the effect of constraining the Commission's approaches to control under Part 5;
- specific provision should be made to allow the Commission to use comparative benchmarking as a methodology for setting control terms and whether there is value in allowing firms to propose their own control terms for consideration;
- there is sufficient regulatory accountability under the current regime and in particular whether Commerce Commission's decisions should be subject to merits review; and whether
- the Part 4A thresholds regime should be retained.

Alternative proposal packages

The MED notes the various proposals put forward for change in the discussion document could be packaged in a variety of ways. By way of illustration in the discussion document, the MED has set them out as two separate options for reform.

Option One

The changes set out in Option One are more limited and appear to be more process based than substantive. Option One does include as one of the purposes of regulation that suppliers:

"...have incentives to innovate and to invest including in replacement, upgraded and new assets and in related businesses".

Importantly, the MED has proposed that input methodologies (such as WACC, etc.) should be set in advance through a stand-alone and transparent process, which would ensure consistency in the application of the regime across industries.

It also proposes that:

- the current thresholds regime could simply be made generic so that additional industries could be placed under this system;
- the Act would be extended to provide for other regulatory options to be considered by the Commission in addition to control; and
- the decision whether to impose price control will remain functionally separate from the decision on how control should be designed and imposed.

Option Two

Option Two incorporates the same features as Option One with some important extensions:

- the decisions whether to impose price control and how control should be designed and imposed would be considered together;
- the Act would provide for other regulatory options to be considered by the Commission in addition to control, such as negotiation/arbitration and information disclosure;
- control terms may be set using comparative benchmarking and/or firm-specific information with firms being given a role to propose their own regulatory control terms; and
- introduction of merits review rights (in addition to judicial review), on final control terms and action taken in the event of a breach for an individual company, although that will be limited to appeal by way of rehearing.

Submissions

MED has invited written submissions on the issues raised by the discussion paper from all interested parties. The closing date for submissions is Friday, 6 July 2007. If you would like to know more about the discussion document or require assistance with your written submissions please contact one of our competition team:

[Phil Taylor](#)
Partner

[Torrin Crowther](#)
Senior Associate

[David Blacktop](#)
Senior Solicitor

A copy of the [Discussion Document](#) is available on the MED's website.

The review of the clearance and authorisation provisions in Part 5 of the Commerce Act are the subject of a separate discussion document which is expected to be released soon.

Competition and consumer law

Bell Gully authors New Zealand chapter of global competition publication

Bell Gully competition specialists, partner Phil Taylor and senior associate Torrin Crowther, have authored the New Zealand chapter of The 2007 Handbook of Competition Enforcement Agencies.

Published by Global Competition Review, the handbook was launched in April at an American Bar Association's Antitrust Spring meeting in Washington DC.

You can read the New Zealand chapter [here](#).

This extract was originally published in *The 2007 Handbook of Competition Enforcement Agencies, a Global Competition Review special report* - www.globalcompetitionreview.com.

Intellectual property and information technology

Is your business spam compliant?: new anti-spam legislation for New Zealand

New Zealand has joined the worldwide legislative battle against spam with the passing of the Unsolicited Electronic Messages Act earlier this year. The new legislation is expected to come into effect on 5 September 2007, following a six-month grace period to allow time for businesses to ensure that their existing practices and policies are compliant with the Act.

Trade mark registration denied in “purely defensive” application

Defensive trade marks are a thing of the past in New Zealand following the abolition of defensive registrations under the Trade Mark Act in 2002 but, as illustrated in a recent High Court case, this hasn't stopped applicants from trying to achieve the same result through a different route.

Copyright: sculptures and t-shirts

The High Court has ruled on the ambit of s73 of the Copyright Act 1994 and assessed the extent to which a work of sculpture displayed in a public place can be reproduced in two dimensions for profit.

Intellectual property and information technology

Is your business spam compliant?: New anti-spam legislation for New Zealand

New Zealand has joined the worldwide legislative battle against spam with the passing of the Unsolicited Electronic Messages Act in February this year. The new legislation is expected to come into effect on 5 September 2007, following a six-month grace period to allow time for businesses to ensure that their existing practices and policies are compliant with the Act.

The Act is designed to tackle the proliferation of electronic junk mail and other messages such as SMS text sent by organisations we don't know and often can't identify. Apart from the annoyance and time factor involved in clearing these messages, spam creates economic costs for both service providers and users and, is being used as a major vehicle for malicious and fraudulent material.

In itself the new legislation is unlikely to have much impact on the bulk of spam received in your inbox. The difficulty is that despite spam accounting for a large proportion of New Zealand's email traffic, only 4 to 10 percent of spam actually originates in New Zealand.

Enforcing New Zealand legislation against foreign-based spammers will depend on the New Zealand Government forming co-operative relationships and multilateral arrangements with other countries and international bodies.

This has always been acknowledged by the Government. The Act is only one part of its "multi-pronged attack on spam" and it will serve as a platform for it to take part in international measures to combat spam.

In this update we provide an overview of the new anti-spam legislation and set out some practical issues businesses will need to address before the Act takes effect in September.

Purpose of the Act

The Act seeks to promote the responsible use of electronic messages by:

- prohibiting the sending of commercial electronic messages that have a New Zealand link, except where the message is sent to people who have provided their consent to receiving those messages;
- requiring all electronic messages with a New Zealand link to identify the person authorising the sending of the message and how that person may be contacted;
- requiring all electronic messages with a New Zealand link to include a functional unsubscribe facility embedded into the electronic message; and
- prohibiting the use of software to harvest electronic addresses, and the use of harvested address lists.

Who will it affect?

The new law changes the ground rules for businesses involved in digital marketing by requiring an opt-in process before commercial electronic messages (as defined by the Act) can be sent to customers or potential marketing targets. Fines of up to \$200,000 for individuals and up to \$500,000 for organisations will be incurred for breaching the Act.

The new rules for electronic messaging

Electronic messages

The Act applies to messages sent to an electronic address using a telecommunications service, and includes email, instant messaging or text messaging. It does not apply to voice calls (including voice messages using voice over internet protocol technology), direct mail or to fax transmissions.

New Zealand link

The Act only applies to electronic messages with a New Zealand link. The definition of "New Zealand link" is very wide and covers not only messages originating in New Zealand being sent to any destination but also messages that originate overseas being sent to an address accessed in New Zealand. The Act also applies where it would be reasonable to expect that an electronic address has a New Zealand link (for instance, email addresses ending in .nz), even if that address does not exist.

This feature is particularly important in addressing the global spam problem. However, liability for breaches of the new rules 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 Act 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 Act requires that any electronic message covered by it clearly and accurately identifies the person who authorised the sending of the message and includes 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. The unsubscribe facility must allow the recipient to respond using the same method of communication that was used to send the original message.

Prohibition on address harvesting software and harvested -address lists

The Act imposes a strict prohibition on the use of address harvesting software or harvested address lists. Address harvesting software means software that is capable of, or marketed for use for searching the Internet for electronic addresses and for collecting and compiling those addresses.

The onus of proving that the use of the software or list was not in connection with, or was not with the intention of, sending unsolicited commercial electronic messages lies with the person who contends that this has occurred.

Defences

The Act 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 Act's rules on electronic messaging, has a defence if they 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).

Regulations

The Act 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.

Enforcement, procedures and penalties

Enforcement

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

On receiving a complaint the Enforcement Department 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.

Penalties and fines

A person affected by spam may seek an injunction from the High Court, may apply to the High Court for compensation for any loss suffered or damages (which are not to exceed an amount equal to the financial benefit obtained by the spammer) or may apply to the High Court to join any court action initiated by the enforcement department. An enforcement officer may issue formal warnings, issue a civil infringement notice requiring the spammer to pay a penalty, apply for an injunction or make an application for the spammer to pay a pecuniary penalty, compensation or damages.

An individual faces pecuniary penalties of up to \$200,000 while an organisation faces penalties of up to \$500,000. Factors to be assessed in deciding the level of fine include the number of messages sent, the number of addresses to which an electronic message was sent, and whether the perpetrator has previously contravened the Act.

Some issues for business

The Act raises a number of practical issues for business, such as:

- will new business processes have to be adopted for a business to comply with the opt-in requirements for commercial electronic messages and what might these be?

- how far can a business rely on inferred consent as opposed to express consent in relation to the sending of commercial electronic messages?
- should more marketing effort be focussed on other forms of marketing not covered by the Act (such as telemarketing)?
- what steps should be taken by businesses to avoid being deemed to have given their consent to receiving unsolicited commercial electronic messages?
- what issues arise for businesses based here and overseas in order for them to comply with legal requirements in other countries for the regulation of unsolicited electronic messages?
- what new policies are required for compliance with other parts of the new legislation?
- what further training is required to ensure that staff are in a position to support your company's compliance efforts?

One area likely to cause considerable difficulty for organisations is being able to determine with certainty when they will be able to rely on inferred consent. A recent review of the Australian anti-spam legislation, which has been in place since 2003, indicates that many Australian businesses have found compliance with an equivalent provision to be confusing and unduly onerous. As noted above, some of these difficulties may be addressed in regulations setting out circumstances giving rise to inferred consent. However, it is likely that this will be an on-going issue, which will require further clarification in the Act as well as the development of industry guidelines and codes of practice.

The road ahead

No-one expects the Act to deliver an immediate end to spam. However, it is an important element in solving the problem and brings us in line with other countries such as Australia, the United Kingdom and the United States in fighting the increasing cost of spam. The new legislation should be seen as one step in a range of complementary strategies, including the development of industry codes and international cooperation.

While the efficacy of the Act remains to be seen, it introduces further compliance issues for New Zealand business. The biggest initial impact will be on digital marketers and internet service providers, but all businesses will need to review their procedures to ensure that:

- either express or inferred consent exists for all commercial electronic messages;
- all electronic messages contain accurate information identifying the business organisation and provide a functional unsubscribe facility;
- harvested address lists are not used; and
- employees are educated on the new legislative changes and adequate email practices, software programs and databases are in place.

Organisations should start to seek advice on the potential implications of the new legislation for their businesses and develop appropriate strategies to ensure they comply.

For further information, please contact your usual Bell Gully advisor or:

AUCKLAND

Wayne Hudson
Partner

Simon Martin
Partner

WELLINGTON

Dean Oppenhuis
Partner

Stephen Reville
Consultant

Intellectual property and information technology

Trade mark registration denied in “purely defensive” application

Defensive trade marks are a thing of the past in New Zealand following the abolition of defensive registrations under the Trade Mark Act in 2002 but, as illustrated in a recent High Court case, this hasn't stopped applicants from trying to achieve the same result through a different route.

Background

Cadbury Enterprises Pte Ltd (Cadbury) filed an application to register the EARTH trade mark on 15 May 2003. The application was filed in class 30 to cover “*chocolates, chocolate and sugar confectionery (all being non-medicated), chewing gum; biscuits, cakes, wafers, flour and preparations made from cereals, snack foods; food drinks; ice cream and ice confections*”. The application was filed on the basis of proposed use, but as the evidence established, Cadbury's purpose was to protect its MOTHER EARTH trade mark (which it also holds registrations for).

The application proceeded to acceptance and was opposed by Effem Foods Limited (Effem) on the grounds that (i) it had made use of the EARTH trade mark and therefore had prior rights in the trade mark and that it sought to assert its claim by filing an application to register the EARTH (stylised) trade mark; and (ii) that there was no evidence that Cadbury had used the EARTH trade mark or intended to do so.

Effem asserted its prior rights on the grounds that it used the EARTH trade mark in a television advertisement for Effem's MARS chocolate bar which commenced on 27 April 2003 (prior to the date of the Cadbury application). The advertisement depicted a bar in MARS getup, carrying the stylised word EARTH instead of MARS. The advertisement ended with a voiceover stating “Earth. What you'd eat if you lived on Mars”.

At the opposition, the Assistant Commissioner of trade marks found on the facts that Effem had not used EARTH as a trade mark, rather it was a clever way of advertising the MARS bar. In order to meet the requirements of trade mark usage, it is necessary that goods bearing the trade mark be available in trade, or that there is an existing intention to make such goods available. In this case, there was no evidence that the goods bearing EARTH as a trade mark was available (or an existing intention to make them available).

While the Assistant Commissioner found that Cadbury's use of MOTHER EARTH was not tantamount to use of EARTH given that the two are not identical, she found that Effem failed to establish that Cadbury had no intention to use EARTH and it was enough that Cadbury intended to use the mark at the time it filed its application. Therefore, the opposition failed.

Effem appealed the Assistant Commissioner's decision to the High Court on the following grounds:

- that the Assistant Commissioner erred in finding that Effem had not used EARTH as a trade mark;
- that the evidence showed that Effem used EARTH in the television commercial for several months, before the date of Cadbury's application and that, by contrast Cadbury made no use of the EARTH mark; and
- that there was no evidential basis for establishing that Cadbury intended to use EARTH as a trade mark on its own; rather, it sought to register EARTH to protect MOTHER EARTH.

High Court's Decision

At the appeal¹⁰, counsel for Cadbury contended that Effem did not use EARTH in a trade mark sense; rather as a part of a slogan intended to market the MARS bar and that such use is not capable of distinguishing the MARS bar. He accepted that while there is no actual evidence that Cadbury intended to

¹⁰ *Effem Foods Ltd v Cadbury Ltd* (unreported Judgement H.C, Wellington, Miller J, CIV 2005-485-1487, 7 February, 21 March 2007)

use EARTH, its application for registration established intention to use and that the onus was on Effem to establish that Cadbury had no intention to use the mark.

Did Effem use EARTH in a trade mark sense?

In deciding this point at the appeal, Justice Miller stated that the only goods being sold or promoted was MARS bars and that there were no EARTH bars being offered for sale. He stated that the issue was whether EARTH conveyed trade mark significance to the consumer, or whether EARTH was capable of distinguishing the MARS bar. He reached the same conclusion as the Assistant Commissioner and found that there was no evidence that Effem used EARTH in a trade mark sense in the advertisement and that Effem failed to establish prior rights to the EARTH trade mark in New Zealand.

Intended use of EARTH by Cadbury

The judge agreed that use of MOTHER EARTH was not tantamount to use of EARTH as the two marks are distinct.

The judge found that apart from the application filed by Cadbury, it provided no evidence before the Assistant Commissioner to establish that it intended to use EARTH as a trade mark. A director of Cadbury deposed that the application for EARTH was filed to protect the substantial goodwill and reputation that Cadbury has in the MOTHER EARTH trade mark and it appears Miller J placed considerable weight on this evidence.

The judge accepted that Cadbury's application for the EARTH trade mark inferred a prima facie intention to use. However, he stated that in the case of a trade mark opposition, the question is whether the applicant had established that it has used or intends to use the mark. In the present case, Miller J held that any inference of intention to use which arose from the application itself was displaced by Cadbury's own evidence that the purpose of registration was purely defensive (i.e. the director's evidence that the application was filed simply to protect Cadbury's goodwill and reputation of the MOTHER EARTH trade mark).

In allowing the appeal, Justice Miller found that Cadbury failed to establish an intention to use EARTH as a trade mark and that the Assistant Commissioner should have rejected the application. He did agree with the Assistant Commissioner that Effem failed to establish prior use of the EARTH trade mark.

Commentary

The above case establishes that traders cannot use other provisions in the Trade Marks Act to try and obtain a defensive registration indirectly. Filing an application to protect a trade mark would be considered a prima facie intention to use, and it is not for the Registrar of Trade Marks to enquire as to the applicant's intention. However, when the application becomes the subject of an opposition, or if it is challenged, it will now become necessary for the applicant to establish an intention to use. If a trade mark registration is sought for purely defensive reasons, with no intention to use the trade mark, it may be rejected, on the basis of this decision.

Advice and information

This case note is by Bell Gully solicitor Jeanette Singh. Bell Gully's [Intellectual Property team](#) can advise you on all types of IP issues, including the registration and maintenance of trade marks. Contact the team for more information.

Intellectual property and information technology

Copyright: sculptures and t-shirts - *Radford v Hallenstein Bros Ltd*

The High Court has ruled on the ambit of s73 of the Copyright Act 1994 and assessed the extent to which a work of sculpture displayed in a public place can be reproduced in two dimensions for profit.

The High Court recently ruled on the true construction of s73 of the Copyright Act 1994.

Section 73 has always appeared to be intended to exempt from being an infringement the copying of a sculpture that is permanently situated in a public place (or in premises open to the public), so long as the copy made is a graphic work, or a photograph or film of the sculpture in question. In other words, s73 appeared to condone the copying of such sculptures in two-dimensional form even if the copies made are sold commercially.

The background to the case was as follows. Hallensteins sold a number of t-shirts which featured on their front a photograph of two large sculptures produced by Mr Radford in 1998 and displayed in a park in Ponsonby, Auckland.

Mr Radford brought a claim based on three causes of action. First, he claimed, Hallensteins had breached his copyright in the sculptures by reproducing them on the t-shirts. Second, he claimed Hallensteins had imported into New Zealand copies of his sculptures, intent on selling them knowing or having reason to believe they infringed copyright. This cause of action was based on the importation of t-shirts from China bearing the relevant photographs. Third, he claimed a breach of his moral rights. Under this cause of action, he asserted that Hallensteins had set his sculptures on the t-shirts and that was "incongruous, distorting and derogatory".

The claim had initially been brought in the District Court and on 17 July 2006 a District Court Judge struck out Mr Radford's first two causes of action. He did so on the basis of s73 of the Copyright Act 1994.

Mr Radford appealed to the High Court and asserted that s73, while permitting copying of sculptures in the public domain, in spite of copyright in certain circumstances, did not permit the indirect copying of underlying works, such as drawings or models.

Justice Keane in the High Court carefully reviewed the history, provenance and purpose of s73. In doing so, he accepted that the section when literally read, did not explicitly exclude from the protection of copyright underlying works created in the course of making a sculpture (for instance elevations or drawings). In this regard, he said "on a literal reading they lie beyond s73."

Notwithstanding this finding, he went on to hold that to construe s73 in such a limited way would lead to an absurdity and undermine the intent and purpose of the section. For that reason, Keane J held that s73 must condone indirect copying of such underlying works whether in two or three dimensions and whether or not they too are in the public domain.

This is obviously a sensible construction of s73 as a literal reading of the section would not marry with the obvious intentions of the legislature and would also result in a section that was thoroughly impractical.

As far as we are aware Mr Radford's moral rights claim has yet to be determined.

Advice and information

This article is by Bell Gully senior associate, [Garry Williams](#). Bell Gully's [Intellectual Property team](#) can advise you on all types of IP issues, including the registration and maintenance of trade marks. Contact the team for more information.

Utilities and resources

Getting down to the business of climate change

The New Zealand Stock Exchange and several leading companies recently announced their intention to establish a New Zealand-based carbon trading market to service the Asia-Pacific region. The Government has also indicated that it will be making cabinet decisions on emissions trading over next few months. In this article, Bell Gully partner Simon Watt provides some background on emissions trading and the growing body of support for using emissions trading as a means for businesses to reduce their carbon footprint.

New discussion document on the Permanent Forest Sink Initiative (PFSI)

Following on from the Sustainable Land Management and Climate Change discussion document released at the end of 2006, the Ministry of Agriculture and Forestry has now issued a consultation document on the proposed regulations and cost recovery methods for the PFSI together with a proposal for a forest sink covenant.

Toing and froing in telecommunications

Bell Gully senior solicitor, David Blacktop, provides an overview of developments in the telecommunications sector this quarter where the toing and froing and posturing in relation to telecommunications regulation continues.

National Policy Statement on electricity transmission

A draft National Policy Statement (NPS) on electricity transmission has been prepared and approved by Government and a Board of Inquiry set up. The Board has published the NPS and called for public submissions on the NPS by 25 July.

Recent developments in the electricity sector

An overview of decisions, discussion documents and terms of reference released in the electricity sector over this quarter.

Utilities and resources

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Climate change is an area of public policy where grandstanding, prevarication, self-interest, hypocrisy and breathtaking U-turns are all virtually *de rigueur*. So it was surprising to see a cross-party consensus on emissions trading emerge at a recent Environmental Defence Society forum held in Bell Gully's Auckland office.

Likewise there was common ground among the mix of suits and dreadlocks in the audience. They sent a collective message to our politicians: they must work together to develop a more cohesive response to the threat of global warming.

Although emissions trading has more than a ring of market mechanism about it, Green Party co-leader Jeanette Fitzsimons accepted that emissions trading was at the core of the Kyoto Protocol, which her party supports for want of any more ambitious international agreement to limit greenhouse gas emissions.

National Party Environment spokesperson Nick Smith supported emissions trading as an efficient and effective economic instrument, while the Minister for Climate Change Issues David Parker had shed earlier scepticism and foreshadowed the roll-out of emissions trading at least initially in the electricity sector. The Government has also signalled a possible requirement for deforesters converting to alternative land uses to hold tradable emissions permits.

So what is emissions trading, as it would apply to business? In essence it involves setting a cap on the emissions any one company can produce each year. If a company historically emitted 100 tonnes of CO₂ each year it might be capped at 90 tonnes and allocated 90 emission units – encouraging it to find ways to emit less. If the company reduces its emissions to 80 tonnes of CO₂, it will have 10 units to sell. If it still emits 100 tonnes of CO₂ in a year, it will have to buy 10 more units at the market price from a company that has managed to cut back.

This system drives efficient behaviour as it encourages emissions to be cut first where it costs least to do so – unlike a regulatory system which could force all companies to make the same level of emission reductions regardless of cost. The attraction of the system is that there is still an overall cap on emissions, so there is more certainty about the actual level of emissions achieved. In contrast, a carbon tax would not guarantee reductions and might simply be absorbed and passed on like many other business costs.

It is not only politicians who are getting excited about emissions trading. Business is at the forefront, no doubt reflecting a lack of confidence in Parliament's ability to deliver the best outcome. Business New Zealand is leading a project from which will flow a recommended framework for an emissions trading market in New Zealand. NZX has announced that it will establish its own emissions trading market, which it expects will be in operation by 2008. Chief Executive Mark Weldon sees New Zealand as well placed to be the centre for carbon trading in the Asia-Pacific region. This might be along the lines of the Chicago Climate Exchange, where emission units are actively traded. However, at this stage NZX is still working through the market's framework, including the ownership structure, trading rules and whether a carbon credit will be classified as a future, a spot product or a security.

Some are impatient and are trading already. The initial trading is sporadic but largely made possible by the Government's (now suspended) Projects to Reduce Emissions mechanism. Under that mechanism a number of local businesses and councils were awarded rights to emission units for a range of projects – such as wind farms – which will reduce emissions. Projects were only eligible if they would have been uneconomic and would not have gone ahead without the cash injection offered by the grant of emission units.

Some of the recipients have already forward sold their future rights to emission units. For these and indeed all recipients under the Projects mechanism, the challenge will be to implement the rigorous systems required to verify the emission reductions they have promised to achieve. It has to be an unusual market where someone pays cash for thin air (or strictly speaking for the value of a reduction in thin air!)

so there are some significant hoops to jump through before anyone will pay for this intriguing property right.

With many businesses rushing headlong towards carbon neutrality – not least for the marketing and reputational advantage – carbon off-sets are in short supply, particularly tradable emission units such as those arising out of the Projects mechanism. More will come on stream between 2008 and 2012, the period recognised by the Kyoto Protocol when emission reductions can be off-set against Kyoto liabilities. In the meantime, the value of non-Kyoto compliant units is significantly discounted because they don't reduce any immediate financial exposure.

If all this talk of emissions trading has whetted your appetite for a dabble in the market, how do you get started? First, recent amendments to the Climate Change Response Act have made it possible for businesses and individuals to hold accounts in the national registry for Kyoto-compliant emission units, although it will be at least mid-year before the registry is up and running.

Unfortunately the European Union's Emission Trading Scheme is still off-limits to non-EU companies, although New Zealand's Climate Change Office is talking to the EU about extending the scheme to enable an exchange of units with New Zealand. Other countries are doing likewise.

If you have a few thousand dollars to spare that will buy you entry to the Chicago Climate Exchange. Emission units are currently trading on that exchange at around US\$4 so it wouldn't be too expensive a place to start familiarising yourself with the market, while furthering your quest for carbon neutrality.

Closer to home you can purchase carbon off-sets via the carboNZero scheme (a *Google* search for that word will take you straight there). The scheme is administered by Landcare Research, a Crown Research Institute.

These steps may just be a precursor to trading Kyoto-compliant units under a broader New Zealand emissions trading scheme if Government policy does embrace the emissions trading route. Recent statements from David Parker signal that the Government is likely to do so with final decisions on emissions trading being taken by cabinet from May to July this year. David Parker has indicated that the scheme will be economy wide to prevent market distortions, however the transition periods for implementing the scheme are likely to vary in different sectors. He has also noted that the existing devolution of credits and tradable permits schemes in the forestry sector would be likely to be merged into an emissions trading scheme should it proceed.

The political issues and technical complexities of emissions trading are such that it is likely to progress more quickly and effectively if it is also driven upwards by the markets (such as the new carbon trading market, TZ1, proposed by NZX) than top-down from Parliament.

Either way climate change has met the market and the momentum is gathering.

[Simon Watt](#) leads Bell Gully's Climate Change Practice. An abridged version of this article was first published in *The Independent Financial Review* on 28 March 2007. The article has been updated to reflect recent developments

For further information about carbon trading, visit NZX's new website for its regional carbon trading market, TZ1 at www.tz1market.com. On this site you'll find a paper entitled "Carbon Markets 101"

To view David Parker's press release on the Government's emissions trading timeline visit the Government's website at www.beehive.govt.nz

Utilities and resources

New consultation document on the Permanent Forest Sink Initiative (PFSI)

In March, the Government released a consultation document on the regulations and forest sink covenant required for the PFSI to become operational in January 2008.

The Climate Change Response Amendment Act passed in November last year introduced the Permanent Forest Sinks Initiative (PFSI). This creates an opportunity for Kyoto-compliant landowners to gain financially through newly established permanent forest sinks. Landowners meeting the requirements of the initiative will be able to obtain tradable Kyoto Protocol compliant emission units in proportion to the carbon sequestered in their forests. However there are a number of outstanding issues to finalise before the PFSI becomes operational.

The Ministry of Agriculture and Forestry's consultation document released in March called for submissions on proposed regulations covering the following issues on the PFSI:

- the application process and proving eligibility of Kyoto-compliant land;
- harvesting, including allowable levels, reporting and monitoring requirements and penalties for breaching levels;
- carbon accounting and entitlement to units; and
- record-keeping requirements and certifiers.

In addition, the paper outlines the options for recovering costs associated with administering the PFSI which are likely to be a combination of fixed fees and annual levies.

A draft of the forest sink covenant is also included as part of the discussion document. This covenant sets out the rights and obligations of both the landowner and the government and once signed is to be registered on the land title.

There is some concern that the PFSI might have been superseded by the Government's latest afforestation options outlined in its December 2006 Sustainable Land Management and Climate Change discussion document (and noted in the Summer 2007 issue of [Commercial Quarterly](#)). This includes the proposal for a devolving sink credits and liabilities mechanism (DCL) for Kyoto-compliant forests established from 2007 onwards which would be run in a similar manner to the PFSI. However, this consultation document states that the PFSI will "*proceed no matter what other policy options are chosen*".

Submissions on the discussion document closed on 14 May 2007. The Government hopes to have the regulations approved later this year so that MAF's Indigenous Forestry Unit will be able to start approving PFSI applications and have the PFSI fully operational in time for the commencement of the first Kyoto commitment period in January 2008.

A copy of MAF's consultation document is available on their website at www.maf.govt.nz/forestry/.

To access a copy of the Sustainable Land Management and Climate Change discussion document visit the MAF's website at www.maf.govt.nz/climatechange

For further information on climate change issues, please contact Bell Gully partner [Simon Watt](#).

Utilities and resources

Toing and froing in telecommunications

Bell Gully senior solicitor David Blacktop provides an overview of developments in the telecommunications sector this quarter where the toing and froing and posturing in relation to regulation continues.

Mobile termination rates

Until the Government's decision to mandate local loop unbundling was leaked in May 2006, a key battleground had been the Commerce Commission's investigation into whether to recommend regulation of mobile termination rates (MTRs) – the price paid by a caller's network to connect a call to a mobile network customer.

The Commission originally recommended that MTRs for 2G mobile networks should be regulated but that MTRs on 3G networks should not because of a concern over investment incentives. The Minister did not accept that recommendation and asked the Commission to reconsider that position as well as to consider commercial offers put forward by the two mobile operators Vodafone and Telecom.

The Commission reconsidered its recommendations and concluded that MTRs for both 2G and 3G networks should be regulated. However, on 30 April 2007, the Minister again rejected the Commission's revised recommendation and instead accepted commercial undertakings from Telecom and Vodafone under which Telecom will reduce its MTR from 20 cents per minute (cpm) to 12 cpm and Vodafone will reduce its MTR from 20 cpm to 14 cpm over the next five years.

The outcome is that while Telecom and Vodafone have avoided specific legislation, they are now subject to informal price control.

Telecom's separation

The Ministry of Economic Development (MED) has embarked on a further round of consultation on the operational separation of Telecom's wholesale, retail and fixed line businesses as a result of Telecom's proposal to structurally separate its business. The proposal involves three components:

- Telecom selling its existing fixed line local access bottleneck network into a Netco reinforced by a new regulatory contract between the Netco and the Government;
- a simpler form of operational separation for the remainder of Telecom's businesses; and
- tighter co-ordination of future regulatory priorities and activity.

The recurring theme in this debate, as it was in the MTR investigation and seemingly all regulatory debates, is the requirement for a business to earn a return on capital so as to provide investment incentives. In its proposal, Telecom has noted that to achieve the Government's objectives for ICT in New Zealand, it would need to invest NZ\$1.5 billion in the local access network. Telecom has argued that the Government's proposal would result in high risks and low returns for the company that it could only justify investing around NZ\$500 million.

The debate over returns to Telecom is by no means unique. Telstra and the ACCC are currently engaged in a very public debate over the incentives for Telstra to invest in new fibre to underpin a Australian broadband network following the ACCC's decisions in relation to the prices Telstra can charge access seekers for using that network. Similarly in August 2006, Vector threatened to suspend its investment plans after the Commerce Commission declared an intention to place Vector under price control.

Utilities and resources

National Policy Statement on electricity transmission

A draft National Policy Statement (NPS) on electricity transmission has been prepared and approved by the Government and a Board of Inquiry set up. The Board has published the NPS and called for public submissions on the NPS by 25 July.

The NPS has been developed because currently, there are no guidelines for local authorities to use when they have to decide on proposals for transmission network development. Any decisions affecting electricity transmission are important for achieving the purpose of the Resource Management Act – sustainable management of natural and physical resources. The NPS is, therefore, an acknowledgement by the Government of the national significance of secure and efficient electricity supply, through the electricity transmission network.

The NPS is intended to address national distribution lines, i.e. lines that have national benefits but (largely) local costs, such as local environmental impacts. The NPS provides policies that help local councils make decisions about whether and/or where electricity transmission lines should be allowed, and how environmental effects should be managed. Crucially, however, the actual resource management decisions would still be taken at the local authority level. The policies outlined in the NPS are therefore intended as guidelines only.

National Environmental Standards (NES) are also being developed in addition to the NPS on electricity transmission. The NES address the management of electricity transmission in a nationally consistent way. There will be an opportunity for public input into the development of such standards when the proposed NES have been drafted.

To access a copy of the [draft NPS](#) and further background on the NPS and NES visit the Ministry for Environment's website at www.mfe.govt.nz.

Utilities and resources

Recent developments in the electricity sector

An overview of decisions, discussion documents and terms of reference released in the electricity sector over this quarter.

Commerce Commission agrees administration settlement with Unison Networks

The Commerce Commission has decided not to place electricity lines company Unison under formal price control in exchange for Unison agreeing essentially to a form of informal price control under which it has agreed to:

- reduce its average prices for electricity distribution services ; and
- to rebalance its line charges to different regions and customer groups, so that the prices paid by consumers better reflect the costs of supplying them.

For background and further information on the terms of this settlement visit the Commerce Commission's website at www.comcom.govt.nz.

Review of clause 62 of the Electricity Act underway

In March, the Government released its [Terms of Reference](#) for the consideration of what, if any, arrangements should be put in place when the statutory obligation in clause 62 of the Electricity Act 1992 requiring lines companies to supply line function services to places supplied in April 1993 expires in 2013. The Government wants to ensure that any community affected by the repeal of this clause continues to have an electricity supply after 2013.

The Government expects to release a discussion document for public consultation on this issue in June.

Transpower's 2007/2008 Draft Policy Statement

Submissions on Transpower's latest draft policy statement for the 12-month period beginning on 1 September 2007 closed on 14 May. The policy, updated annually, is central to the set of rules, contracts and arrangements which collectively deliver common quality and orderly system operations for the national electricity grid. The changes proposed for the 2007/2008 period include:

- more detailed description of security planning and co-ordination;
- extended discretion and flexibility in identification and management of risks; and
- defined methodology of identification, assessment and notification of risks.

The Electricity Commission supports the proposals put forward in the policy and will recommend that changes are made to the Electricity Governance Rules to achieve Transpower's latest objectives.

A copy of [Transpower's Draft Policy Statement](#) and the [proposed amendments to the Electricity Governance Rules](#) can be viewed on the Electricity Commission's website.

Revised Draft Regulations for Connection of Distributed Generation

In August 2006 the Government issued a discussion paper on draft regulations that specify a process under which generators may apply to distributors for approval to connect distributed generation. A second discussion paper was released in April 2007 on the revised regulations with submissions on this paper closing on 4 May.

Some of the key changes made to the draft regulations in response to feedback from the 2006 consultation include:

- an increase in the size limit (now up to 10 kW) for smaller scale generation units in response to submissions that the rating of a generator large enough to supply a large household or small family farm could be of that size; and

- changes to streamline the application process. For generation up to 10kW only one application is required and for generation over 10kW, there is a two-stage process of initial and final application;

It is intended that the final regulations will be in place by mid-2007.

The discussion paper can be accessed on the Ministry of Economic Development's website at www.med.govt.nz.

Proposal for mandatory routine testing of "grid connected assets"

The Electricity Commission is seeking to amend Rule 8.2 of the Electricity Governance Rules to ensure that all asset owners have a legal obligation to comply with the Test Plan agreed by Transpower and the Commission for the routine testing of "grid connected assets". The Commission considers that the Test Plan obligations on asset owners can significantly affect Transpower's ability to meet its performance obligations. However the Commission has received legal advice that Rule 8.2 as drafted does not allow compliance with the Test Plan to be legally enforced.

The Commission issued a consultation paper on this issue in March requesting submissions on its proposal to modify Rule 8.2 and on the proposed new rules. Submissions closed on April 24.

A copy of the Commission's [consultation paper](#) is available on its website.

If you would like to know more about an item noted above, please contact any of our [electricity law team](#) or in the first instance please call:

[Andrew Brown](#)
Partner

[Garry Downs](#)
Partner

[Chris Gordon](#)
Partner

Bell Gully news

Competition practice named New Zealand's best

Bell Gully's competition lawyers have been praised as the standout practitioners in a report on competition law in New Zealand.

Bell Gully and client legal team recognised at awards

Bell Gully's work on leading deals and the in-house legal team of a major client have been recognised at the ALB Australasian Law Awards 2007.

Bell Gully advises on Griffins expansion

Bell Gully has advised Griffins Foods on its expansion into the snack foods market through the acquisition of Nice & Natural.

Two companies liquidated as one

The High Court has ordered that the liquidations of two related companies proceed together as if the companies were one under section 271(1)(b) of the Companies Act 1993.

New securities law website

The Securities Commission has set up a website to help people understand the impact of the new legislation expected to be introduced in the next few months.

Financier refunds \$49,000 following breach of CCCFA

A financier has refunded \$49,000 to consumers following receipt of a warning from the Commerce Commission for breaching the Credit Contracts and Consumer Finance Act.

The private equity boom

An article discussing the boom of private equity funds due to the high level of takeover activity undertaken globally in 2006. It considers what private equity funds are, the risks, and international equities in 2007.

Off the shelf

Other useful articles and publications from Bell Gully

For further details and more news visit:

www.bellgully.com

Useful web links

New Zealand Government

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

New Zealand regulatory agencies and organisations

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

New Zealand commercial sites

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

Australian sites

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

International sites

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