



**BELL GULLY**

# Commercial Quarterly

---

WINTER 2007

---



## Welcome to the Winter 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

### In this issue, feature articles include:

- Tips for drafting a dispute resolution clause that works
- Expanded liability under the continuous disclosure regime
- Has Auckland had its last blackout? Final decision on Transpower's new Auckland power line

### Also in this issue:

- Bell Gully's response to MED's review of the clearance and authorisation provisions under the Commerce Act 1986
- Raising capital: how well do you know your investors?
- New uncertainty in the construction of commercial contracts?
- Do your business arrangements require more than compliance with contractual terms?
- Limited Partnerships Bill
- Insider trading: how effective is a Chinese wall defence?
- Cadbury fail in quest to obtain trade mark registration for the word PURPLE
- Transformation of the telecommunications industry continues
- Bell Gully news
- useful Web links

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](http://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](mailto: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

### **Don't wait until it's too late – drafting dispute resolution clauses that work**

Let's face it, the dispute resolution (DR) clause is not the most glamorous aspect of a commercial document. They're a bit like a pre-nuptial agreement – nobody wants to be the first to raise the topic, and “we probably won't need it in any event”.

As a result, DR clauses often don't get the drafting attention they deserve. A poorly drafted DR clause can seriously undermine the efficient and cost effective resolution of a dispute – months, and dollars, are often wasted on a dispute over how the dispute is to be resolved! A timely reminder of such problems is the very recent court of Appeal decision in *Porter & Ors v Gullivers Travel Group Ltd*, where the proceedings may well have been avoided had the DR clause been drafted in a different way. In this article, Bell Gully senior associate Sally Fitzgerald provides some insight into how to avoid some common drafting errors when using DR clauses in commercial contracts.

### **New uncertainty in the construction of commercial contracts?**

In this article, solicitor Rachel Woods discusses a recent Supreme Court case which indicates that courts are prepared to look at the subsequent conduct of parties as an aid to interpreting a contract's provisions.

### **Do your business arrangements require more than compliance with contractual terms?**

It is generally understood that parties to certain types of business arrangements, such as partnerships and joint ventures, are subject to fiduciary obligations in addition to the legal obligations arising from the arrangement. But are you aware that it is possible for fiduciary obligations to be imposed due to the nature of the roles assumed by the parties in the course of a standard contractual arrangement? In this article, solicitor Rachel Woods discusses a recent Supreme Court decision which found on the facts that a contracting party was not only entitled to adherence to the contractual terms but also to the duty of utmost loyalty in the performance of a function which the other side had agreed to perform.

### **One clause doesn't fit all: beware the boilerplate**

In this article, solicitor Tony Dunn reminds us of the importance of ensuring that standard boilerplate clauses are tailored to meet parties' specific contracting requirements in light of a recent High Court case.

### **Limited Partnerships Bill – providing a new vehicle for investment in New Zealand**

Earlier this month, the Government introduced the Limited Partnerships Bill which will replace the current special partnership regime and provide a new vehicle for venture capital investment. In this note, Annie Cho outlines the key features of the proposed limited partnerships regime and how it differs from its predecessor.

### **KiwiSaver – time to review your employment agreements**

KiwiSaver, which went live on 1 July, has a number of implications for employment agreements. In this article, Bell Gully senior associate Naomi Cervin and solicitor Matt McGoldrick outline some of the key issues employers will need to consider to ensure that their employment agreements are compliant with the new legislation and accurately record the terms of the employer's approach to KiwiSaver.

## Don't wait until it's too late – drafting dispute resolution clauses that work

*Let's face it, the dispute resolution (DR) clause is not the most glamorous aspect of a commercial document. They're a bit like a pre-nuptial agreement – nobody wants to be the first to raise the topic, and “we probably won't need it in any event”.*

*As a result, DR clauses often don't get the drafting attention they deserve. A poorly drafted DR clause can seriously undermine the efficient and cost effective resolution of a dispute – months, and dollars, are often wasted on a dispute over how the dispute is to be resolved! A timely reminder of such problems is the very recent Court of Appeal decision in *Porter & Ors v Gullivers Travel Group Ltd*,<sup>1</sup> where the proceedings may well have been avoided had the DR clause been drafted in a different way. In this article, Bell Gully senior associate Sally Fitzgerald provides some insight into how to avoid some common drafting errors when using DR clauses in commercial contracts.*

If there is no DR clause in your agreement, then the default position is that either party may commence court proceedings in relation to a dispute. A DR clause can contain any one or more of the following processes as an alternative or precursor to litigation: mandatory negotiation (often “escalating” to higher levels within the respective parties), mandatory mediation, expert determination and arbitration.

Negotiation between the parties will result in resolution of the dispute if the parties agree on a settlement. Mediation involves a third party assisting with the negotiations, and will only result in resolution of the dispute if the parties agree on a settlement. Expert determination is used for fast track resolution of certain specific disputes: valuation, accounting or similar “technical” disputes (for example, the dispute to be referred to an expert in the *Gullivers Travel Group* case concerned a price adjustment mechanism in a contract for the sale and purchase of a travel business). Arbitration is the only true alternative to litigation, in that it is an adversarial process that results in a third party issuing a binding decision.

### **First consideration: do you really want a DR clause?**

Too often, DR clauses involving long and tortuous steps that must be followed before a dispute can be litigated or arbitrated are included in commercial agreements. These are often included as a matter of course, with little thought given as to how it might work in practice.

For example, when the parties end up in a dispute, often they will have been negotiating the issue for some time before one party “triggers” the formal DR clause process. Once that occurs, the parties may be required to engage in weeks, if not months, of further mandatory negotiations (often with a number of different layers) before a formal claim can be issued. Such “forced” negotiations are often used by one party as a delaying tactic.

Another example is requiring compulsory mediation at a very early stage of the dispute. The feedback from leading mediators is that too many disputes are being taken to mediation “undercooked” – usually as the result of a mandatory mediation clause. Whilst there is no doubt that mediation is a very effective means of resolving disputes, it is more likely to be so further down the track in the dispute process. At the outset of a dispute, a party often doesn't have a full understanding of its own position (both factual and legal), let alone the other party's position. Like mandatory negotiation, mandatory mediation at an early stage of a dispute is often used by one party as a delaying tactic.

So before putting a multi-tier DR clause into a contract, think carefully about whether it is really necessary. If you do want such a clause, take note of five drafting tips.

---

<sup>1</sup> [2007] NZCA 345; 14/08/07

### **Drafting tip number 1 – keep any “multi-tier” DR clause short and simple**

A key issue with “multi-tier” clauses is the length of time it can take to work through the various steps involved. Such escalating negotiation clauses often involve second, third, or even fourth, layers which can take weeks, or longer, to complete.

Sometimes, it may be helpful to have a round of formal, mandatory negotiations (for example, to get the dispute away from those with a personal interest in it), but do **all** disputes really have to be elevated to the CEOs level, for example?

If mandatory negotiation is included, make sure the various steps are kept to an absolute minimum, and that fixed and short time limits are set before the parties can move onto the next stage (the parties can always agree at the time to extend time periods, if the process is going well). The process should take days, not weeks or months, to complete.

### **Drafting tip number 2 – remove all references to “reasonable endeavours”, “amicable negotiations”, “good faith negotiations”**

Consider the following clause:

“In the event of a dispute, the parties shall use all reasonable efforts to amicably resolve the dispute through good faith negotiations. If the dispute is not so resolved then.....”

What does this mean? What does it require the parties actually do? By what standard is compliance to be measured? How long must the negotiations go on for? Is it enforceable in any event?

DR clauses often contain provisions similar to this. However, such clauses often add nothing to the process, and can cause serious problems. For example, there are a number of cases where one party has sought to delay the dispute resolution process by seeking to argue that the parties have not yet engaged in “amicable” negotiations, and therefore the dispute cannot yet go to the next level of the DR clause.

The recent Court of Appeal decision in *Gullivers Travel Group* is a prime example. The DR clause in that case required the parties to “use their best endeavours to resolve the dispute by negotiation in good faith”, before the dispute could be referred to an expert for determination. That led to one of the parties seeking court orders to restrain the dispute being referred to the expert on the basis the parties had not yet engaged in “good faith” negotiations (primarily that one party had failed to hand over documents which were said to be essential to enable “good faith” negotiations to take place). This issue resulted in High Court and then Court of Appeal court proceedings, all of which could probably have been avoided had the clause been drafted without reference to such subjective, and ultimately “vague” requirements.

The upshot is that clauses like this may well be unenforceable, as they are too uncertain (akin to an agreement to agree). Despite this, however, if a party wants to derail and delay the efficient resolution of a dispute, a DR clause containing terms such as “amicable” or “good faith” negotiations will be a useful starting point!

Rather than including vague and uncertain language - which may ultimately be meaningless – instead give the parties something concrete to do. Specify that they must meet, for example, at least two times within a specified time period before the dispute can be progressed to the next stage. And if one party does not comply with such a process, they cannot later set up that failure to prevent the other party from taking the dispute to the next level – a fundamental principle of contract law is that a party cannot benefit from their own wrong.

### **Drafting tip number 3: Getting the mediation clause right**

If you are going to include mandatory mediation, make sure the clause works. To be enforceable, a mediation clause must be sufficiently certain, and this will require some drafting as to the mediation process and in particular, how the mediator is to be appointed. The parties usually specify that the mediator is to be appointed by the agreement of the parties. The clause should then address what happens if the parties cannot agree. Usually this will be by way of specifying that the mediator is to be appointed by a named institution, such as the Arbitrators’ and Mediators’ Institute of New Zealand Inc (AMINZ). It

will also be helpful to adopt a set of mediation rules and incorporate them by reference into the clause, for example, the AMINZ Mediation Protocol.

**Drafting tip number 4 – be aware of what disputes you are actually sending to expert determination, and that the process is final**

As noted at the outset, expert determination is a useful process for a “fast track” resolution of certain technical disputes. If a dispute is referred to an expert, it is often resolved on the papers, sometimes with short submissions from the parties, in accordance with a procedure adopted at the discretion of the expert, and often within a very short time period. The expert is usually not legally trained, but will be someone with suitable qualifications for the particular dispute – for example, an accountant, an engineer or a valuer. As will be apparent, expert determination is not suitable for full scale disputes which involve complex legal and factual issues.

Despite this, however, parties often end up referring a much wider class of dispute than intended to expert determination, sometimes **all** disputes under the agreement. This is the result of poor drafting of an expert determination clause. There are a number of cases where the parties have spent months, and thousands of dollars, before the courts, arguing over whether a particular dispute can be brought before the court or, in accordance with the DR clause, must be referred to an expert for resolution.

For example, in a recent contract the author worked on, the contract contained a payment adjustment formula (contained in clause 23), with various inputs to the formula that were to be agreed by the parties. The parties intended that, if they could not agree on a particular input, the value of the input would be determined by an expert. The expert determination clause, as originally drafted, read:

“All disputes concerning payment shall be referred to an expert for determination in accordance with this clause.”

As will be appreciated, most disputes under a contract involve a dispute over payment!

A further attempt was as follows:

“Any dispute concerning clause 23 will be referred to an expert for determination in accordance with this clause.”

Again, this was too wide, as a dispute might arise as to whether clause 23 had been triggered in the first place, or a dispute as to the interpretation of clause 23.

A more suitable clause which captured only the disputes the parties intended to send to the expert was as follows:

“Any dispute concerning the value of the inputs to the payment formula contained in clause 23 will be determined by an expert in accordance with this clause.”

In addition to defining the scope of disputes to be referred to the expert, the clause should set out some of the basic provisions concerning process, including, like a mediation clause, a process for appointing the expert. The clause will also normally specify the qualifications or experience the expert must have.

One other point to bear in mind about expert determination is that it can be very difficult to overturn an expert determination if you are not happy with the outcome. In short, the only grounds on which an expert’s determination can be overturned are fraud, partiality or some kind of “jurisdictional” error which takes the determination outside what the expert was mandated by the contract to actually determine. A mistake, even a serious mistake, will not by itself be sufficient to have an expert’s decision overturned. The courts have refused to imply a term into an expert determination clause that the determination must be reasonable and free from error.<sup>2</sup>

---

<sup>2</sup> *Legal & General Life of Australia Ltd. v Hudson Pty Ltd* (1985) 1 NSWLR 314

## **Drafting tip number 5 – if choosing arbitration, keep the clause short and simple, and be sure to address the “arbitration basics”**

If all else fails and a dispute is to be finally resolved by arbitration, the agreement will need to contain an arbitration clause. Arbitration is a consensual process, and thus a dispute cannot be arbitrated other than by way of agreement of the parties.

An arbitration clause should address the following issues:

- the fact that the dispute is to be referred to arbitration;
- the number of arbitrators – usually one or three (do not, for obvious reasons choose an even number of arbitrators!);
- a process for the appointment of the arbitrator, including if the parties fail to agree on the arbitrator (the default position under the Arbitration Act 1996 is that the High Court can appoint the arbitrator, but it will be quicker and cheaper to have an institution, such as AMINZ, act as the default appointing authority);
- incorporate by reference any chosen arbitration rules;
- specify the place of arbitration – useful in the context of a domestic transaction, and crucial in a cross-border transaction; and
- in the context of a cross-border transaction, specify the language of the arbitration (you don't want to have to be the party who pays for translating all their documents).

An arbitration clause along the following lines is all that should be required:

“Any dispute, difference or claim arising out of or in connection with this agreement, or the subject matter of this agreement, will be referred to and finally resolved by arbitration in accordance with the **[specify particular arbitration rules]** (Rules). The tribunal will consist of **[a sole arbitrator/three arbitrators]** appointed in accordance with the Rules. The place of arbitration will be **[specify place]**. The language of the arbitration will be **[English]**.”

In the event the arbitration is to take place in New Zealand (and therefore the New Zealand Arbitration Act is to apply), the parties should consider contracting out of or into various “optional” provisions contained in the Act, for example, appeals on points of law.

Finally, dispute resolution in cross-border transactions is a complex area. Specialist advice should therefore be sought on DR clauses for such transactions.

## New uncertainty in the construction of commercial contracts?

*In this article, solicitor Rachel Woods discusses a recent Supreme Court case which indicates that courts are prepared to look at the subsequent conduct of parties as an aid to interpreting a contract's provisions.*

Until recently, the courts only considered the conduct of parties after entry into a contract (subsequent conduct), where questions arose as to the interpretation of the contract involving rectification, estoppel and contract formation. In *Wholesale Distributors Ltd v Gibbons Holdings Ltd (Gibbons)*,<sup>3</sup> however, the Supreme Court has accepted subsequent conduct as a legitimate tool for the interpretation of contracts more generally.

### The background

In *Gibbons* the court was required to interpret a complex deed of lease, which had been “unhappily” adapted from a standard form.<sup>4</sup> Wholesale argued that their obligation to pay rent under the lease terminated in 2002, while Gibbons argued that the obligations continued until 2010. The language of the lease was equivocal.

In support of its interpretation of the contractual language, Gibbons relied on the following subsequent conduct as evidence of the parties' intentions when entering into the lease:

- Wholesale had entered into a sublease of the property which included rights of renewal to extend the sublease to 1 November 2008.
- Wholesale later assigned its interest under the lease as part of the sale of its business. Documents referring to the assignment of lease stated that the lease was to expire on 31 October 2010.
- Internal documents created by Wholesale following entry into the lease stated that the lease continued beyond 2002.

### The decision

The majority of the Supreme Court held that subsequent conduct was admissible for the purposes of contract interpretation.<sup>5</sup> The court held that subsequent conduct formed part of the factual matrix which is used to objectively assess the parties' intentions when entering into the contract.

Some uncertainty remains, however, as to what will constitute admissible subsequent conduct. In *Gibbons*, the court was divided as to whether the conduct relied upon was admissible as the conduct was unilateral, in that it related solely to conduct of Wholesale which did not involve Gibbons.

Justice Tipping held that such unilateral conduct did not illustrate the mutual or shared intentions of the parties, and therefore could not be relied on. His Honour would only have permitted conduct that involved both parties to be used in interpreting the contract. However, a broader approach to the admission of subsequent conduct was adopted by Justice Thomas. His Honour held that unilateral conduct would be admissible where, as in this case, it contradicted the interpretation advocated by the party that had engaged in the conduct. In this case, Wholesale's entry into a sub-lease and an assignment of lease which purported to grant an interest in the property beyond 2002, was inconsistent with its contention that the parties intended the lease obligations to terminate in 2002. Similarly, the view

---

<sup>3</sup> [2007] NZSC 37

<sup>4</sup> For a discussion of the factual background of the case see Bell Gully's article [Key property rulings from the courts – Who pays the rent?](#) January 2006.

<sup>5</sup> Justice Blanchard reserved judgment on the issue.

expressed in Wholesale's internal documents was at odds with the interpretation it proposed. Justice Thomas noted that in this case "[t]he value of the evidence stems from the inconsistency".

### **Conclusion**

Following *Gibbons*, it would appear that Justice Thomas's approach to the admissibility of subsequent conduct will prevail. His Honour received support from Chief Justice Elias, as well as implied support from Justice Blanchard.

Therefore, where parties have failed to express their contractual obligations unambiguously, they should be aware that their subsequent conduct may be examined to establish the true contractual intentions of the parties.

## Do your business arrangements require more than compliance with contractual terms?

*It is generally understood that parties to certain types of business arrangements, such as partnerships and joint ventures, are subject to fiduciary obligations in addition to the legal obligations arising from the arrangement. But are you aware that it is possible for fiduciary obligations to be imposed due to the nature of the roles assumed by the parties in the course of a standard contractual arrangement? In this article, solicitor Rachel Woods discusses a recent Supreme Court decision which found on the facts that a contracting party was not only entitled to adherence to the contractual terms but also to the duty of utmost loyalty in the performance of a function which the other side had agreed to perform.*

It is well settled that certain commercial relationships, including partnerships and joint ventures, attract fiduciary duties of utmost loyalty. In such relationships, the fiduciary must act in the best interests of the other party and their obligations will be strictly enforced. In a recent decision, *Maruha Corporation v Amaltal Corporation Ltd (Maruha)*<sup>6</sup>, the Supreme Court held that it was possible for fiduciary duties to apply to certain aspects of other, non-fiduciary, commercial relationships.

### The facts

Amaltal and Maruha were the shareholders of ATL. ATL's business had previously been conducted under a partnership structure between the two shareholders. Under the agreement to continue operations in the guise of ATL, Amaltal assumed responsibility for the accounting and tax return functions of ATL. For this purpose, an accountant employed by Amaltal was seconded to ATL.

Due to the misrepresentation of tax liability by Amaltal, Maruha made overpayments for expenses to ATL, which were then paid to Amaltal. Maruha sued Amaltal in deceit and for breach of fiduciary duty.

In the High Court, Maruha was successful on both grounds. However, the breach of fiduciary duty finding was overturned by the Court of Appeal. Maruha appealed to the Supreme Court.

### The decision

The Supreme Court held that the relationship between the two parties was not, in general, of a fiduciary nature. The court stated that where "commercial parties elect to use an incorporated vehicle for a venture that can only loosely be called a joint venture, it is unlikely that their relationship as a whole will be fiduciary in nature". However, the court went on to find that Amaltal was subject to fiduciary obligations in respect of the accounting and tax functions it had taken on under the agreement. The court held that fiduciary obligations will apply where "one party is entitled to rely upon the other, not just for adherence to contractual arrangements between them, but also for loyal performance of some function which the latter has either agreed to perform for the other or for both or has, perhaps less formally, even by conduct assumed".

Factors that the court considered to indicate that fiduciary duties existed were:

- Amaltal had taken responsibility for all aspects of the accounting functions of ATL, providing personnel and facilities for those functions;
- The court held that the accountant seconded to ATL was an agent of Amaltal, which was in turn an agent of Maruha. Therefore, Maruha could expect the accountant to act with loyalty to both shareholding parties.

Significantly, the court held that fiduciary obligations were not negated by the fact that Maruha had employed a "watchdog" to audit the accountancy carried out by ATL's accountant. An entitlement to rely

---

<sup>6</sup> [2007] NZSC 40

on a fiduciary will not be destroyed by the fact that the other party elects to confirm that that reliance is well founded. Further, the fact that any such supervision is deficient will not provide a defence to an allegation of breach of fiduciary duty. This emphasises the strict nature of fiduciary obligations.

### **Practical implications**

What then are the implications of a finding of fiduciary obligations in a commercial relationship? The role of a fiduciary requires that the fiduciary act with utmost loyalty to the other party, and that it act in the interests of that other party. Such duties will be applied strictly, and few if any defences or mitigating factors will be relevant to such a breach.<sup>7</sup>

Parties to commercial relationships should be aware of the possibility that fiduciary duties will be imposed due to the nature of the roles assumed by the parties. This is especially relevant where one party has undertaken a role in which it has comparatively greater power or experience, and in which it undertakes to act on behalf of all of the parties. In such a situation, it is possible that a court may find that it is reasonable for the other parties to expect the more experienced party to act in their best interests. As with this case, such a finding may be made despite the fact that the parties generally have similar business experience or power.

---

<sup>7</sup> The Supreme Court assumed that contributory negligence was available in respect of breach of fiduciary duty, without making any finding on that point.

## One clause doesn't fit all: beware the boilerplate

*In this article, solicitor Tony Dunn reminds us of the importance of ensuring that standard boilerplate clauses are tailored to meet parties' specific contracting requirements in light of a recent high court case.*

Boilerplate clauses are standard clauses commonly found in commercial contracts. The areas they cover are considered to be applicable, and sometimes essential, to most contractual arrangements. Some common examples include clauses covering waiver, governing law, assignment, counterparts, entire agreement and notice.

The key is not to become complacent and treat boilerplate clauses as an afterthought once the terms of the operational clauses have been negotiated and agreed. Too often, the boilerplate clauses can become like the obligatory speech after a sports game. Once the real action is over, the captain dutifully thanks the sponsors, the other team and maybe the referee. But every game, like every contract, is different, and a good captain will carefully consider how to arrange his speech to reflect that.

Similarly, it is important to always consider whether a boilerplate clause is applicable to the parties' transaction, and if so, how it should be worded to reflect the intentions of the contracting parties. A poorly worded boilerplate clause, or misunderstanding as to its effect can have major implications for the parties and can often end up being the subject of litigation.

An illustration of the type of problem that may arise with one standard boilerplate, the entire agreement clause, is provided by a recent High Court case noted below.

### Entire agreement clause

The purpose of an entire agreement clause is to make it clear that the agreement between the parties is recorded completely in the contract and that any previous arrangements between the parties (on the same subject matter) are superseded by the terms of the contract. An example of a standard entire agreement clause is:

"This agreement constitutes the entire understanding between the parties concerning the subject matter of this agreement and supersedes all prior representations, proposals, discussions and communications between the parties."

It is therefore essential where a party does intend to rely on a prior agreement or representation, or if the contract makes up only one part of the overall arrangement between the parties, that an entire agreement clause is either not included in the contract or is carefully drafted to include references to the additional agreements or other relevant terms.

On the flipside, it is also important to ensure that if you do refer to other arrangements in the entire agreement clause, that these arrangements are still relevant and applicable to the transaction at hand.

In the case of *Gatehouse v Middleton*<sup>8</sup> a franchise agreement contained the clause:

"THIS Agreement, the Customer List and Operations Manual set forth the entire agreement between the parties as to the subject matter of this Agreement..."

An operations manual and customer list, however, were never produced in court and the entire agreement between the parties could not be established. Presumably, although not entirely clear from the facts given, this clause was retained from a standard franchise agreement without any consideration being given as to whether an operations manual or customer list would be provided for the purposes of the parties' own

---

<sup>8</sup> (Unreported judgment, Hamilton, High Court CIV 2006-419-808, 19 April, 29 May 2007)

franchise arrangement. The court was therefore obliged to imply a term into the agreement to give it business efficacy.

### **Conclusion**

Although boilerplate clauses provoke little, if any, discussion in most commercial transactions, if they are not given sufficient attention they can effect the outcome of the agreement in a way which was not intended by the parties. A little time spent considering whether a boilerplate clause is relevant to a contract and is worded to reflect the intention of the parties is time well spent.

Another standard clause which is often included in a contract with little consideration of whether it will work in practice is the dispute resolution clause. See the article *Don't wait until it's too late – drafting dispute resolution clauses that work* by senior associate Sally Fitzgerald in this issue of *Commercial Quarterly* for guidance on how to avoid some common drafting errors when using dispute resolution clauses in commercial contracts.

## Limited Partnerships Bill – providing a new vehicle for investment in New Zealand

*Earlier this month, the Government introduced the Limited Partnerships Bill which will replace the current special partnership regime and provide a new vehicle for venture capital investment. In this note, Annie Cho outlines the key features of the proposed limited partnerships regime and how it differs from its predecessor.*

Limited partnerships are a form of partnership involving general and limited partners. General partners transact the business of the partnership while limited partners are passive investors and are liable only to the extent of their capital contribution to the partnership.

New Zealand currently has a form of limited partnership, called the special partnership, which is provided for in Part 2 of the Partnerships Act 1908. The existing regime is commonly viewed as outdated and inconsistent with limited partnership structures in other jurisdictions such as the United States, Britain and Australia. The Limited Partnerships Bill aims to ameliorate this by providing for limited partnerships in New Zealand that have similar features to their overseas counterparts.

Some of the key features of the proposed new regime are:

- A limited partnership can be formed with one general partner and one limited partner.
- General partners are responsible for the management of the business of the partnership while limited partners must not engage in such activity. Doing so results in loss of limited liability; instead, the limited partner will be liable as a general partner (unless the limited partner's actions are covered by a "safe harbour" – see below).
- A general partner is liable for all partnership debts and liabilities *to the extent* that the limited partnership itself cannot pay such debts and liabilities. The partnership agreement can provide for a greater level of general partners' liability and any limited partner who is liable as a general partner will be liable according to the level set in the partnership agreement.
- Regulations passed from time to time can set out "safe harbour" activities for limited partners. These are activities which may ordinarily amount to "taking part in the management of the business of the limited partnership" but which, by virtue of regulations promulgated, make it safe for limited partners to carry out those activities without losing the protection of limited liability. It is not known at this stage what those activities might be but safe harbour activities will certainly remove some of the current limitations around a limited partner's involvement in the partnership business.
- A partner can change its status i.e. a general partner can become a limited partner and vice versa, but it cannot be both a general partner and a limited partner at the same time.
- The general partner must not make a capital contribution to the limited partnership. A limited partner may, but does not have to, make a capital contribution to be a limited partner. "Capital contribution" is defined as the share of assets contributed by a limited partner to the limited partnership (in property or in money), but does not include a loan by a limited partner to the limited partnership.
- The current special partnerships regime prohibits the withdrawal of capital (including distributions to partners) to the extent that such withdrawal results in a reduction partnership capital. Special partnerships are therefore commonly formed with a nominal sum of capital contribution from the special partners to get around this restriction. The limited partnerships regime abandons this capital maintenance rule in favour of a solvency test, as currently in place under the Companies Act 1993. Distributions to limited partners can be made so long as the

general partners are satisfied, on reasonable grounds, that immediately after a distribution is made, the limited partnership will be solvent.

- Limited partners can offset partnership losses against their income from other sources to the extent of their contribution to partnership “capital”. For tax purposes, capital includes the partner’s capital contribution as well as any loan made to the partnership.
- An online, centralised limited partnership register will be maintained by the Registrar of Companies. This register will be similar to the companies register currently available online. A limited partnership will be created upon registration and general partners will have the responsibility of ensuring the partnership’s details on the register are correct. The register is available to the public and accessible for searching.
- Currently, special partnerships have a lifespan of seven years after which time they can either be renewed or dissolved. The new regime does not prescribe any particular lifespan for limited partnerships; limited partnerships continue until a “terminating event” occurs. A terminating event can be provided for in the partnership agreement (e.g. the limited partnership exists for a fixed time).

The Limited Partnerships Bill is expected to take effect as legislation from 1 April 2008. Special partnerships existing at that time can continue as such, but will cease to exist at the end of their prescribed period. Special partnerships can then register as a limited partnership (but can also do so prior to its expiry).

## KiwiSaver - time to review your employment agreements

*KiwiSaver, which went live on 1 July, has a number of implications for employment agreements. In this article Bell Gully senior associate Naomi Cervin and solicitor Matt McGoldrick outline some of the key issues employers will need to consider to ensure that their employment agreements are both compliant with the new legislation and accurately record the terms of the employer's approach to KiwiSaver.*

### Why employers should review employment agreements now

KiwiSaver heralds both new obligations and opportunities for employers. There are certain issues with KiwiSaver that can be turned into opportunities – but to do so employers will need to ensure their employment agreements are both compliant with the law and accurately record the terms of their company's approach to KiwiSaver.

Employers should consider these issues:

- how they are going to deal with the compulsory employer contribution which takes effect next year;
- whether to move to setting remuneration on a “total cost to the company” approach, so that employees who do not participate in KiwiSaver are not disadvantaged;
- whether employees will be able to “salary sacrifice” in favour of increased employer contributions (this impacts on the level of tax benefits);
- whether the employees will be allowed to have employer contributions count toward their contribution rate of 4% or 8%;
- how KiwiSaver fits in with any existing company superannuation scheme; and
- how remuneration packages can be structured to attract and retain key staff by providing KiwiSaver benefits over and above the minimum.

### A “total cost to the company” approach to remuneration

Compulsory employer contributions kick in on 1 April 2008 at 1% of an employee's gross salary or wages, rising by 1% each year up to 4% from 1 April 2011.

In light of this change, employers may wish to consider setting an employee's remuneration on a total cost to the company basis, i.e. irrespective of whether the employee participates in KiwiSaver they will still receive the same total remuneration package.

This approach can avoid disparity between employees who choose to (or can afford to) participate in KiwiSaver and those who don't. Setting an employee's remuneration on a total cost to the company basis could involve topping up an employee's salary if they choose not to participate in KiwiSaver.

For existing employees, employers may wish to shift to a total cost to the company approach as part of their employee's next pay review.

For new employees, employers may wish to include a 4% employer contribution to KiwiSaver as part of all new offers of employment to avoid the ratcheting effect which the proposed new compulsory employer contributions will entail.

Care needs to be taken in drafting clauses which set remuneration on a total cost basis to avoid the possibility of an employee's salary being inadvertently increased in the event that the employee elects to opt out of KiwiSaver in the first instance (and thereby receives a salary top-up), and then later decides to opt-in, or to restart contributions.

### **“Salary sacrifice” and “setting off” employer contributions**

Salary sacrifice where an employee’s salary is reduced and the employer agrees to pay an amount equivalent to the reduction into a superannuation scheme as an employer contribution.

Salary sacrifice of a sort is available under KiwiSaver and the employer contribution qualifies for a zero percent tax rate under the tax changes introduced in the last budget.

It is also possible, prior to 1 April 2008, for an employee to count employer contributions towards the employee’s total KiwiSaver contribution, subject to certain transitional arrangements. Where such an agreement is entered into before 1 April 2008, employees can continue counting employer contributions towards their contribution rate to a limited extent up until 2011.

Employers offering salary sacrifice or wanting to count employer contributions toward the employee’s total KiwiSaver contribution should seek advice on the appropriate way to achieve this and ensure the arrangement is properly provided for in the employee’s employment agreement.

### **Existing superannuation schemes**

An employer with an existing scheme needs to make an important choice – whether to continue to offer this in addition to KiwiSaver, and, if not, whether it is practicable to wind up the existing scheme.

Employers also need to consider whether to become an exempt employer – which means that new employees are not subject to the automatic enrolment rules.

Employers should seek advice on what contributions they will need to make for employee participating in both an existing scheme and KiwiSaver. Proposed amendments to KiwiSaver provide that, in certain circumstances, an employee with an entitlement to participate in two such schemes will not be entitled to seek full contribution from the employer for both.

### **Practical matters**

We recommend employers take the following steps for new employees who are automatically enrolled into KiwiSaver:

- Employees should be given a covering letter enclosing their employment agreement – which also contains information in relation to KiwiSaver. The letter should outline the new employee’s options in respect of joining KiwiSaver, and the employer’s approach to KiwiSaver.
- As part of the workplace induction process, KiwiSaver options should be outlined and information necessary to complete payroll obligations should be collected.

Put simply, those with HR and payroll responsibilities need to be familiar with KiwiSaver so they can meet their obligations as employers.

## COMPANY LAW

### **Voluntary administration - when it finally happens, will we be ready?**

In this article, Bell Gully partner Murray Tingey summarises the key aspects of the new voluntary administration regime and considers its impact on financial institutions and secured creditors.

## Voluntary administration- when it finally happens, will we be ready?

In this article, Bell Gully partner Murray Tingey summarises the key aspects of the new voluntary administration regime and considers its impact on financial institutions and secured creditors.

### Background

Amendments to the Companies Act 1993 (the Act) to introduce voluntary administration were passed in November last year. Despite a lengthy gestation, it is not expected that the changes will come into force until the end of this year at the earliest.

The introduction of voluntary administration will impact on those who deal with companies facing financial uncertainty, particularly financial institutions and secured creditors. These groups should take the opportunity now to implement procedures for dealing with voluntary administration.

Currently, the only rehabilitative insolvency regime for viable companies is the compromise regime in Part XIV of the Act. In practice, it has been difficult for companies to get the votes required to pass a compromise while fighting off creditors.

### The new regime and its impact

Under the new regime, the administration of a company begins when an administrator is appointed. This is usually by board resolution but it can be done by a liquidator or a secured party. The appointment of an administrator has three main consequences:

1. control of the company's business is vested in the administrator;
2. the administrator is obliged to hold creditors' meetings to try to seek a consensus on the company's future; and
3. a stay is imposed on certain creditor actions.

While a company is in administration, in the absence of administrator consent or a court order, a transaction or dealing that affects the company's property is void. Significantly, a person may not enforce a charge over the company's property or commence or continue court proceedings against a company in administration.

In addition, the owner or lessor of property occupied or used by a company in administration may not repossess that property.

More controversially, in the absence of a court order, a lender may not enforce a guarantee given in respect of a company in administration's liabilities by a director or their spouse or relative.

It is important to note that these general prohibitions do not apply to a secured creditor with a security interest over all of the company's property who begins enforcing its security within 10 days after receiving notice of the administration.

Creditors who do not have security, or who do not have security over all of the company's property, must understand that the administration process may compromise their position. Most importantly, if a deed of company arrangement is approved by the requisite creditors (a majority in number and 75 percent by value of those voting), it will bind all of the creditors. In addition, if a company in administration borrows money, the liability for repayment of that debt has priority over the company's existing unsecured creditors.

## **Required action**

Many contracts provide for receivership or liquidation to be events of default. These clauses will often not extend to administration, and should be amended to do so. Indeed, all standard form documentation should be amended to ensure that administration is included as an event of default.

Creditors who typically take "all present and after-acquired assets" security will need to ensure they are in a position to make enforcement decisions within the 10 working day "decision period". For this purpose, secured lenders will need to ensure that they have in place appropriate internal systems to ensure any notice of administration received is promptly directed to the appropriate person so that a decision as to whether or not to enforce their security can be made.

Creditors who typically take security over specific assets of a company will need to appreciate that they are at a relative disadvantage to creditors who take security over all assets of a company. In order to adequately protect their interests, such creditors may wish to consider requiring security over all of a company's assets.

*This article was first published in The Independent, June 2007.*

## **SECURITIES AND CAPITAL MARKETS**

### **Expanded liability under the continuous disclosure regime**

The Securities Legislation Bill passed in late 2006 introduces a raft of changes to the securities regime including a wider ambit for imposing liability under the civil and criminal penalty provisions. In this article, senior associate Anna Buchly highlights how these new provisions affect the continuous disclosure regime and, using some recent cases as examples, provides some guidelines for ensuring that public issuers and their officers are not inadvertently subject to increased liability for non-disclosure when the new provisions come into force.

### **Raising capital: how well do you know your investors?**

It's easy to assume that investments made in exchange for shares in a company by a few acquaintances and friends of the issuer are not subject to the Securities Act requirements for offers to the public. But an offer of securities does not have to be "to the world at large" in order to fall within the scope of the Act. In this article, solicitor Julian Benefield discusses a recent case which provides a useful illustration of the type of smaller offers caught by the Act and a reminder of the consequences for those who get it wrong.

### **Insider trading: how effective is a Chinese wall defence?**

A recent Australian case, involving the ASIC's action against the Australian arm of Citigroup Inc., provides some insight into how the New Zealand courts may assess the effectiveness of a Chinese wall defence to an allegation of insider trading and confirms the importance for financial institutions to have appropriate systems in place to manage conflicts of interest between their dealing and advisory functions.

### **New rules for financial sector**

In June, the Ministers of Finance and Commerce announced new rules that will have a significant impact on the operations of finance companies and financial advisers in New Zealand.

### **Securities Commission enforcements**

The Securities Commission has become involved in two recent breaches of the Securities Act. The first breach was by two companies developing properties with common facilities for residents. The second breach was by a company that issued a prospectus omitting material information.

### **Report on cycle four of review of financial reports**

The Securities Commission has completed the fourth cycle of its financial reporting surveillance programme.

## Expanded liability under the continuous disclosure regime

*The Securities Legislation Bill passed in late 2006 introduces a raft of changes to the securities regime including a wider ambit for imposing liability under the civil and criminal penalty provisions. In this article, senior associate Anna Buchly highlights how these new provisions affect the continuous disclosure regime and, using some recent cases as examples, provides some guidelines for ensuring that public issuers and their officers are not inadvertently subject to increased liability for non-disclosure when the new provisions come into force.*

On 12 October 2006 the Securities Markets Amendment Act 2006 (the SMAA) was enacted.<sup>9</sup> The SMAA will introduce substantial amendments to the Securities Markets Act 1988 (the Act), including the new insider trading and market manipulation regimes which have been discussed in previous issues of *Commercial Quarterly*.<sup>10</sup>

One area that will remain relatively unchanged by the SMMA is the continuous disclosure regime implemented by the last round of securities law reform in 2002. This provides for the on-going timely release of price-sensitive information by public issuers to the market in order to retain a level playing field for market participants dealing in their securities. However, making a decision about when to disclose under this regime may become even more complex after the SMMA is implemented because getting it wrong will not only have consequences for the disclosing entity but also the directors, officers and other individuals responsible for making the decision.

### Extended definition of “contravene”

Under the current regime, the Act provides a number of statutory consequences for non-compliance by public issuers of the continuous disclosure requirements. The remedies, however, are directed only at breaches by the public issuer and not at the individuals responsible for ensuring that the public issuer has complied with its continuous disclosure obligations. When the SMAA comes into force, this will no longer be the case.

Under the SMAA remedies for contraventions of the continuous disclosure requirements (and other provisions of the Act) have been incorporated in a new Part 5 of the Act. The SMAA extends the definition of “contravene” in this Part of the Act to include “*aiding, abetting, counselling or procuring any other person to contravene*” the relevant provision of the Act. This means that when the amendments are in force individuals involved in a public issuer’s failure to comply with the continuous disclosure regime can be held personally liable for the public issuer’s contravention of the continuous disclosure regime, subject to a due diligence defence discussed below.<sup>11</sup>

### Remedies for contravention

The remedies for contravention of the continuous disclosure obligations contained in Part 5 of the SMAA include:

- the Securities Commission making a disclosure order requiring a person to make disclosure in accordance with the Act;
- the court, on application by the Securities Commission or any other person, granting an injunction restraining a person from engaging in conduct that constitutes or may constitute a contravention of the continuous disclosure obligations;

<sup>9</sup> The SMMA will come into effect on a date to be appointed by order in Council. The regulations for the new laws are expected to be signed by the Governor General in October and the new law should come into force at the end of the year.

<sup>10</sup> See in particular, the Spring 2006 issue of *Commercial Quarterly*.

<sup>11</sup> A similar (although arguably clearer) position exists in Australia under sections 674(2A) and 674(2B) of the Corporations Act 2001.

- the court, on application by the Securities Commission or any other person, making a disclosure order requiring a person to make disclosure in accordance with the Act;
- the court making, on application by the Securities Commission, a pecuniary penalty order and declaration of contravention; and
- the court, on application by the Securities Commission or any other person, making a compensatory order.

### **Pecuniary penalty orders and compensatory orders**

Of particular concern to individuals caught by the expanded definition of a contravention of a continuous disclosure obligation will be the possibility of being subject to a pecuniary penalty order or compensatory order by the court.

In deciding whether to make an order that the person pay a pecuniary penalty to the Crown, the court must make a declaration of contravention and in doing so must be satisfied that the contravention:

- (a) materially prejudices the interests of persons acquiring or disposing of securities; or
- (b) materially prejudices the public issuer or its shareholders; or
- (c) is likely to materially damage the integrity or reputation of any of New Zealand's securities markets; or
- (d) is otherwise serious.

The maximum amount of any pecuniary penalty in respect of a breach of a continuous disclosure obligation or exemption has been increased from \$300,000 to \$1,000,000 and, in contrast with other jurisdictions with similar provisions, this figure applies regardless of whether the penalty is applied to the public issuer itself or an individual.

A declaration by a court of a breach of a continuous disclosure provision also enables a person who has suffered or is likely to suffer loss or damage because of the contravention to seek a compensatory order in respect of such contravention. A court can make a compensatory order to compensate an aggrieved person in whole or in part for the loss or damage suffered as a result of such contravention. However, in contrast to a pecuniary penalty order, there is no cap on the monetary sum which can be awarded under this type of order.

There is, therefore, the potential for the new enforcement and remedy provisions to have serious implications for directors, executives, advisers and other individuals involved in the management of public issuers.

### **Due diligence defence**

In recognition of this, the government has provided for a new due diligence defence to a contravention of the continuous disclosure provisions under section 19PA of the Act. This defence is similar to the defence provided in Australia under sections 674(2B) and 675(2B) of the Corporations Act 2001.

The defence provides that a person will not be liable in relation to a contravention by a public issuer of a continuous disclosure obligation if that person proves on the balance of probabilities that:

- (a) they took all steps (if any) that were reasonable in the circumstance to ensure that the public issuer complied with its continuous disclosure obligations; and
- (b) after doing so, that person believed on reasonable grounds that the public issuer was complying with its obligations.

In practical terms, establishing an adequate due diligence defence will depend, to a large extent, on the effectiveness of a company's policies and procedures to ensure appropriate continuous disclosure. But even then the complexities involved in complying with the continuous disclosure regime mean that it is not always going to be easy to get it right. This is perhaps best illustrated by the facts of the following two recent cases.

## ***Riley v Jubilee***

In *Riley v Jubilee Mines*,<sup>12</sup> the Supreme Court of Western Australia considered whether it was reasonable for the senior managers of a company not to disclose to the market certain information which had no direct impact on the company's operations, but would nonetheless have a speculative effect on the company's share price.

### **BACKGROUND**

In 1994, Jubilee received a letter from Western Mining Corporation (WMC) advising the company that WMC had inadvertently drilled on one of Jubilee's mining tenements. The WMC letter was accompanied by the tenements drill results, which suggested the possible presence of nickel within that tenement. Jubilee's senior management met to discuss the matter and subsequently held a meeting with WMC to discuss the possibility of exchanging tenements. The matter, however, never progressed beyond this point, nor did Jubilee's senior managers disclose the drill results to the company's non-executive directors or to the market.

In 1996, WMC contacted Jubilee again to discuss the tenement. Following that meeting, the new managing director of Jubilee announced the 1994 drill results to the ASX. Jubilee's share price rose by nearly 10% following that announcement.

### **THE CAUSE OF ACTION**

The case was brought on behalf of the former managing director of Jubilee who, not having been made aware of the WMC drill results in 1994, sold all his shares in the company before the 1996 market announcement. The plaintiff argued that the failure to announce the drill results in 1994 was a negligent breach of the company's continuous disclosure obligation and claimed damages based on the differential loss suffered by him.

### **THE DECISION**

In deciding the case, the Australian Court noted that Jubilee had a number of reasonable explanations on why the WMC drill results were not disclosed back in 1994. In particular, the court noted that at the time of receiving the WMC drill results, the company had primarily dealt with gold exploration and had no interest in nickel exploration. The court also noted that Jubilee had limited financial resources at that time which prevented the company from capitalising on the information provided by WMC. Nevertheless, despite noting these factors, the Australian Court upheld the plaintiff's claim.

The Australian Court found that the share market for the company consisted primarily of investors seeking to extract short term capital gains. In such an environment, speculative information that would be insignificant to another company could have a significant impact on Jubilee's share price. The Australian Court concluded that the failure by Jubilee's senior managers to appreciate the drill results and to follow up on the matter constituted negligence on the part of the company. Accordingly, the Australian Court awarded Jubilee's former executive director the damages sought.

The decision in *Jubilee* establishes that any steps taken to ensure compliance with a public issuer's continuous disclosure obligations will necessarily have to include an appropriate assessment and determination of the materiality of the information to the price of the issuer's listed securities. A public issuer's internal policies should ensure that an assessment of materiality is made at an appropriate level within the organisation.

## ***Auckland International Airport Limited v Air New Zealand Limited***<sup>13</sup>

Under statute, Auckland International Airport Limited (AIAL) has the power to set airport charges after it has consulted with its substantial customers. As part of this consultation process, AIAL provided confidential pricing information to Air New Zealand Limited (Air NZ). The pricing information was provided subject to the terms of a confidentiality deed between AIAL and Air NZ.

---

<sup>12</sup> [2006] WASC 199 SC (WA)

<sup>13</sup> [2006] 3 NZCCLR 382 (HC)

Air NZ advised AIAL that it intended to disclose the pricing information to the market in accordance with the continuous disclosure regime in the NZSX Listing Rules. Air NZ's view was that the confidentiality deed permitted disclosure of confidential information if disclosure was required by a relevant stock exchange listing rules. AIAL applied to the High Court for interim and permanent injunctions restraining disclosure on the grounds of anticipatory breach of contract and confidence.

The High Court held that the confidentiality deed only permitted disclosure where a party had given specific notice of disclosure to the other party and certain other requirements were complied with. The High Court held that Air NZ had not given maximum notice of disclosure practicable in the circumstances as required by the confidentiality deed.

The High Court ordered Air NZ not to disclose the pricing information. The High Court held that all of the conditions of the confidentiality exception to the continuous disclosure regime contained in the NZSX Listing Rules had been met and Air NZ was entitled to withhold the pricing information from the market.

### **Practical steps for action**

Perhaps the main lesson to be learnt from these cases is, as the court observed in *Jubilee*, "if there is any doubt whether information is material, then the company ought to err on the side of caution to make the release".<sup>14</sup>

Of course, as noted earlier, this assumes that there is a suitable system in place to deal with identifying information which could be subject to the continuous disclosure requirements.

We would recommend that, in light of these recent decisions and the amendments to be made to the continuous disclosure regime through the SMAA (which could put you personally at risk), senior management of public issuers promptly consider the following action points:

- Review the public issuer's communication policies to ensure clear responsibilities for continuous disclosure and identification of price sensitive information have been established.
- Ensure senior management are aware of and understand the public issuer's continuous disclosure obligations and their potential personal liability.
- Ensure that an appropriately qualified compliance officer is appointed who senior management can report any material concerns regarding continuous disclosure and who will internally investigate whenever appropriate disclosure has been made.
- Ensure that regular reviews of the public issuers continuous disclosure and communication policies are undertaken.
- Maintain records in order to establish a due diligence defence if the public issuers internal policies fail, resulting in a breach of the continuous disclosure provisions.
- Check that the new personal liability under the amendments made by the SMAA will be covered under any Directors and Officers Liability Insurance policies.

---

<sup>14</sup> See clause 312 of the *Jubilee* decision

## Raising capital: how well do you know your investors?

*It's easy to assume that investments made in exchange for shares in a company by a few acquaintances and friends of the issuer are not subject to the Securities Act requirements for offers to the public. But an offer of securities does not have to be "to the world at large" in order to fall within the scope of the Act. In this article, solicitor Julian Benefield discusses a recent case which provides a useful illustration of the type of smaller offers caught by the Act and a reminder of the consequences for those who get it wrong.*

In the life of a small business there will often be a need for a cash injection to assist with the expansion and growth of the business. This can come from a variety of sources, including from private investors willing to provide funding in exchange for shares or other securities.

The problem with this type of funding is that it can easily be caught by the requirements of the Securities Act 1978 (the Securities Act) relating to "public offers" unless the offer is structured to bring it within one or more of the exceptions available.

The Securities Act provides, in broad terms, that no security can be "offered to the public" for subscription by or on behalf of an issuer without being accompanied by an investment statement and a registered prospectus, unless the offer falls under one of the four categories of "private" offers.

Under section 3(2) of the Act, a "private" offer (or placement) is one made only to one or more of the following:

- relatives or "close business associates" of the issuer, or a director of the issuer, of the securities being offered;
- persons whose principal business is the investment of money or who, in the course and for the purposes of their business, habitually invest money (known as "habitual investors");
- persons who each pay a minimum subscription price of at least \$500,000 for the securities<sup>15</sup>; or
- any other person who in all the circumstances can properly be regarded as having been selected "otherwise than as a member of the public".

### The case

In the recent High Court decision of *De Alwis & Ors v Luvit Foods*<sup>16</sup>, it was unclear whether the defendant, Mr Chean, had section 3(2) in mind as he went about raising capital for the expansion and development of his manufacturing business, Luvit Foods International Limited (Luvit Foods). Between March 2000 and September 2001, Mr Chean gathered together seven individual investors who together contributed a total of \$1.68 million in funds in exchange for shares in the holding company of Luvit Foods.

On the facts, it appeared that none of the investors selected by Mr Chean (the sole director and shareholder of Luvit Foods) were known to Mr Chean, or knew anything about Luvit Foods and its business prior to their respective investments. All of the investors had been persuaded to invest in Luvit Foods on the strength of an information memorandum and various oral representations made by Mr Chean at meetings held at the business premises and elsewhere.

---

<sup>15</sup> It should be noted that at the time the offers of shares were made in *De Alwis* there were only the three other categories for private offers, with the close business associates exception being more limited. Under the Securities Amendment Act 2004, the category of offers to relatives or close business associates was expanded to include the reference to "a director of the issuer" and the category referring to offers to persons required to pay a minimum \$500,000 subscription was introduced.

<sup>16</sup> *De Alwis & Ors v Luvit Foods* (Unreported, High Court, Auckland, CIV-2002-404-1944 15, 23 May 2007)

## The claims

In addition to several claims made under the Fair Trading Act 1986, the investors sought recovery of their investments on the basis that the shares issued to them should not have been offered without a registered prospectus complying with the Securities Act and that, in the absence of such a prospectus, the allotment of the shares was void and of no effect. If successful, this Securities Act claim would likely result in a refund of the investors' subscription monies.

## The decision

On the evidence in *De Alwis*, Justice Courtney found that the representations made in the information memorandum and the various oral representations made by Mr Chean amounted to misleading and deceptive conduct for the purposes of the Fair Trading Act.

In terms of the claim under the Securities Act, the court had to consider whether the offers of shares to the individual investors constituted a "public offer", or an offer made only to specified persons (taking the offers outside the requirements of the Securities Act to register a prospectus by virtue of one or more of the section 3(2) exceptions).

Other than the "close business associates" exception, the judgment provides little analysis of the categories of "private" offers set out in section 3(2) of the Securities Act.

Justice Courtney noted that the purpose behind the Securities Act was the protection of members of the public who might be participating in the purchase of securities. He referred to one case which stated that the broad statutory goal of the Securities Act was to "facilitate the raising of capital by securing the timely disclosure of relevant information to prospective subscribers for securities", with the protection of investors being paramount. This purpose was said to be achieved by regulating the conduct of issuers of securities and by providing sanctions for infringements by those issuers and their directors and officers.

In Justice Courtney's discussion on the "close business associates" exception, he referred to *Securities Commission v Kiwi Co-operative Dairies Ltd.*<sup>17</sup>. In that case, the court of Appeal considered the meaning of the close business associates exception, concluding that close business associates must be:

"sufficiently closely connected on a personal basis with the issuer that the assumption could be made that they would each have sufficient relevant knowledge of their relative's affairs or the means of readily obtaining that knowledge".

To Justice Courtney, it was clear that none of the investors in *De Alwis* enjoyed a relationship with Luvit Foods or Mr Chean that came near the description from *Kiwi Co-operative Dairies*. None of the investors had known Mr Chean prior to the 2000-2001 investing period, and apart from their investment in Luvit Foods, none had had any other previous business or personal dealings with Mr Chean.

Accordingly, Justice Courtney concluded that the relationship between Luvit Foods, Mr Chean and the investors fell well short of that required by section 3(2) of the Act for close business associates. As a result, a registered prospectus should have accompanied the offers of shares.

## Relief provided by the Securities Act

The consequence of not complying with the Act's requirements for a registered prospectus resulted in the allotment of shares in Luvit Foods to the investors being deemed void and of no effect under section 37 of the Act. In this event, the Act requires the investors to be refunded in full for their subscription, and since this was not done, the court found both Luvit Foods and Mr Chean jointly and severally liable to repay the investment monies plus interest to all of the investors.

## Conclusion

As noted at the outset, this case provides a clear illustration of what can go wrong if the provisions of the Securities Act are not taken into account when embarking on a capital raising exercise. Potential issuers and promoters of an offer of shares or other securities (regardless of the size of the offer or the number of

---

<sup>17</sup> [1995] 3 NZLR 26

investors) should take extreme care when soliciting outside investors for a (intended) private placement. This is especially so where the placement is attempted or intended to be made under the “close business associate” exception.

It is also important to remember that when making an offer of shares to a select few, it only takes one of the potential investors to fall outside the private offer exceptions to trigger the requirement for the offer to be accompanied by a registered prospectus.

## Insider trading: how effective is a Chinese wall defence?

*A recent Australian case involving the ASIC's action against the Australian arm of Citigroup Inc., provides some insight into how the New Zealand courts may assess the effectiveness of a Chinese wall defence to an allegation of insider trading and confirms the importance for financial institutions to have appropriate systems in place to manage conflicts of interest between their dealing and advisory functions.*

A recent Australian case involving the ASIC's action against the Australian arm of Citigroup Inc., provides some insight into how New Zealand courts may assess the effectiveness of a Chinese Wall defence to an allegation of insider trading. It also confirms how important it is for investment banks, acting as advisers, to explicitly exclude fiduciary duties in their terms of engagement and ensure that appropriate systems are in place to manage conflicts of interest between their dealing and advisory functions.

In a case that was followed closely by the media and investment banks around the world, the Federal Court of Australia<sup>18</sup> has found that Citigroup Global Markets Australia Pty Ltd (Citigroup) was not involved in insider trading, while acting as the investment advisers for transport group Toll Holding's (Toll) takeover bid for Patrick Stevedoring (Patrick) in 2005. It also found that the terms of Citigroup's engagement letter with Toll were sufficient to prevent any conflict of interest based claims from succeeding.

The decision is considered to be a significant win for investment banks in so far as it allows them to continue business as usual, operating their advisory services to corporate clients alongside their proprietary trading desks, without the need to put their clients' interests ahead of their own so long as their retainer arrangements exclude fiduciary obligations and adequate information barriers are in place.

In contrast, it is seen as a major disappointment for Australia's securities watchdog, the Australian Securities and Investments Commission (ASIC), who by taking on one of the world's largest financial companies had challenged the way investment banks managed inside information and dealt with conflicts of interest.

### Background facts

The case arose after the ASX's surveillance division notified ASIC that Citigroup had acquired a significant parcel of shares on its own account on the last business day prior to Toll making its takeover announcement for Patrick. ASX had observed that there may have been a possible breach in Citigroup's Chinese wall between its corporate advisory division (the private side of Citigroup's business which was acting as investment advisers in Toll's takeover bid) and its proprietary trading division (the public side of Citigroup's business trading in Patrick shares).

On the day the trading took place, Citigroup's advisory division had noted that its proprietary desk had been acquiring Patrick shares and had discussed the possibility that this might be perceived by the ASIC as insider trading by Citigroup. This eventually led to a conversation between two advisory and proprietary division heads in which no details were given, but it was made known that Citigroup "may have a problem" with Citigroup's trading in Patrick shares. Later on the same day, while on a cigarette break, the proprietary trader who had been responsible for purchasing the Patrick shares was told by his supervisor not to buy any more Patrick shares (again with no reasons given to him). Following this direction, the trader went on to sell a portion of the Patrick shares he had acquired earlier that day.

---

<sup>18</sup> *Australian Securities and Investments Commission (ASIC) v Citigroup Global Markets Australia Pty Ltd*. (No 4) [2007] FCA 963

## ASIC's claims

A number of the ASIC's claims against Citigroup were based on establishing that Citigroup owed a fiduciary duty to Toll which, in turn, gave rise to a series of conflicts of interest on the facts and statutory contraventions.<sup>19</sup> In particular, by trading in Patrick shares on its own account, ASIC argued that:

- Citigroup required Toll's express informed consent to trade and this had not been given.
- Citigroup could no longer provide disinterested advice to Toll as it may conflict with a desire by Citigroup to ensure that Toll did not think that Citigroup's Chinese walls had failed.
- Citigroup had placed itself in a position where its duty of loyalty to Toll conflicted with its own interests, since it was in Toll's interests for Patrick's shares to remain as low as possible whereas Citigroup's purchasing of the shares, contrary to Toll's interests, had the possible effect of driving the price of Patrick shares up.

The ASIC also argued that there were two separate insider trading claims arising from the purchase and subsequent sale by Citigroup's proprietary trading desk of a portion of the parcel of Patrick's shares.

## The Federal Court's decision

### CONFLICTS-BASED CLAIMS

The Federal Court found that, although it was possible for a financial adviser and client relationship to give rise to fiduciary obligations, in this case Citigroup's relationship with Toll was determined by the specific terms of an engagement letter which stated Citigroup was engaged as Toll's adviser for the takeover bid "as an independent contractor and not in any other capacity including as a fiduciary". The letter was held to override any fiduciary obligations on their relationship that might have otherwise arisen and also overrode any requirement (identified by the ASIC) for Citigroup to obtain the express "informed" consent of Toll before trading in Patrick shares.

Accordingly, having found that there was no fiduciary relationship between Toll and Citigroup, all of the ASIC's conflicts-based claims were dismissed.

### INSIDER TRADING CLAIMS

The insider trading claims also failed. First, in relation to the trader being told by his supervisor not to acquire further Patrick shares, the court found, on the evidence presented, that the individual trader had not traded on the basis of inside information.<sup>20</sup> In reaching this conclusion, the court noted that his selling off of Patrick shares after being told not to acquire any further shares was consistent with his explanation that he had taken the comment from his supervisor to mean that he was over-exposed rather than that Citigroup was acting for Toll in the rumoured takeover of Patrick. This particular claim also failed because under the Australian insider trading provisions Citigroup's liability for the trader's actions was premised on the trader being an "officer" of Citigroup.

Second, the claim that Citigroup's trading in Patrick shares constituted insider trading because other Citigroup officers and employees from the corporate advisory division had knowledge of the imminent takeover also failed because Citigroup was able to show that it had satisfied the requirements of the statutory Chinese wall defence against insider trading.

### CHINESE WALL DEFENCE

Chinese walls are a means of restricting the flow of information between different departments of the same organisation and are a favoured technique for dealing with conflicts of interest which arise from carrying on business by large financial institutions as well as many legal and accounting firms.

---

<sup>19</sup> The main statutory contravention was based on s.912A(1)(aa) of the Corporations Act 2001 which requires Australia's financial service providers to have in place adequate arrangements to manage conflicts of interest. New Zealand does not have an equivalent statutory requirement, but like Australia, most financial providers are bound by common law obligations affecting their management of conflicts of interest.

<sup>20</sup> The court did, however, agree that the inference or supposition made by the trader following his conversation with his supervisor could constitute information based on the Australian statutory definition of "information", rejecting Citigroup's submission that the trader's own internal thought processes were incapable of constituting information.

The court noted an English authority which drew upon the observations of a UK Law Commission consultation paper to illustrate the type of organisational arrangements which would ordinarily constitute an effective Chinese wall. These are:

- the physical separation of departments to insulate them from each other;
- an educational programme, normally recurring, to emphasise the importance of not improperly or inadvertently divulging confidential information;
- strict and carefully defined procedures for dealing with situations where it is thought the wall should be crossed and the maintaining of proper records where this occurs;
- monitoring by compliance officers of the effectiveness of the Chinese wall; and
- disciplinary sanctions where there has been a breach of the wall.

The question of whether Citigroup's Chinese wall arrangements were adequate as a defence for insider trading depended on whether they met the requirements of the Chinese wall defence in s1043F of the Corporations Act 2001. This section is similar to the wording of New Zealand's proposed Chinese wall defence for insider trading (new section 10D of the Securities Markets Act 1988<sup>21</sup>) which is expected to come into force later this year.

One of the requirements of both the Australian and the new New Zealand Chinese wall defence is to be able to show that "arrangements existed that could reasonably be expected to ensure" that the inside information was not communicated to the individual who made the decision to act.

The ASIC contended that there were two reasons why the Chinese walls defence must fail. The first was that Citigroup had no mechanism to bring proprietary traders, such as the one involved in these facts, across the Chinese wall. The second was that Citigroup had no effective arrangements to prevent the duty of loyalty conflict (noted above) from arising.

The court disagreed. It considered that Citigroup's arrangements satisfied the test in s.1043F. The judge noted that the Citigroup's Chinese wall measures appeared to follow accepted international practice and included all of the requirements stated by the UK Law Commission listed above.

The court also noted that the test in s1043F was an objective one and did not require a standard of "absolute perfection".

On the question of whether there should have been procedures in place to bring proprietary traders across the wall, the court acknowledged that Citigroup's written policies did not in express terms anticipate the situation which arose. However it found that they did set out "general procedures which could reasonably be expected to ensure that legal or compliance officers of Citigroup vetted any communication of potentially price sensitive information to prevent it crossing the Chinese wall." The court did not agree that a further step was required in order to put in place appropriate arrangements for proprietary traders and noted that to bring a trader across a wall, on these facts, risked "sending a signal to the market that confidential investment banking activities" were in progress.

Further, it noted that underlying the ASIC's attack on the adequacy of Citigroup's Chinese walls was its contention that Citigroup required Toll's informed consent to carry out trading on its own account. A finding in favour of ASIC on this point in the court's opinion would have been contrary to the express recognition of the statutory Chinese wall defence.

#### **CAUTION ON USE OF CHINESE WALLS**

Citigroup may have passed the test in this case, but the judgment includes several cautions on the use of Chinese walls. The court acknowledged that, as illustrated by the facts of this case, there is an inherent risk of leakage through Chinese walls and that it is not always realistic to place reliance on Chinese wall arrangements. It was also stressed by the court that:

---

<sup>21</sup> This section is part of the new insider trading regime introduced by the Securities Markets Amendment Act 2006. This Act is subject to Orders in Council being issued to bring its provisions into force.

“Adequate arrangements require more than a raft of written policies and procedures. They require a thorough understanding of the procedures by all employees and a willingness and ability to apply them to a host of possible conflicts.”

### **Practical implications**

Clearly this case highlights the importance for advisers to ensure that their terms of engagement explicitly exclude fiduciary duties. In this case many of the ASIC’s claims failed on the basis that, due to effective restrictions in Citigroup’s engagement letter with Toll, a fiduciary relationship did not arise between the parties.

The case also highlights the types of organisational arrangements required for effective Chinese walls. Although it may not be necessary to demonstrate “absolute perfection” in order to take advantage of a Chinese wall defence under New Zealand’s new insider trading regime, it will be critical to be able to show that reasonable arrangements have been put in place and that the arrangements have been applied consistently.

This will require more than written policies and procedures. As noted in this judgment adequate Chinese wall arrangements include the requirement for physical separation, wall crossing procedures and records, monitoring by compliance, and sanctions for breach. In addition, employees should have a thorough understanding of the procedures and be able to demonstrate a willingness and ability to apply them in a variety of possible conflict situations. In this regard, it would be advisable to put in place regular education and training exercises.

To view ASIC’s comments on the decision visit the ASIC website - <http://www.asic.gov.au>

A copy of the Federal Court’s decision can be viewed online at [http://www.austlii.edu.au/au/cases/cth/federal\\_ct/2007/963.html](http://www.austlii.edu.au/au/cases/cth/federal_ct/2007/963.html)

## SECURITIES AND CAPITAL MARKETS

### New rules for financial sector

*The Ministers of Finance and Commerce recently announced new rules that will have a significant impact on the operations of finance companies and financial advisers in New Zealand.*

Bell Gully has tracked and reported on the progress of two separate but related reviews that began in 2004 and 2005 - the Review of Financial Intermediaries and the Review of Financial Products and Providers.

Changes arising from the reviews will result in comprehensive changes to New Zealand's regulation of all non-bank financial institutions, financial advisers and financial products.

#### Summary of changes

##### NON-BANK DEPOSIT TAKERS

Finance companies, building societies and credit unions (known as non-bank deposit takers or NBDTs) will be subject to a new framework that will require them to:

- be licensed by the Reserve Bank, which will become the prudential regulator for all banks, NBDTs and insurers;
- obtain and publicly disclose a credit rating; and
- belong to a dispute resolution scheme.

##### FINANCIAL ADVISERS

Financial advisers (previously described as financial intermediaries) will be:

- regulated by a co-regulatory model involving Approved Professional Bodies overseen by the Securities Commission; and
- required to be registered on a publicly-searchable database.

#### Implementation

Implementation of the new regime will be carried out in two phases.

Phase one will include:

- registration of all non-bank financial institutions;
- strengthening of the current model of trustee supervision;
- strengthening of the prudential regulation of NBDTs;
- provision for more comprehensive regulatory oversight of financial advisers; and
- provision for effective consumer dispute resolution and redress.

Bills for implementation of phase one are expected to be introduced later this year and passed in 2008.

Phase two, to be reported back by the end of November this year, will include:

- enhancement of the trustee supervision model for collective investment schemes and debt issuers;
- simplification of disclosure requirements for issuers of securities;
- modernisation of the regulation of insurers;

- improvement of the governance of mutual entities; and
- regulation of "platforms", which are computerised services that act as financial adviser, custodian and administrator; and regulation of "portfolio management services", which act as financial adviser and custodian for investors.

For further information, please contact:

**David Craig**

PARTNER

**Murray King**

PARTNER

**Hugh Kettle**

PARTNER

**Rachel Gowing**

SENIOR ASSOCIATE

## Securities Commission enforcements

*The Securities Commission has become involved in two recent breaches of the Securities Act.*

### **The first breach was by two companies developing properties with common facilities for residents.**

Each development set up an incorporated society to make and enforce bylaws for the development and to own and manage the facilities. The companies offered membership in the incorporated societies to prospective buyers of the properties. The memberships were participatory securities under the Securities Act 1978 (the Act) but the offers were made without an investment statement or registered prospectus, in breach of the Act.

While the directors of the companies were unaware that the offers breached the law, they have accepted that they did, and have given the following undertakings:

- Any future offers of securities to the public will be made in accordance with the provisions of the Act and the Securities Regulations 1983, subject to the terms and conditions of an exemption granted by the Commission.
- Procedures will be established so that advertisements for offers of securities to the public comply with the law.
- Investors who subscribed for the securities will have the opportunity to either:
  - cancel their subscription and receive a refund within 15 working days of the closing date of the offer; or
  - re-subscribe for their securities under the terms and conditions of an exemption granted by the Commission.

General Counsel for the Commission commented that: "Failure to comply with securities laws carries serious consequences. Issuers and their directors may be required to repay the subscription amounts with interest, and may face civil or criminal penalties".

He also noted that residential property developers should seek advice from a lawyer who is experienced in securities law. Developers may be able to rely on class exemptions to reduce compliance costs. Alternatively, they may seek an individual exemption from the Commission. These are considered on a case by case basis.

### **The second breach was by a company that issued a prospectus omitting material information.**

The Securities Commission cancelled the prospectus because it failed to note that the company's sole director is bankrupt, banned from management, and facing charges of forgery and dishonestly using his position as a company officer, all in Australia.

The Commission's Director of Primary Markets stated that: "A prospectus must contain all material information about an offer of securities. [The director's] bankruptcy and management ban relate directly to his competence to handle investors' money and to run a finance company. The fact that he is facing criminal charges, although these have not yet been heard, would also be likely to influence people deciding whether or not to invest."

The company had been seeking to raise \$15 million by issuing secured debenture stock. The Commission understood that no money had been invested.

## Report on cycle four of review of financial reports

*The Securities Commission has completed the fourth cycle of its financial reporting surveillance programme.*

The Commission reviewed financial reports of 40 issuers with balance dates from 30 June 2005 to 31 March 2006, nine of which were early adopters of New Zealand Equivalents to International Financial Reporting Standards (NZIFRS).

The Commission's chief accountant noted that the level of compliance for the early adopters of NZIFRS was generally good. However, the Commission found that 17 issuers had matters that needed to be addressed. In respect of those 17 issuers, satisfactory agreement was reached on 85 percent of the matters raised, and three significant matters are being followed up separately.

The review also identified issues relating to non-disclosure of waivers in annual reports. One matter was referred to the NZX and two other matters were referred to the NZX Discipline Special Division.

The reviews aim to encourage issuers to improve the quality of their financial reports and thus contribute to the integrity of New Zealand's securities markets.

The Commission has published its report because it believes the information will be useful to issuers who want to improve the quality of their financial reporting - particularly those adopting NZIFRS.

To a view a copy of the report visit the Securities Commission website -  
<http://www.seccom.govt.nz/publications/documents/cycle-4/index.shtml>

## COMPETITION AND CONSUMER LAW

### **Bell Gully responds to MED's review of the clearance and authorisation provisions under the Commerce Act 1986**

Details of Bell Gully's key submissions on the Ministry of Economic Development's discussion document *Review of the Clearance and Authorisation Provisions under the Commerce Act 1986* are set out in this note, together with a link to Bell Gully's full submission paper to MED.

### **Greenlight given for next stage of Commerce Act dispute between Transpower and Todd Energy**

The court of Appeal has ruled that Todd Energy's claim against Transpower and allegations under the Commerce Act that Transpower is charging Todd for an "unwanted" and "unused" service can (at least in part) proceed to trial.

### **Commission steps up enforcement of Credit Contracts and Consumer Finance Act**

Two recent actions under the Credit Contracts and Consumer Finance Act 2003 (CCCFA, or the Act) demonstrate that the Commerce Commission has made enforcing the Act a priority in 2007.

## Bell Gully responds to MED's review of the clearance and authorisation provisions under the Commerce Act 1986

*Bell Gully has responded to the Ministry of Economic Development's (MED) discussion document "Review of the Clearance and Authorisation Provisions under the Commerce Act 1986".*

The discussion document called for submissions on the authorisation and clearance provisions in Part 5 of the Commerce Act to assist MED determine whether some possible changes could improve the effectiveness and efficiency of these provisions. Part 5 allows the Commerce Commission to clear a merger if it considers that a merger is not anti-competitive, or authorise a merger or trade practice on the grounds that it is of benefit to the public.

Bell Gully made four key submissions on the current merger regime:

- **Merger: onus**

Bell Gully considers that the MED should give detailed consideration to amending the Commerce Act to ensure that clearances are only declined where the Commission is satisfied, on the balance of probabilities, that the proposed merger will have the effect of substantially lessening competition in a market. In Bell Gully's experience, the current provisions - whereby the applicant has the onus of satisfying the Commission that a merger will not have, or would not be likely to have the effect of substantially lessening competition - encourages an overly conservative approach and places the barrier too high for some potentially wealth creating mergers to proceed. Bell Gully believes that the current approach has led to the Commission declining some applications simply because "it cannot be sure". In Bell Gully's view, the current onus encourages the Commission to respond conservatively and, when in doubt, to say no rather than making a decision based on the balance of probabilities of what is really likely to occur. It does not encourage a rigorous analysis of the future, whether with or without the merger in place.

- **Default number of working days for clearance time frames**

A best practice merger regime should seek to provide certainty to businesses. Uncertainty can have a significant effect on investment decisions and, in the case of publicly listed companies, a significant impact on a company's valuation. Bell Gully therefore supports increasing the statutory default number of days in which the Commission is expected to provide a clearance decision. To provide the required certainty, Bell Gully considers it would be preferable to provide an even more realistic timeframe, for example 40 working days, in the Act but to limit the circumstances in which extensions to that timeframe can be made. Similarly, Bell Gully considers that encouraging certainty also requires that the Commission be statutorily obliged to provide written reasons for its decisions within a settled timeframe.

- **Publication of written merger clearance decisions**

Bell Gully considers that the Commerce Act should be amended to require the Commission to publish full reasons for its decisions within 15 working days after the date of the Commission's decision, with the reasons being in the same form as is presently the case. Making this a statutory requirement would again add more certainty to New Zealand's merger process. It would avoid the unsatisfactory position whereby parties considering an appeal of a Commission decision are reliant on the Commission and third parties not opposing an appeal lodged outside the statutory 20 working days.

- **Acceptance of behavioural undertakings**

Bell Gully considers that the Commission should have the flexibility to accept behavioural undertakings as part of a divestment package proposed by the applicant. However, the Commission should not be obliged to accept such undertakings. As noted in the discussion document, the flexibility and use of behavioural undertakings is recognised by other jurisdictions, including Australia and the United Kingdom. Bell Gully considers that New Zealand's merger regime would be enhanced by having this option also available here.

Bell Gully also submitted that a clearance process should be available for arrangements as well as for mergers.

To read Bell Gully's submissions in full, visit <http://www.bellgully.com>

Bell Gully's submission reflects the views of our competition law team who are well placed to comment on the procedural issues raised in the discussion document, given their regular dealings with the Commission on merger (and other) matters.

**For further information, please contact:**

**Phil Taylor**  
PARTNER

**Torrin Crowther**  
SENIOR ASSOCIATE

**David Blacktop**  
SENIOR ASSOCIATE

## Greenlight given for next stage of Commerce Act dispute between Transpower and Todd Energy

*The Court of Appeal has ruled that Todd Energy's claim against Transpower<sup>22</sup>, and allegations under the Commerce Act that Transpower is charging Todd for an "unwanted" and "unused" service, can (at least in part) proceed to trial.*

However, the court has said that it will not compel Transpower to change the way it charges, given that its pricing methodology is authorised by the Electricity (Transpower's Pricing Methodology) Regulations 2004. Todd's ongoing claim will therefore be limited to seeking damages or a declaration.

Todd is a partner in a joint venture that owns a co-generation plant producing electricity within the dairy factory at Whareroa, near Hawera in South Taranaki. Todd's claim was that Transpower, as the owner of the national grid, charges Todd to send electricity that is only sold in South Taranaki across the national grid. Todd argued that, because the electricity is not transmitted outside the South Taranaki area, Todd is effectively paying for a service it does not require, nor use.

Seven causes of action will now proceed to trial, where the court will consider Todd's claim for damages or declaratory relief. Based on its findings that Transpower's pricing methodology is authorised by the Electricity (Transpower's Pricing Methodology) Regulations 2004, the Court of Appeal has ruled out Todd seeking mandatory relief to change its pricing practices.

---

<sup>22</sup> *Transpower New Zealand Limited v Todd Energy Limited* (CA80/05 & CA177/06)

## COMPETITION AND CONSUMER LAW

### Commission steps up enforcement of Credit Contracts and Consumer Finance Act

*Two recent actions under the Credit Contracts and Consumer Finance Act 2003 (CCCFA, or the Act) demonstrate that the Commerce Commission has made enforcing the Act a priority in 2007.*

In only the second prosecution of a lender under the Act, the partners of car finance business, Dolbak Finance, were fined \$100,000 and required to pay \$46,600 in statutory damages to customers after each pleaded guilty to 22 charges. Among their breaches, the partners had not told customers what fees and charges applied, how interest was calculated, or how to pay the loan off early. The Commission reported that Dolbak was twice warned about not providing full and accurate information required by the Act, but chose to ignore the reminders.

Another car finance company, Club Finance, settled with the Commission out of court and agreed to refund \$788,000 to over 1,500 of its customers after breaching the CCCFA by requiring borrowers to take out insurance that was "not reasonably necessary for the protection of their legitimate interests".

Club Finance had required the borrowers to insure their car loans against the risk of redundancy, even though they were unemployed. Even if the borrowers eventually found employment and were subsequently made redundant, the contract contained a clause that meant the borrowers were ineligible to claim the insurance.

These enforcement actions signal that the Commission has stepped up its activity in the consumer finance sector and is looking to make examples of any lenders who fail to comply with CCCFA requirements.

In addition, the Commission is currently conducting an industry survey of credit industry fees and charges. Based on its publications about the Act, the Commission appears to have a different view on how consumer credit fees should be calculated to some industry participants. These issues have not yet been tested in court.

In view of the Commission's current activity in this area, now would be a good time for lenders who provide consumer credit finance to review their fees and CCCFA compliance procedures.

#### **What is the CCCFA?**

The CCCFA is the successor legislation to the Credit Contracts Act 1981 and the Hire Purchase Act 1971, and provides the legislative framework for credit contracts, consumer leases, and buy-back transactions of land.

The CCCFA is intended to protect borrowers by imposing strict disclosure requirements on lenders. In addition, the Act restricts the fees that lenders may charge and the manner in which they are calculated, with the aim of enhancing transparency and borrowers' ability to compare products.

#### **Does the CCCFA apply to you and what does it require?**

The CCCFA will apply to you if you enter into one of the kinds of transactions that the Act covers. Most commonly, these transactions will involve providing credit to a private individual under a consumer credit contract.

Lenders have obligations under the Act relating to:

- disclosure;
- interest;
- fees and charges;
- cancellation;

- payments and prepayments; and
- variation of the contract.

Among its provisions, the Act regulates:

- how interest may be calculated and charged; and
- the type and amount of fees and charges payable under a consumer credit contract.

In particular, the Act requires that lenders' fees, charges and insurance are reasonable and are clearly explained to the borrower.

### **What liability do you have under the CCCFA?**

If you are in breach of the CCCFA, then you are not only a target for investigation, but face the risk of criminal conviction, with fines of up to \$30,000 for each offence. In addition, the Commission is able to seek remedies on behalf of borrowers as a group.

You may be ordered to pay statutory damages, compensation, or refund money obtained in breach of the Act.

Non-compliance has other potentially serious implications. For example, if you do not disclose the required information, the debtor may cancel the contract and you will not be able to enforce it until disclosure is made.

Finally, you may also face the prospect of being banned from operating within the finance industry.

### **What are the Commission's powers?**

The Act gives the Commission the role of promoting compliance with the CCCFA.

The Commission has the power to prosecute creditors, lessors, and buy-back operators for non-compliance with the Act; the power to bring civil proceedings on behalf of customers, and a range of investigatory powers.

### **Getting advice**

Bell Gully is able to provide comprehensive advice on all aspects of the CCCFA including compliance, regulatory investigations, and proceedings.

*This article was written by senior associate Jenny Cooper and solicitor Nick Christiansen and was first published on Friday 8 June 2007.*

## **INTELLECTUAL PROPERTY AND INFORMATION TECHNOLOGY**

### **Cadbury fails in quest to obtain trade mark registration for the word PURPLE**

In this article, senior associate Colleen Cavanagh discusses a recent decision from the Court of Appeal which underscores the difficulty in obtaining registered trade mark protection for words describing colours.

### **Is Google responsible for everything ever said on the internet?**

A new case in the UK is again raising the issue of who is responsible for information available on the internet - and its outcome could reach as far as New Zealand.

### **IT arch-rivals do battle over website documents**

Oracle is in the process of suing its arch-rival SAP in the United States District Court of the Northern District of California over alleged copying of thousands of documents from the Oracle website.

## Cadbury fails in quest to obtain trade mark registration for the word PURPLE

*In this article, senior associate Colleen Cavanagh discusses a recent decision from the Court of Appeal which underscores the difficulty in obtaining registered trade mark protection for words describing colours.*

The Court of Appeal has decided that registration of the word PURPLE cannot be allowed as it would afford Cadbury<sup>23</sup> (the applicant for registration) a de facto monopoly on use of the word PURPLE and provide a disincentive to other traders using that word, even in a descriptive sense, on purple goods – something not within the scheme of the trade mark regime.

### Background

Cadbury, which holds registrations of the colour purple, sought to register the word PURPLE as a trade mark in class 30 for “chocolate, chocolates, non medicated confectionery, biscuits, wafers, cakes, snack food, preparations made from cereal; ice cream, ices, frozen confection; none of the foregoing goods being coloured purple.”

Effem Foods Limited opposed registration of the trade mark on the basis that PURPLE is not a trade mark that is eligible for registration. In September 2004, the Assistant Commissioner of Trade Marks held that the word PURPLE was eligible for registration. This decision was appealed by Effem Foods and overturned in the High Court by Justice McKenzie, in 2005. Cadbury appealed that decision.

This case was being considered under the provisions of the old 1953 Trade Marks Act rather than the current 2002 Act.

Under the 1953 Act the five characteristics that a trade mark must possess at least one of in order to be registrable, were set forth in section 14. The two which are relevant to this case are:

- d* A word or words having no direct reference to the character or quality of the goods...
- e* Any other distinctive sign...

On appeal, one of the issues considered was whether or not the word PURPLE has direct reference to the character and quality of the goods and if not, whether there was a separate requirement of distinctiveness.

### The decision

The Court of Appeal held that Cadbury’s argument that the word PURPLE has no direct reference to the character and quality of the goods for which registration was sought could not be upheld. The Appeal Court was of the view that due to people’s perception of the purple colour, the question might well be asked whether the word PURPLE is apt to describe lilac, lavender, mauve or violet goods. The court also considered that there is an issue of how much purple there has to be in the goods, or on the packaging, before goods can be described as being purple and come within the exclusion included in the list of goods.

Accordingly, the court did not consider that the word PURPLE met the registrability criteria. It could not be said to be a word having no direct reference to the character or quality of the goods. Although this point was determinative of the appeal, the court went on to consider other issues raised in the appeal.

A second issue was whether or not a finding that a trade mark does not have direct reference to the character or quality of the goods or services in a trade mark application will necessarily mean that it is distinctive. The Court of Appeal considered that whilst the question of the lack of direct reference to the

---

<sup>23</sup> *Cadbury Limited v Effem Foods Limited* [2007] NZCA 303

character or quality of the goods will be relevant to the distinctiveness enquiry, it is a separate enquiry and one that must be made.

On the issue as to whether the word PURPLE met the distinctiveness criterion, the Court of the Appeal was of the view that the word PURPLE is in most cases inherently descriptive and connotes the colour purple. It considered that goods in the same market as the goods for which registration was sought by Cadbury are commonly coloured purple and that traders would be inhibited in using the word PURPLE in relation to those goods. The Court of Appeal was unable to divorce the word PURPLE from the colour purple. It held that the extent to which purple goods might be held to be similar to non purple goods was uncertain. It was possible that use of the word PURPLE, even on purple goods, might constitute infringement. The court considered that registration of the word PURPLE as being distinctive of the goods for which registration was sought would be granting a monopoly over what is essentially a feature of the goods in the relevant class – something which it could not allow.

A final point, which was considered by the court and which is of practical significance is the issue of whether a registration excluding goods of a particular type should be allowable. In this case the list of goods for which Cadbury sought registration excluded goods coloured purple. It was submitted by Effem Foods that a negative restriction relating to a characteristic of goods, as opposed to an exclusion of certain categories of goods should not be allowed. They relied on a decision of the European Court of Justice which has been applied in the United Kingdom pointing out that the definition of trade mark in Europe and in the United Kingdom is very similar to the New Zealand definition.

Cadbury submitted that the Commissioner of Trade Marks has a very broad and unfettered discretion to accept applications subject to conditions or limitations and that this should not be read down by excluding limitations of the type in issue in this case.

The Court of Appeal accepted Effem's submission that the European and UK decisions could be applied in New Zealand to the extent that they stand for the proposition that an exclusion based on the particular characteristics of goods or services covered by any registration, as against the types of goods or services, will in most cases be too uncertain as to scope to be allowable. The court considered that the exclusion of purple goods was too vague to be a meaningful exclusion.

### **Practical implication**

The upshot of this decision is that it will be very difficult for any trade mark owner to obtain registration of a word which describes a colour, even if goods of that colour are specifically excluded from the list of goods for which registration is sought. This will be particularly so if the class of goods for which registration is sought does include some goods of the colour described by the word for which registration is sought.

## INTELLECTUAL PROPERTY AND INFORMATION TECHNOLOGY

### IT arch-rivals do battle over website documents

*Oracle is in the process of suing its arch-rival SAP in the United States District Court of the Northern District of California over alleged copying of thousands of documents from the Oracle website.*

Oracle claims SAP logged onto its website using the log-on information of some of Oracle's clients and wrongfully downloaded software support and maintenance documents and software that even those clients did not have the right to copy.

The downloaded documents and software can apparently be used by SAP in direct competition with Oracle in the support and maintenance of Oracle products.

Oracle's court documents outline a host of claims against SAP including copyright infringement, violations of the Computer Fraud and Abuse Act and of the Computer Data Access and Fraud Act, breach of contract, intentional interference with prospective economic advantage, negligent interference with prospective financial advantage, unfair competition, trespass to chattel and unjust enrichment and restitution.

Many of Oracle's claims will be based on copyright notices, terms of use and notices that were set out on its website.

The case can serve as a reminder for businesses to check the terms of use posted on their own website. Here are some pointers:

- Ensure that the terms of use are clear and complete. They should apply to every user of the website. If a user doesn't like the terms of use, they can stop using the website.
- Put a general copyright notice on the website and also on any downloadable document and software on the website.
- Include a privacy statement on the website which includes information about how users may be tracked (including that cookies may be used and that a user's IP address may be tracked).
- Ensure that every user knows that the user is subject to the terms of use by putting them in a prominent place on the website. If it is a subscription website, ensure that new subscribers must actively agree to the terms of use.
- Provide that users are bound by the terms of use simply by accessing and using the website. Specify that all users are bound by changes to the terms of use when the changes are posted on the site.

Proper preparation and posting of the terms of use for your website can offer valuable protection to your copyrighted materials.

Full details of the Oracle claim against SAP can be viewed at [www.oracle.com/sapsuit/amended-complaint.pdf](http://www.oracle.com/sapsuit/amended-complaint.pdf)

*This article was written by senior associate Heidi Leslie and first published on Friday 6 July 2007.*

## Is Google responsible for everything ever said on the internet?

*A new case in the UK is again raising the issue of who is responsible for information available on the internet – and its outcome could reach as far as New Zealand.*

London businessman Brian Retkin is bringing a claim against Google for defamation, alleging that Google is responsible for not removing links to defamatory information posted on the internet by anonymous sources. Mr Redkin has reportedly spent years trying to get Google to remove links to the defamatory content about his internet domain name business Dotworlds from its search results. He is now taking legal action that if successful could hold the world's largest search engine liable for publishing inaccurate or defamatory material on the internet.

Regardless of the outcome in this case – touted the first of its kind in the UK – it raises the immediate question as to whether such a claim could be brought in New Zealand now and what the outcome might be.

There are three main issues to consider:

- Is information available over the internet considered “published” for the purposes of a defamation claim in New Zealand?
- Is information that has been published in another country subject to New Zealand defamation laws?
- Is an internet service provider (ISP) or search engine responsible for distributing defamatory information?

Whether information available on the internet has been “published” for the purposes of defamation proceedings has not been questioned in New Zealand, although in the case of *O'Brien v Brown*, the issue was highlighted. In that case, the defendant Alan Brown made personal remarks about Patrick O'Brien relating to Mr O'Brien's capabilities as the CEO of DOMAINZ.

In the proceedings, Mr Brown admitted that the statements he had posted on the internet had been “published” for the purposes of the Defamation Act 1992. This is consistent with subsequent defamation cases and the general view that internet material has been “published” for the purposes of defamation laws.

Whether information published in another jurisdiction is subject to New Zealand defamation laws has been considered by the courts. In *University of Newlands v Nationwide News Pty Ltd. (University of Newlands)*, the High Court found that an Australian-based publication could be sued in New Zealand for defamatory remarks made on a website because the defamatory information was downloaded in New Zealand.

In reaching its decision, the High Court applied an Australian High Court judgment in the case of *Dow Jones and Company Inc. v. Gutnick (Gutnick)*, in which that court found that the defamation occurred in Australia even though the publication in question was published in the United States. The judge noted “those who post information on the World Wide Web do so knowing that the information they make available is available to all and sundry without any geographic restriction”.

However, the High Court decision in *University of Newlands* has subsequently been overruled by the court of Appeal and leave to appeal to the Supreme Court has been declined. The Court of Appeal decision expressly leaves open whether *Gutnick* has been adopted as law in New Zealand and therefore the question of whether the tort of defamation is available in New Zealand in relation to information published overseas remains unsettled. What is clear is that if there are no damages suffered in New Zealand, a claimant will not successfully bring a defamation case here.

This brings us to our third issue: is an ISP or search engine responsible for the distribution of defamatory information and do they have a responsibility to remove postings or remove links to postings that are claimed to be defamatory?

“Distributors” of defamatory information are in fact covered by the Defamation Act 1992. However, the law provides a defence for innocent distribution of defamatory information. It is a defence if a person proves:

- they did not know that the matter contained the material that is alleged to be defamatory; and
- they did not know that the matter was of a character likely to contain material of a defamatory nature; and
- their lack of knowledge was not due to any negligence on their part.

Presumably, an ISP or search engine is simply an “innocent” distributor if it has not been complicit in the actual publication of the material. A question arises over whether an ISP or search engine could plead innocence under the defence if they had been repeatedly asked to remove defamatory content from the internet. While this point has yet to be settled, the logical answer is that ISPs and search engines cannot be expected to act as defamation police.

Unless there has been a clear ruling requiring the removal of material or links to the material, it would be a significant step backwards in the realm of freedom of speech to require ISPs and search engines to remove all material or links to material that is claimed to be defamatory.

We shall google the Google case with interest in the meantime. Whatever the outcome, it will no doubt have a big impact on how ISPs and search engines are considered in future defamation cases in New Zealand.

*This article was written by senior associate Heidi Leslie and was first published in The National Business Review, 20 July 2007*

## UTILITIES AND RESOURCES

### **Has Auckland had its last blackout? Final decision on Transpower's new Auckland power line**

On 5 July, the Electricity Commission issued its final decision approving Transpower's amended North Island Grid Upgrade Proposal for the supply of electricity into and north of Auckland. The final result is three Commissioners in favour of the proposal, one against, and one declining to be involved (due to his previous relationship with Transpower). In this article, senior associate Louise Hill discusses the background and legal framework for the decision reached by the Electricity Commission and outlines the next hurdles facing Transpower before the upgrade can commence.

### **Commerce Commission commences standard terms process**

A further update from senior associate David Blacktop on the latest steps in the transformation of the telecommunications sector.

## Has Auckland had its last blackout? Final decision on Transpower's new Auckland power line

*On 5 July, the Electricity Commission issued its final decision approving Transpower's amended North Island Grid Upgrade Proposal for the supply of electricity into, and north of, Auckland. The final "result" is three Commissioners in favour of the proposal, one against, and one declining to be involved (due to his previous relationship with Transpower). In this article, senior associate Louise Hill discusses the background and legal framework for the decision reached by the Electricity Commission and outlines the next hurdles facing Transpower before the upgrade can commence.*

The process leading up to the Electricity Commission's final decision<sup>24</sup> on Transpower's North Island Grid Upgrade Proposal (the proposal) has been surrounded by public protest and controversy. There has been much discussion over what form the upgrade should take and whether Transpower's proposals represent the most appropriate and cost effective option for ensuring security of electricity supply to the upper North Island. Members of the public have been vocal over the impact the proposal will have on the environment and on the communities directly affected by the infrastructure development associated with the proposal.

The Electricity Commission's decision was not unanimous. Commissioner Pinnell stated that the proposal "comprehensively fails" the grid investment test set out in the Electricity Governance Rules 2003 and designed to prevent "Transpower from gold-plating the grid and passing the cost through to consumers". One Commissioner (Commissioner Rodger) declined to participate in the decision, on the basis that until September 2006, when he joined the Commission, he was a director of Transpower.

In a further development, Minister Pete Hodgson (on behalf of the Minister of the Environment), announced on 9 August 2007 that he would "call in" Transpower's Notice of Requirements and applications for the proposal under the Resource Management Act (RMA), and would refer decisions about the proposal to a Board of Inquiry. The Minister determined that the proposal warranted a rare intervention under the Resource Management Act. The result of the "call in" is that the Board of Inquiry will hear all submissions and make a decision regarding the designations and consents for the transmission line, instead of the nine councils with jurisdiction over land where the line would be built.

The end result is that nearly two years after Transpower's initial grid investment upgrade proposal was first submitted to the Commission, the Commission has approved the current proposal. Transpower now has to navigate the Board of Inquiry process under the RMA. It will then have to negotiate easement and access arrangements with landowners (this should not be underestimated – aside from the actual costs of the equipment required for the construction of the proposal, property costs are the single largest category of costs for which Transpower sought approval), before actually commencing the construction phase.

### Background to the decision

Transpower first submitted a grid upgrade plan to the Electricity Commission in September 2005. Under the original proposal, Transpower proposed the construction of a new 400kV double circuit line between Whakamaru and Otahuhu. This construction was seen as the first step in accomplishing Transpower's long-term strategic vision for 400kV to replace 220kV as the core grid transmission voltage. Transpower suggested that the proposed upgrade was necessary to avoid an increase in risk to security of supply in the Auckland and Northland region at times of peak loading from 2010.

However, on 27 April 2006, the Commission gave notice under rule 15.1 of Section III of Part F of the Electricity Governance Rules 2003 (Rules) that it intended to decline the original proposal.

---

<sup>24</sup> The decision of the Commission was by a majority comprising Deputy Chair Harris and Commissioners Close and Dell. Commissioner Pinnell dissented. Commissioner Rodger abstained from voting having joined the Commission from the Board of Transpower in September 2006.

A full commentary on Transpower's original proposal and the Commission's reasons for declining the proposal is available in an earlier Bell Gully article on our website [Electricity Commission turns down Transpower's proposed 400kV Whakamaru - Otahuhu line to be installed by 2010: A review](#). In brief, some of the key reasons given by the Commission for its refusal of the original proposal included:

- Transpower's analysis did not consider all alternative proposals and its analysis of the benefits of its proposal were over-stated. In particular, Transpower's analysis did not consider the credible alternative project consisting of a new 220kV double circuit transmission line between Whakamaru and the South Auckland urban boundary.
- The Commission placed considerable value on delaying investment, giving time to consider advances in technology or changes in the electricity system that may mitigate against a new line being needed for Auckland, such as new generation in Auckland or Northland.
- The Commission's estimate of the capital cost of Transpower's proposal was higher than Transpower's estimate.

On 31 May 2006, Transpower informed the Commission of its intention to amend the original proposal and requested that the Commission suspend its consideration of the original proposal. The Commission agreed to such suspension. Transpower advised the Commission that it intended to provide another proposal for the Commission's consideration and that it no longer wished to progress the 400kV proposal originally submitted by Transpower in September 2005. Accordingly, the Board of the Commission revoked the notice of intention issued on 27 April 2006.

On 20 October 2006, Transpower submitted its revised proposal, which is described below. It is this revised form of the proposal which has received the Commission's final approval.

### **The approved proposal**

In brief, the proposal involves Transpower:

- Build an overhead double-circuit transmission line from Whakamaru to a near transition station near the South Auckland urban boundary by 2011. This transmission line will initially be capable of 220kV operation, and later, when load growth requires it, will be capable of being operated at 400kV, although operation at 400kV will be subject to later Commission approval of and Transpower commission of 200kV-400kV transformers and associated switchyards near the existing Whakamaru substation and in the vicinity of the South Auckland urban boundary.
- Construct and commission two underground cables from the new transition station in the South Auckland area to the Pakuranga substation (rather than Otahuhu to increase diversity of supply). The new underground cables are capable of 220kV operation.
- Construct and commission the necessary substation / transition station facilities near the existing Whakamaru substation, a transition station in the vicinity of the South Auckland urban boundary, and Pakuranga substation.
- Dismantle the existing 110kV Arapuni to Pakuranga transmission line.
- Carry out the works necessary to convert and connect the existing 110kV Otahuhu – Pakuranga line to 220kV operation, for which it is already designed and consented.

The proposal also provides for Transpower to plan the works, including the acquisition of designations, consents and easements to allow for future upgrade to 400kV operation through future addition of new transformers and associated works near the Whakamaru substation; a new switchyard near the transition station; new 220kV underground cables to the Otahuhu substation; new overhead lines or underground cables to connect the new switchyard to the new transition station; and extensions to the Otahuhu switchyard. Thus, while Transpower will require the approval of the Commission to subsequently operate the new line at 400kV, the current approval permits Transpower to commence work required to obtain that approval.

Transpower estimated that the major projects would all be completed by 2011. In this timing, Transpower has allowed two years for delivery risk. That is, while Transpower considers the need date is 2013, the proposed commissioning date of the proposal is 2011.

Transpower sought approval of costs incurred in the implementation of the proposal of \$824 million in 2011 dollars (\$683 million in 2006 dollars). This is the 90% upper limit on project costs. This amount includes the cost of transmission works, acquisition of property rights and project management.

### **The Commission's role**

The Electricity Commission (Commission) is required, as set out in Part F of the Electricity Governance Rules 2003 (Rules), to consult on and approve (or not) investments proposed by Transpower in a grid upgrade plan.

The proposal is an "investment proposal" which, once approved by the Commission, allows Transpower to recover the approved costs of that investment (\$824 million in 2011 dollars) from designated transmission customers in accordance with the transmission pricing methodology set out in Section IV of Part F of the Rules.

The Commission is required to consider and assess investment proposals in accordance with the processes and considerations set out in Section III of Part F of the Rules. In particular, rule 13.4 provides that, in order to approve the proposal, the Commission must be satisfied that the proposed investment:

- reflects good electricity industry practice in meeting grid reliability standards;
- complies with the processes set out in the Rules; and
- meets the requirements of the grid investment test. The grid investment test is set out in clause 4 of Schedule F4, and essentially requires that a proposed investment that is necessary to meet the reliability standard must maximise the expected net market benefit or minimise the expected net market cost compared with a number of alternative projects and that such conclusion is sufficiently robust having regard to the results of a sensitivity analysis (if one is conducted).

The Rules do not require Transpower to identify and propose the cheapest option for grid enhancement. Rather, in broad terms, an investment proposal must meet the reliability standard set by the Rules, comply with good electricity industry practice in doing so, and must be cost effective by minimising the expected net cost to the market or by maximising expected net benefit to the market, in comparison with a number of alternative projects.

In analysing an investment proposal the Commission must also have in mind the objectives and outcomes specified in the latest Government Policy Statement (GPS) on Electricity Governance issued in October last year. These include:

- timely decision making;
- business confidence arising from more certainty around long-term planning and infrastructure development, adequate capacity to allow for the development of renewable generation; and
- priority to be given to reliability over cost where there is an element of uncertainty.

### **Notice of Intention to approve the proposal**

The Commission issued its Notice of Intention to approve the proposal under the Rules on 31 January 2006. The Commission, in its reasons for decision of its Notice of Intention to approve the proposal, stated that the proposal demonstrates a much better understanding by Transpower of how the Commission interprets and applies the Rules than was the case in relation to the original proposal. The Commission also stated that it has benefited from a better understanding of the rationale for Transpower's investment proposals. The Commission considered that this greater level of understanding has led to a substantial level of agreement between the Commission and Transpower.

The "base case" adopted by the Commission in analysing the proposal was the same base case used by Transpower in assessing the proposal and in its application. The base case is the 220kV transmission line. This was determined to be an appropriate reference option because it is essentially the "business as usual"

reference case, since the existing grid already comprises 220kV as its core voltage. This reference option involved building a new 220kV double circuit transmission line between Whakamaru and Ormiston Road, south of Otahuhu, with 220kV underground lines from Ormiston Road to Pakuranga and then subsequently to Otahuhu (this was a modified version of the alternative 220kV proposal used to assess Transpower's original proposal). The key distinguishing feature between the proposal and the alternative option is the ability for the transmission line to which the proposal relates to be converted to 400kV operation in the future.

The Commission's analysis concluded that, unless there is a reduction in the growth in demand or assurance of new generation near Auckland, substantial transmission upgrades will be required. On the basis of information provided to date, the Commission considered that the proposal:

- reflects good electricity industry practice in meeting grid reliability standards;
- minimises expected net market cost compared with the 220kV alternative (the view of the majority).

The view of the majority was that the proposal meets the requirements of the grid investment test, and thus the decision of the Commission (by a majority) was to approve the proposal.

### **Public conference**

The Notice of Intention to approve the proposal was followed by a public conference in May 2007 where the Commission heard from a number of concerned individuals, groups and companies. The key concerns raised related to:

- Whether Transpower had significantly underestimated the costs of the proposal. Some suggested that the Commission is required to consider all costs, including non-market costs, of the proposal. Many submissions expressed concern that Transpower has significantly underestimated the costs of securing access to easements over properties in order to construct the transmission line to which the proposal relates. Other submissions queried Transpower's capital cost estimates.
- The impact of electromagnetic fields on people living in the vicinity of the proposed transmission line.
- The impact of the transmission towers on the environment. Some submissions stated that the Commission should undertake a full environmental impact assessment.
- Whether Transpower and/or the Commission had disregarded other, better, alternatives which should have been used as comparisons under the grid investment test. Many submissions expressed concern about the alternatives selected for the purpose of applying the grid investment test. Some were concerned that the 220kV alternative represented a "gold plated" alternative designed to compare unfavourably with the proposal.

### **The Commission's final decision**

In its final decision, the majority of the Commission determined to confirm the proposal. On the basis of the information provided, the Commission considers that the proposal reflects good electricity industry practice in meeting the grid reliability standards, and the view of the majority remained that the proposal minimises expected net market cost compared with the 220kV alternative.

The majority of the Commission were satisfied that the proposal:

- meets the requirements of the grid investment test with a result of similar magnitude to that described by Transpower in its application;
- is consistent with meeting its principal objectives under the Electricity Act 1992; and
- has a slight advantage to the alternative 220kV proposal in achieving the outcomes sought in the GPS.

In addressing each of the four main issues raised (as described previously), the Commission stated that:

- The Commission does not consider that it is able to take into account costs such as possible decreases in the value of properties located near the route of the transmission line, except to the extent that such matters impact on the cost of easements or likely costs associated with the RMA process. The Commission noted that loss of amenity value is a relevant consideration for the consent authority when it considers the Notices of Requirement and applications for resource consent. In addition, while acknowledging the risks and uncertainties, the Commission considered that it remained appropriate to rely on the property costs put forward by Transpower for the purposes of applying the grid investment test to the proposal. In relation to capital costs, the Commission obtained advice on capital cost estimates from Parsons Brinckerhoff Associates. The Commission considered that both estimates were within reasonable accuracy bounds in respect of each other, and has no basis to establish that the Parsons Brinckerhoff estimates were more accurate than Transpower's estimates, in which case the Commission stated that it intends to continue to rely on the estimates provided by Transpower.
- The Commission stated that from information provided to it, it was clear that a number of scientific and health organisations are considering the long-term effects of electromagnetic fields on the health of individuals and communities. However, at present the prevailing standards remain those set out in the guidelines published by the International Commission for Non-Ionising Radiation Protection (ICNIRP). On this basis and on the basis of a report provided to the Commission by PB Power, the Commission stated that the easement width proposed by Transpower (65 metres) for the proposal meets a much higher standard than the ICNIRP guidelines require. In the absence of clear information regarding an anticipated change to existing standards relating to electromagnetic fields, the Commission did not consider that it had any grounds for concluding that Transpower's easement width was inadequate.
- The Commission noted that its responsibility was to consider environmental sustainability, which requires an holistic assessment – consideration of the environmental sustainability of the electricity system as a whole in light of the proposed investment. The environmental impact analysis is required to be left for the appropriate body under the RMA. As part of its holistic assessment, the Commission concluded that the proposal is likely to better support remote generation, which is more likely than Auckland generation to be based on renewable energy sources.
- The Commission considered again alternative proposals to the proposal and concluded that the 220kV alternative was most likely to challenge the proposal, in terms of whether the proposal minimises expected net market costs.

The Commission noted in its decision that it anticipates Transpower will, during the RMA process, actively seek to mitigate some of the environmental concerns. These may include options such as additional undergrounding, route diversion, varying tower height, increasing easement width and the use of single circuit towers. The question is whether Transpower's contingency of \$105million which has been allocated, for, amongst other things, further design refinement during the RMA process will be sufficient to cover the mitigation measures adopted. The current status of the RMA process is described below.

### **Dissenting opinion**

In the original Reasons for Decision document, published in relation to the Notice of Intention to approval the proposal, Commissioner Pinnell dissented from the majority. Commissioner Pinnell stated that he supported the majority decision of the Commission on all regulatory tests except one. While he was of the opinion that a substantial upgrade of transmission is required into Auckland, and that the options put forward by Transpower are all capable of providing secure supply, Commissioner Pinnell believed that the proposal failed the grid investment test and that there is at least one option having better value, namely the 220kV alternative.

In his dissenting opinion, Commissioner Pinnell notes that the proposal:

- comprehensively fails the grid investment test and in doing so passes unnecessary costs on to consumers; and

- is less economic than the alternative 220kV proposal by a significant margin.

Further, he is concerned that there is no evidence to confirm energising at 400kV before duplicating the line represents good electricity industry practice.

On the grid investment test, Commissioner Pinnell noted that he does not agree with seven of the assumptions made by the majority, four of which he considers are crucial to the proposal passing the grid investment test. These include the electricity demand growth projections used by the majority to assess the proposal and the majority's assumption on where new electricity generation sources for Auckland would be located. If Pinnell's preferred assumptions were used as a basis for the grid investment test, it would result in a shift in the economics that would be substantially adverse to the proposal.

Commissioner Pinnell considered that when the proposal is energised at 400kV and becomes highly loaded, the upper North Island would be very dependent on this line, and any double circuit failure, even if of short duration, makes widespread blackouts due to voltage collapse and cascade failure a distinct possibility. Restoration would take days if the failure was physical damage to the conductors or towers, and hours if caused by trippings such as lightning strike.

Commissioner Pinnell stated that the 220kV alternative would have a much larger capacity than any other existing transmission line in New Zealand, and is capable of meeting the needs of Auckland and Northland until about 2050. Only if load growth turns out to be substantially greater than expected or if no new local generation is built in the upper North Island would there be a need for additional capacity in the next 30 years. Commissioner Pinnell favoured an alternative such as the 220kV alternative, and then reassessing once the 220kV alternative had reached its maximum capacity (around 2050), at which point other options may be available that are not available now.

Pinnell also believes that the savings to consumers by rejecting the proposal would far outweigh the costs of reviewing a new proposal, and that there was adequate time for such a review without threatening the timely delivery of capacity enhancement.

The majority stated that there is a need to upgrade the capacity of the transmission line supplying electricity into Auckland and further north, and that there will be a need to upgrade it further some decades hence. The majority considered that the proposal is for the best in the longer term, and more cost effective than the alternative, which involves constructing another 220kV line when the second upgrade is needed.

### **Judicial review?**

It remains to be seen whether any interested party will challenge the Commission's decision through a judicial review.<sup>25</sup> The grounds for a judicial review are likely to be limited to a challenge based on the processes taken by the Commission in reaching its decision and in particular whether they gave due consideration to alternative proposals.

### **Call in of proposal under the Resource Management Act**

On 28 May 2007, Transpower lodged Notices of Requirement under the Public Works Act with seven councils whose areas are affected by the proposed transmission line and substations. This marked the start for the RMA process. A Notice of Requirement is the way a network utility operator gives formal notice to a city or district council of its requirement for designation of land for a project under the RMA. A designation, once included in a district plan, gives effect to the Notice of Requirement and enables the utility operator to undertake specified activities without obtaining land use consents from the city or district council.

On 9 August 2007, Minister Pete Hodgson announced that he was calling in Transpower's Notice of Requirements and applications for the proposal, and will refer decisions about the proposal to a Board of Inquiry. This means that the Board of Inquiry will make decisions regarding the Notices of Requirement,

---

<sup>25</sup> It has been reported that Federated Farmers and New Era Energy are considering making a judicial review application but are waiting to see what position is taken by Manukau City Council which also opposes the proposal. <http://www.stuff.co.nz/sundaystartimes/Auckland/4123130a22395>

instead of the nine affected councils. The call in process effectively combines the councils' consideration and the Environment Court appeal process.

The Minister stated that he was calling in Transpower's proposal because he considers the proposal to be a project of national significance on the basis that the proposal:

- has aroused widespread public concern and interest regarding its actual or likely effect on the environment;
- involves significant use of natural and physical resources;
- affects more than one region or district;
- involves technology, processes or methods which are new to New Zealand and which may effect the environment; and
- is likely to result in or contribute to significant or irreversible changes to the environment.

The Minister will publicly issue notice of the proposal and invite submissions in the near future.<sup>26</sup> Any person can make a submission within 20 days of public notification. Hearings will also be held and those submitters that indicate that they want to be heard will have the right to speak along with Transpower. Councils will be able to make submissions and attend hearings.

A Board of Inquiry will decide on the Notices of Requirement. A Board of Inquiry must be chaired by a current, former or retired Environment Court judge, and can have a total of three to five members.

Once established, the Board of Inquiry will consider Transpower's proposal. Following the hearing, the Board of Inquiry will issue a draft decision. Councils, submitters, Transpower and the Minister will then have an opportunity to comment before the Board makes its final decision.

For access to documents relating to the Electricity Commission's decision, including:

- the Commission's final decision in respect of the Proposal;
- various documents that the Commission considered in making its decision; and
- Commissioner Pinnell's dissenting opinion,

visit: <http://www.electricitycommission.govt.nz/opdev/transmis/auckgridinvest/final>

For more information on the RMA process under the Board of Inquiry visit the Ministry for the Environment website - <http://www.mfe.govt.nz/rma/call-in-transpower/>

### **Bell Gully's views**

Bell Gully believes in the sustainable development of New Zealand's capital infrastructure, for the benefit of all New Zealanders.

The decision of the Electricity Commission to approve Transpower's upgrade proposal and the Minister's decision to call in the project are both good steps in the right direction.

Sure, easy to say if you don't have a large pylon built in your backyard. However, in some cases the national interest has to take precedence over local interests.

For further information, please contact:

**Garry Downs**  
PARTNER

**Chris Gordon**  
PARTNER

**Louise Hill**  
SENIOR ASSOCIATE

---

<sup>26</sup> This is expected to be on 8 September 2007.

## UTILITIES AND RESOURCES

### Commerce Commission commences standard terms process

*A further update from senior associate David Blacktop on the latest steps in the transformation of the telecommunications sector*

The process of determining the terms on which Telecom will be required to provide access to its unbundling local loop network is now well underway. On 31 July 2007, the Commerce Commission issued its draft decision – the decision being the first from new Commissioner Dr Ross Patterson.

#### **Process is an improvement**

The standard terms process under which these terms will be set by the Commission is a new process, which was enabled by amendments to the Telecommunications Act passed at the same time as the Government mandated unbundling of the local loop. In essence, the standard terms process provides a benchmark agreement that all telecommunications companies can use to obtain access to Telecom's local loop. A similar "standard terms" determination process is currently being undertaken in the electricity industry with the Electricity Commission finalising the arrangements surrounding benchmark transmission agreements and transmission pricing.

Prior to the amendments to the Telecommunications Act to enable standard terms determinations, parties seeking access to the local loop would have been required to enter into bilateral negotiations with Telecom. Parties would only have been entitled to seek a determination from the Commission if there was a dispute and the parties had made reasonable attempts to reach agreement.

Such a process in respect of local loop unbundling would have been cumbersome and could have introduced opportunities for regulatory gaming and delay. While there will be no doubt be grizzles from industry participants about the precise terms set by the Commission, the benefit of the process is that a decision will be made by late this year.

#### **Key points of the draft determination**

The key aspect of the draft determination is the prices set. These prices were set taking into account international benchmarks. The draft distinguishes between "urban areas" where Telecom can charge \$16.49 per month and "rural areas" where the charge is \$32.20 per month. The major justification for the difference appears to be the economies of scope implicit in more densely populated areas. At first blush, the pricing suggests that new entry and hence the benefits of unbundling are more likely to occur in urban areas.

#### **Next steps**

Parties had until 29 August 2007 to provide submissions on the draft. A final decision is expected in November or December 2007.

To access a copy of the Commerce Commission's *Draft Standard Terms Determination for the designated service Telecom's unbundled copper local loop network* visit the Commerce Commission website - <http://www.comcom.govt.nz>.

## **BELL GULLY NEWS**

### **Bell Gully advises on Datasquirt IPO**

Bell Gully has advised Datasquirt on the New Zealand aspects of its Australasian IPO and ASX listing. Bell Gully corporate partner Dean Oppenhuis, assisted by solicitor Fleur Adcock, advised on the listing which aims to raise up to A\$12 million (NZ\$13 million) for international expansion. The Datasquirt business, started in New Zealand in 2001, develops contact centre solutions using mobile and wireless technology, providing businesses and their customers with options for communicating with each other, for example through text messaging. The company is now focusing on the international market through partnerships with companies in the US, Europe and Australia. The IPO closed on August 16.

### **Bell Gully's corporate partners highly ranked in M&A guide**

Bell Gully's corporate partners top the rankings in the recently released Cross-border Mergers and Acquisitions Handbook 2007/08 published by the Practical Law Company. Gavin Macdonald ranked in the top tier as a leading lawyer. Highly recommended rankings went to David Boswell, Andrew Brown, David Flacks and Brynn Gilbertson with Peter Castle and Garry Downs both recommended.

### **Partners talk finance law reform across Tasman**

The implications for Australian-based business of the significant reform of New Zealand's finance sector law was on the agenda at a seminar held recently in Sydney. Bell Gully partners David Craig and Hugh Kettle briefed 70 Sydney-side lawyers and banking specialists on the changes and their impact on Australian entities doing business in New Zealand.

### **Bell Gully key legal advisors on major global deal**

Bell Gully has advised Fletcher Building on its major acquisition of United States-headquartered Formica Corporation. Fletcher Building, New Zealand's second largest listed company, signed an agreement on 22 May 2007 to buy Formica from private equity investors, Cerberus Capital Management LP and Oaktree Capital Management LLC, for NZ\$1 billion (US\$750 million).

A Bell Gully team of partners and lawyers led by Brynn Gilbertson and including Jayne Kirton, Murray King and Louise Hill, has been working with Fletcher Building on the transaction since October last year.

For further details and more news visit: <http://www.bellgully.com/>

## USEFUL WEB LINKS

### New Zealand Government

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

### New Zealand regulatory agencies and organisations

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

### New Zealand commercial sites

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

### Australian sites

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

### International sites

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

---

**AUCKLAND** VERO CENTRE, 48 SHORTLAND STREET  
PO BOX 4199, AUCKLAND 1140, NEW ZEALAND, DX CP20509  
TEL 64 9 916 8800 FAX 64 9 916 8801

**WELLINGTON** HP TOWER, 171 FEATHERSTON STREET  
PO BOX 1291, WELLINGTON 6140, NEW ZEALAND, DX SX11164  
TEL 64 4 473 7777 FAX 64 4 473 3845

---

**BELL GULLY**